

Regional Inspector General for Audit
Cairo, Egypt

FD-ARM-565

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**Financial Audit of the Egyptian Small
Enterprise Development Foundation
(Cooperative Agreement No. 263-0212-A-00-9064)**

**Report No. 6-263-96-10-N
February 29, 1996**



U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT



**UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL/AUDIT**

CAIRO, EGYPT

February 29, 1996

MEMORANDUM

TO : DIRECTOR USAID/Egypt, John R. Westley

FROM: RIG/A/C, Lou Mundy *Lou Mundy*

SUBJECT: Audit of the Egyptian Small Enterprise Development Foundation
(Cooperative Agreement No. 263-0212-A-00-9064)

The attached report, transmitted on January 9, 1996, by Arthur Andersen & Co., presents the results of a financial audit of the Egyptian Small Enterprise Development Foundation (Foundation) as it pertains to USAID/Egypt Cooperative Agreement No. 263-0212-A-00-9064 under the Small and Micro Enterprise Development Project. The purpose of the cooperative agreement is to provide loans to small and micro enterprises located in the Cairo metropolitan area through a loan fund administered by the Foundation.

We engaged Arthur Andersen & Co. to perform a financial audit of the Foundation's incurred expenditures of \$678,685 (equivalent to LE2,273,593) for the period June 1, 1991 through August 31, 1994. The purpose of the audit was to evaluate the propriety of costs incurred during this period. Arthur Andersen & Co. also evaluated the Foundation's internal controls and compliance with applicable laws, regulations and agreement terms as necessary in forming an opinion regarding the Fund Accountability Statements.

The audit report questions \$11,957 (equivalent to LE40,055) in costs billed to USAID/Egypt by the Foundation. The questioned costs related primarily to entertainment expenses, advertising, petty cash advances, and social insurance determined by the auditors to be ineligible or unsupported. Additionally, the auditors noted three non-material instances of noncompliance with applicable laws, regulations and agreement terms.

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In response to the draft report, responsible Foundation officials provided additional explanation to the questioned costs. Arthur Andersen & Co. reviewed the Foundation's response to the findings and where applicable made adjustments to the report or provided further clarification of their position (see Appendices A and B).

The following recommendation is included in the Office of the Inspector General's recommendation follow-up system.

Recommendation No. 1: We recommend that USAID/Egypt resolve the questioned costs of \$11,957 (ineligible costs of \$5,714 and unsupported costs of \$6,243) detailed on page 15 of the Arthur Andersen & Co. audit report, and recover from the Egyptian Small Enterprise Development Foundation the amounts determined to be unallowable.

Recommendation No. 1 is unresolved and will be considered resolved upon the Mission's determination of the amount of recovery; it will be considered closed upon the recovery of funds, offset of funds, or issuance of a bill for collection.

The three non-material instances of noncompliance with applicable laws, regulations, and agreement terms should be handled directly between the Mission and Foundation officials.

Please advise this office within 30 days of any action planned or taken to close the recommendation. Thank you for the cooperation and assistance extended to the audit staff on this engagement and your continued support of the financial audit program in Egypt.

Attachment: a/s

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Fund Accountability Statements
For the Period from June 1, 1991 to August 31, 1994

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Fund Accountability Statements
For the Period from June 1, 1991 to August 31, 1994

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ALLIED ACCOUNTANTS

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Public Accountants & Business Advisors

Fellows & Members of the Egyptian Society of Accountants & Auditors



المحاسبون المتضامنون

راغب، اسطنبولي والكيلاني

مراسلو آرثر أندرسن وشركاه

محاسبين قانونيين وخبراء تنظيم وإدارة

زملاء وأعضاء جمعية المحاسبين والمراجعين المصرية

January 9, 1996

Mr. Lou Mundy
Regional Inspector General for Audit/Cairo
United States Agency for International Development
Cairo, Egypt

Dear Mr. Mundy:

This report presents the results of the financial audit of the Small and Micro Enterprise Project funded by the United States Agency for International Development Mission to Egypt (USAID/Egypt), pursuant to Cooperative Agreement No. 263-0212-A-00-9064. We were engaged to perform an audit of the operating expenditures incurred and reimbursed for the period from June 1, 1991 to August 31, 1994 and a review of the loan portfolio pertaining to the Small and Micro Enterprise Loan Fund.

Background

Grant Agreement No. 263-0212 between the Arab Republic of Egypt and the United States of America for the Small and Micro Enterprise (SME) Development Project was signed on September 30, 1988; the Agreement remains in effect until September 30, 1997.

Cooperative Agreement No. 263-0212-A-00-9064-00 was signed between The Egyptian Small Enterprise Development Foundation (ESED) and USAID/Egypt on June 26, 1989. The purpose of the Cooperative Agreement is to provide loans to small and micro enterprises located in the Cairo Metropolitan area through a loan fund administered by ESED. The Agreement also provides funds for rental/lease or purchase of a main and branch offices, equipping those offices, and supports for operation until financial self-sufficiency is reached. Special projects in support of SME's will also be funded.

Audit Objectives, Scope, and Methodology

The objective of this engagement was to conduct a financial audit of USAID/Egypt resources managed by ESED pursuant to Cooperative Agreement No. 263-0212-A-00-9064 related to the Small and Micro Enterprise Development Project (the "Project"). The specific objectives of our engagement were to:

1. Express an opinion on whether the fund accountability statements for the USAID/Egypt financed Project of the SME present fairly, in all material respects, funds received and costs incurred for the audit period in conformity with generally accepted accounting principles or other comprehensive basis of accounting, including the cash basis and/or modifications of the cash basis;
2. Determine if the costs reported as incurred under the SME Project are in fact allowable, allocable, and reasonable in accordance with the terms of the Cooperative Agreement.

3. Evaluate and obtain a sufficient understanding of the internal control structure of ESED as it relates to the SME, assess control risk, and identify reportable conditions, including material internal control weaknesses;
4. Perform tests to determine whether ESED complied, in all material respects, with the cooperative agreement terms and applicable laws and regulations.
5. Perform a detailed review and testing of the automated loan processing system to determine if proper control and security safeguards are in place to ensure the integrity of the data.

The scope of the financial cost-incurred audit was the loan fund, collateral loan fund, and operating expenditures provided by USAID/Egypt for the period from June 1, 1991 to August 31, 1994.

The methodology of the audit consisted of an internal control evaluation, testing of loans and expenditures remitted under the financing agreement, and testing of ESED compliance with the Cooperative Agreement, OMB Circular No. A-122, and the applicable laws and regulations.

Our testing included a judgmental selection of loans, costs incurred, and revenue, as disclosed in the fund accountability statements. We tested costs and loans as follows:

A. Operating Expenditures:

<u>Line Item</u>	<u>Total Cost</u>	<u>Tested Amount</u>	<u>Percentage</u>
Office operational costs (LE) (Equivalent in US\$)	\$1,760,318 525,468	424,382 126,681	24%
Equipment (LE) (Equivalent in US\$)	590,215 176,184	246,693 73,250	42%
International travel (LE) (Equivalent in \$)	45,918 13,707	45,918 13,707	100%

B. Loan and Collateral Funds:

<u>Description</u>	<u>Actual</u>	<u>Tested Amount</u>	<u>Percentage</u>
Collateral funds (LE) (Equivalent in \$)	3,511,877 1,048,322	3,511,877 1,048,322	100%
Interest collected on collateral funds (LE) (Equivalent in \$)	455,585 135,997	455,587 135,997	100%
Outstanding Loans (LE) (Equivalent in \$)	4,282,024 1,278,217	284,000 84,766	6.6 %

Our testing included, but was not limited to, the following procedures:

1. A review of direct Project expenditures billed to and reimbursed by USAID/Egypt. General Ledgers and subsidiary records were reconciled to billings submitted to USAID/Egypt.
2. A review of the funds provided by USAID/Egypt to ensure that they were deposited in separate bank accounts, and that the related transactions were properly recorded. We also performed a review of the procedures used to control cash.
3. A review of training costs to determine if they are adequately documented and approved
4. A review of procurement procedures to determine that sound commercial practices, including competitive bids, were used.
5. A determination of whether advances of funds were justified based on existing documentation, including a reconciliation of funds advanced, disbursed and available.
6. A judgmental selection and review of 60 loans to determine eligibility of borrowers, proper calculation of fees, compliance with Cooperative Agreement policies, and repayment of loan. The 60 selected borrowers were visited by different members of our audit team to determine their existence, confirmation of loan disbursement, outstanding balance and use of loan.
7. A review of the design of controls related to the automated loan processing system/information system (IS), through interviews with the key IS personnel to determine the administration of the IS system, applications, system software support, computer operations, security administration policies and procedures, security, internal audit, and backup and recovery/contingency plan.
8. A verification of findings, noted during the review of the automated loan processing system, through observations and testing.

We reviewed and evaluated ESED's internal control structure as it relates to the Project to obtain an understanding of the design of relevant control policies and procedures, and whether those policies and procedures have been placed in operation. We obtained a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing and extent of tests to be performed.

The agreement terms and pertinent laws and regulations applicable to the Cooperative Agreement were reviewed and audit procedures were designed to test for material noncompliance.

Initial planning began with an entrance conference attended by RIG/A, our audit team and ESED management staff and USAID/Egypt Project Officer. The Grant Agreement, Cooperative Agreement and their amendments were reviewed to gain an understanding of the Agreement terms and applicable laws and regulations.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

Results of Audit

Fund Accountability Statements

This section includes four fund accountability statements related to the USAID/Egypt funds managed by ESED under Cooperative Agreement No. 263-0212-A-00-9064 as follows:

Loan Fund

This fund accountability statement shows the net effect of the principal and interest repayment made by borrowers, the outstanding loans, bank charges on the overdraft bank accounts, and the ending balance of the overdraft bank accounts.

Collateral Loan Fund

This fund accountability statement represents the collateral loan funds provided by USAID/Egypt, which are deposited in local banks, and the interest earned and bank charges on the collateral funds. The collateral funds are used as security for the settlement of the overdraft bank accounts.

Operating Expenditures Funds, Egyptian Pounds and US Dollar Budgets

The Cooperative Agreement provides funds in Egyptian Pounds for local operating expenditures and US Dollars for international travel and procurement of vehicles. The Egyptian Pounds (LE) and US Dollar (\$) fund accountability statements are presented separately, for reporting purposes only.

Our audit identified \$11,957 (LE40,055) in aggregate questioned costs, related to the operating expenditures funds, Egyptian Pounds budget. The details of costs questioned are presented in the Fund Accountability Statements - Findings Section of this report.

Internal Control

Our evaluation of the internal control structure did not disclose matters which we believe are material weaknesses. We identified certain matters, including those related to the matters noted during the review of the automated loan processing system, which were communicated to ESED management through a separate letter.

Compliance with Applicable Laws and Regulations

In performing our engagement, we identified certain immaterial instances of noncompliance. These matters relate to: i) reports submitted to USAID/Egypt were underestimated due to the lack of reconciliation with project records, ii) project operating expenses funds were commingled with other ESED sources, and iii) ineligible and unsupported expenses were reimbursed with project funds. Details related to these matters are set forth in the Compliance - Audit Findings Section of the report . We also noted certain matters that were communicated to ESED management in a separate letter.

Management Comments

ESED management has provided comments on the results of the audit findings. The management response is included in Appendix A. We provided responses to management's comments in Appendix B. We deleted questioned costs that were adequately addressed by ESED management and modified findings as necessary.

Allied Accountants

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Mr. Lou Mundy
Regional Inspector General for Audit/Cairo
United States Agency for International Development
Cairo, Egypt

Report of Independent Public Accountants

We have audited the accompanying fund accountability statements relating to the loan fund, collateral loan fund, and operating expenditures for the period from June 1, 1991 to August 31, 1994 of the Egyptian Small Enterprise Development Foundation relating to funds received and costs incurred under Cooperative Agreement No. 263-0212-A-00-9064 financed by the United States Agency for International Development pursuant to the Small and Micro Enterprise Development Project, Grant Agreement No. 263-0212. These fund accountability statements are the responsibility of the management of the Egyptian Small Enterprise Development Foundation. Our responsibility is to express an opinion on these fund accountability statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statements. Our audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall fund accountability statements presentation. We believe that our audit provides a reasonable basis for our opinion.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

As described in Note 3, the accompanying fund accountability statements have been prepared on a modified cash basis, which is a comprehensive basis of accounting other than generally accepted accounting principles. Consequently, revenues and expenditures are recognized when received or paid rather than when earned or incurred. Accordingly, the accompanying fund accountability statements are not intended to present results in accordance with generally accepted accounting principles.

Our testing identified the following aggregate questionable costs as detailed in the accompanying fund accountability statements i) US \$5,714 in costs that are ineligible because they are not project related, unreasonable, or prohibited by the terms of the agreement; and ii) US \$6,243 that are not supported with adequate documentation. The basis for questioning costs are set forth in the Fund Accountability Statements-Audit Finding section of this report.

In our opinion, except for the effect of the questioned costs of US \$11,957 as discussed in the preceding paragraph, the fund accountability statements referred to above present fairly, in all material respects, the Egyptian Small Enterprise Development Foundation's project revenue and expenses, funds received and costs incurred under Cooperative Agreement No. 263-0212-A-00-9064 pursuant to the Small and Micro Enterprise Development Project, Grant Agreement No. 263-0212 for the period from June 1, 1991 to August 31, 1994 in conformity with the modified cash basis of accounting described in Note 3.

This report is intended for the information of the management and others within the Egyptian Small Enterprise Development Foundation and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

Allied Accountants

July 27, 1995

Allied Accountants/Arthur Andersen Egypt

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Loan Fund

Fund Accountability Statement
For the period from June 1, 1991 to August 31, 1994

Balance of overdraft bank accounts as of 5/31/91	\$ (331,743)
Source of funds:	
Interest and late payment collected on loans	688,533
Use of funds:	
Outstanding loans as of 8/31/94 net of provision for doubtful loans of \$57,678 (Note 6)	1,278,217
Bank commissions on overdraft accounts	336,346
Funds transferred to operating expense fund	<u>36,674</u>
Total use of funds	1,651,237
Balance (Notes 4 and 5)	<u>\$ (1,294,447)</u>

See the accompanying notes to the Fund Accountability Statements

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Collateral Loan Fund

Fund Accountability Statement
For the period from June 1, 1991 to August 31, 1994

	<u>Budget</u>	<u>Actual</u>	<u>Questioned Costs</u>	
			<u>Ineligible</u>	<u>Unsupported</u>
Cash on hand on 5/31/91		\$ 435,169		
Source of funds:				
Receipts from USAID/Egypt	\$3,759,452	1,048,322	-	-
Interest in collateral/time deposits		<u>135,997</u>	-	-
Total funds available		1,619,488		
Use of funds:				
Bank charges on time deposits		<u>14,236</u>	-	-
Balance (Note 4)		<u>\$1,605,252</u>		

See the accompanying notes to the Fund Accountability Statements

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Operating Expenditures Fund
Egyptian Pounds Budget

Fund Accountability Statement
For the Period from June 1, 1991 to August 31, 1994

<u>Budget Elements</u>	<u>Budget</u> <u>(Note 7)</u>	<u>Actual</u>	<u>Questioned Costs</u> <u>Ineligible Unsupported</u>	<u>Finding No.</u> <u>(Note 9)</u>
Cash on hand on 5/31/91		\$ 52,532		
Source of funds:				
Receipts from USAID/Egypt		884,222		
Other sources		<u>1,584</u>		
Total funds available		938,338		
Expenditures:				
Office operational costs	\$ 585,185	522,370	\$ 5,714	\$ 6,243
Equipment	359,701	176,184		
Training	61,539	3,098		
Special Projects	<u>373,134</u>	<u>-</u>		
Total expenditures	\$ 1,379,559	701,652		
<u>Less:</u>				
Excess of expenditures funded by the Loan Fund - Transfers from the Overdraft account		<u>36,674</u>		
Total expenditures funded by USAID/Egypt		<u>664,978</u>		
Balance (Note 4)		<u>\$ 273,360</u>	<u>\$ 5,714</u>	<u>\$ 6,243</u>

See the accompanying notes to the Fund Accountability Statements

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Operating Expenditures Fund

US Dollar Budget

Fund Accountability Statement

For the Period from June 1, 1991 to August 31, 1994

<u>Budget Elements</u>	<u>Budget</u>	<u>Actual</u>	<u>Questioned Costs</u>	
			<u>Ineligible</u>	<u>Unsupported</u>
Source of funds:				
Receipts form USAID/Egypt		\$ 13.707	-	-
Use of funds:				
Vehicles	\$ 36,000			
International Travel/Per Diem	<u>32,500</u>	<u>13,707</u>	-	-
Total expenditures	\$ 68,500	13,707		
Balance		<u><u>\$ -</u></u>		

See the accompanying notes to the Fund Accountability Statements

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

For the period from June 1, 1991 to August 31, 1994

Notes to the Fund Accountability Statements

Note 1: Project Activities

Grant Agreement No. 263-0212 between the Government of Egypt and the United States of America Agency for International Development funds Cooperative Agreement No. 263-0212-A-00-9064 signed between the Egyptian Small Enterprise Development Foundation (ESED) and USAID/Egypt on June 26, 1989. The purpose of the Cooperative Agreement is to provide loans to small and micro enterprises (SME) located in the Cairo metropolitan area through a loan fund administered by ESED. The Cooperative Agreement also provides funds for operating expenses, equipment, training, special projects, international travel and vehicles related to the administration of the Project.

Note 2: The Cooperative Agreement

Collateral Loan Fund and Loan Fund

Through the Cooperative Agreement, ESED was appointed as the trustee for the Small and Micro Enterprise Loan Fund. The Agreement provides \$ 3,759,452 for the loan fund. Through the loan fund, ESED established collateral funds in local banks to facilitate the provision of credit to small and micro entrepreneurs (the borrowers), in the Cairo metropolitan area, through overdraft bank accounts. Principal and interest repayments made by borrowers are deposited in the overdraft bank accounts with the intention of creating a self-sustaining project. As of August 31, 1994 USAID/Egypt has provided US \$1,470,226 (LE 4,925,257) of which US \$1,048,322 (LE3,511,877) were provided during the audit period, to ESED as collateral for the loan fund.

Operating Expenses

The Agreement provides funds for rental/lease or purchase of a main and branch offices and equipping those offices. It also provides salary support for the ESED's core management, technical and extension staff, until financial self-sufficiency is reached. Special projects in support of SME's will also be funded. The agreement provides US \$1,503,596 (LE 5,037,049) for the Operating Expenses. As of August 31, 1994, USAID/Egypt has provided US \$1,058,933 (LE 3,547,426) of which US \$884,222 (LE 2,962,145) were provided during the audit period.

Note 3: Basis of Presentation

The fund accountability statements have been prepared on the cash basis for receipts and disbursements, except for the provision for doubtful accounts and accruals for salary withholdings (accounts payable). Consequently, revenues and expenditures are recognized when received or paid rather than when earned or incurred.

Note 4: Cash

In addition to the bank account used for the operating expenses, ESED has time deposits contracts with two banks, where the collateral funds provided by USAID/Egypt are deposited. As of August 31, 1994 USAID/Egypt has provided US \$1,470,226 (LE 4,925,257) to ESED as collateral funds. Total interest earned is US\$ 144,871 (LE485,320) of which US \$135,997 (LE455,587) was earned during the audit period. The calculation of the interest earned is in accordance with the announced international rate at maturity date of each time deposit. ESED has credit facilities (overdraft bank accounts) with these banks and their branches, which are used for lending to the borrowers. The time deposits are used as security for the settlement of the overdraft bank accounts. The average interest rate paid on the overdraft bank accounts is 12%.

As of August 31, 1994, the balance of cash is as follows:

Current Bank Accounts and Cash on Hand for Operating Expenditures Fund

Arab Investment Bank Account	\$ 105
Misr Orman Bank	269,867
Cash on hand	<u>4,725</u>
Total cash available	274,697
Plus:	
Accounts receivable	3,122
Less:	
Accounts payable	<u>4,459</u>
Balance	<u>\$ 273,360</u>

Time Deposits for Collateral Loan Funds

Banque du Caire	\$1,044,677
National Bank of Egypt	<u>560,575</u>
Total	<u>\$1,605,252</u>

Note 5: Overdraft Bank Accounts For Loan Fund

As of August 31, 1994, the balance of the overdraft bank account is comprised of the following:

Banque du Caire	\$ 867,920
National Bank of Egypt	383,843
Cairo Bank	<u>42,684</u>
Total	<u>\$ 1,294,447</u>

Note 6: Provision for Doubtful Loans

Outstanding loans are considered overdue when 90 days after the due date the borrowers have defaulted in the loan payments. ESED's provision for doubtful loans is calculated as 50% of the overdue loans. The remaining 50% of the overdue loans is estimated to be repaid by the borrowers. As of August 31, 1994, the provision balance was US \$57,678 (LE 193,223).

Note 7: Budget

The budget of US \$1,379,559 (LE4,621,527), presented in the fund accountability statement for the operating expenditures, is the budget available for the expenses incurred during the audit period. It has been calculated, for reporting purposes only, by deducting from the total budget approved as of August 31, 1994 of US \$1,503,597 (LE5,037,049) the expenditures incurred as of May 31, 1991 US \$124,038 (LE415,522).

Note 8: Exchange Rate

Expenditures incurred in Egyptian Pounds (LE) have been converted to US Dollars (\$) at an average exchange rate of LE 3.35 to US\$ 1 for the period from June 1, 1991 to August 31, 1994.

Note 9: Questioned Costs

Questioned costs are expenditures that we have determined are not in accordance with the Grant Agreement, Cooperative Agreement or other applicable USAID/Egypt regulations and are presented in the fund accountability statements in two separate categories: ineligible and unsupported. "Ineligible" costs are deemed to be unallowable because they are not program related, unreasonable, or prohibited by the Agreement or applicable laws and regulations. "Unsupported" costs are expenditures which are not supported by adequate documentation.

Our audit identified US \$11,957 (LE40,055) in aggregate questioned costs. US \$5,714 (LE19,141) as ineligible costs and US \$6,243 (LE20,914) as unsupported costs. The basis for questioning specific costs are set forth in the "Audit Findings" section of this report. Some of the questioned costs included in these findings were already identified as part of a financial review performed by the USAID/Egypt Office of Financial and Management/Financial Analysis Support Team, which as of the completion our field work have not been resolved.

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

for the period from June 1, 1991 to August 31, 1994

Audit Findings

Finding No. 1 - Ineligible Expenses

The Project was reimbursed for ineligible expenses such as obituary notices, fines, tips, and tea and coffee. As cited under OMB Circular A-122 advertising costs, entertainment costs, and fines and penalties, paragraph Nos. 1, 12, and 14 respectively, are unallowable.

USAID/Egypt was billed ineligible expenses in the amount of US \$5,714 (LE 19,141).

Finding No. 2: Unsupported Expenses

ESED was reimbursed for expenses that were not supported with any documentation, these expenses relate to the employer share of social insurance for one employee, telephone bill, and petty cash advances in the amount of US \$6,243 (LE20,914). The Accounting, Auditing, and Records section of the Standard Provisions to the Cooperative Agreement requires the grantee to keep records that are supported by documentation adequate to show receipt and use of goods and services acquired under the grant.

USAID was billed unsupported costs in the amount of US\$ 6,243 (LE 20,914).

ALLIED ACCOUNTANTS

Ragheb, Istambouli & El Kilany

A Member Firm of ARTHUR ANDERSEN & CO. SC

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راغب، اسطنبولي والكيلاني

مقر آرثر أندرسن وشركاه

محاسبون قانونيون وخبراء تنظيم وإدارة

لاء وأعضاء جمعية المحاسبين والمراجعين المصرية

Mr. Lou Mundy
Regional Inspector General for Audit/Cairo
United States Agency for International Development
Cairo, Egypt

Report of Independent Public Accountants On Internal Control Structure

We have audited the fund accountability statements relating to the loan fund, collateral loan fund, and operating expenditures for the period from June 1, 1991 to August 31, 1994 of the Egyptian Small Enterprise Development Foundation relating to funds received and costs incurred under Cooperative Agreement No. 263-0212-A-00-9064 financed by the United States Agency for International Development pursuant to the Small and Micro Enterprise Development Project, Grant Agreement No. 263-0212, and have issued our report thereon dated July 27, 1995.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

In planning and performing our engagement, we considered the Egyptian Small Enterprise Development Foundation's internal control structure as it relates to the Small and Micro Enterprise Development Project, Cooperative Agreement No. 263-0212-A-00-9064, to determine our procedures for the purpose of expressing an opinion on the fund accountability statements and not to provide assurance on the internal control structure.

The management of the Egyptian Small Enterprise Development Foundation is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. Among the objectives of the internal control structure are to provide management with reasonable, but not absolute, assurance that the assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and in accordance with the terms of the agreements; and transactions are recorded properly to permit the preparation of the fund accountability statements referred to above in conformity with the basis of accounting described

in Note 3 to the fund accountability statements. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the fund accountability statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control structure and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of the Egyptian Small Enterprise Development Foundation and the United States Agency for International Development in a separate letter dated July 27, 1995.

This report is intended for the information of the management and others within the Egyptian Small Enterprise Development Foundation and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

Allied Accountants

July 27, 1995

Allied Accountants/Arthur Andersen Egypt

ALLIED ACCOUNTANTS

Ragheb, Istambouli & El Kilany

A Member Firm of ARTHUR ANDERSEN & CO. SC

Public Accountants & Business Advisors

Fellows & Members of the Egyptian Society of Accountants & Auditors



حاسبون المتضامنون

راغب، اسطنبولي والكيلاني

شركاء آرثر أندرسن وشركاه

محاسبين قانونيين وخبراء تنظيم وإدارة

د. وأعضاء جمعية المحاسبين والمراجعين المصرية

Mr. Lou Mundy
Regional Inspector General for Audit
United States Agency for International Development
Cairo, Egypt

Report of Independent Public Accountants On Compliance With Laws and Regulations

We have audited the fund accountability statements relating to the loan fund, collateral loan fund, and operating expenditures for the period from June 1, 1991 to August 31, 1994 of the Egyptian Small Enterprise Development Foundation relating to funds received and costs incurred under Cooperative Agreement No. 263-0212-A-00-9064 financed by the United States Agency for International Development pursuant to the Small and Micro Enterprise Development Project, Grant Agreement No. 263-0212, and have issued our report thereon dated July 27, 1995.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

Compliance with laws, regulations, contracts and grants applicable to the Small and Micro Enterprise Development Project is the responsibility of Egyptian Small Enterprise Development Foundation's management. As part of obtaining reasonable assurance about whether the fund accountability statements are free of material misstatement, we performed tests of the Egyptian Small Enterprise Development Foundation's compliance with certain provisions of laws, regulations, contracts and grants. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The result of our tests of compliance indicate that with respect to items tested, the Egyptian Small Enterprise Development Foundation complied, in all material respects, with the provisions referred to in the fourth paragraph of this report. The results of our procedures disclosed immaterial instances of noncompliance with those laws and regulations, which are described in the Compliance with Laws and Regulations - Audit Findings section of this report. We also

noted certain matters that were communicated to ESED management in a separate letter dated July 27, 1995.

This report is intended for the information of the management and others within the Egyptian Small Enterprise Development Foundation and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

Allied Accountants

July 27, 1995

Allied Accountants/Arthur Andersen Egypt

Egyptian Small Enterprise Development Foundation

Audit Expenditures Incurred Under
The Small and Micro Enterprise Development Project
Cooperative Agreement Nos. 263-0212-A-00-9064

For the Period from June 1, 1991 to August 31, 1994

Compliance with Laws and Regulations Finding

Finding No. 1 - Errors in Reports Submitted to USAID

Our review of the financial reports submitted to USAID/Egypt identified that in some months, while the column that identifies the expenditures incurred during the month being reported was correct and was based on information taken from the project records, the accumulated column was incorrect. As a result, the accumulated expenditures reported to USAID/Egypt were underestimated in the amount of US\$4,035 (LE13,517). Standard Provision for Non-U.S. Grantees, Section 2.0 Accounting, Auditing, and Records requires the grantee to maintain books, records, documents, and other evidence to sufficiently substantiate charges to the grant. These reports are prepared by one of the project accountants, and approved by the Financial Manager, but they are not reconciled against the project records. ESED's Executive Director and Financial Manager agreed with the finding and stated that condition will be corrected.

We recommend that ESED ensure that the financial reports submitted to USAID/Egypt are reviewed to ensure clerical accuracy and that they are reconciled to the project records.

Finding No. 2 Commingling of Operating Funds with Other ESED Sources

We noted that ESED has deposited in the project operating expenses account funds provided by ESED members for enrollment and membership fees. Although, these other funds were minor, ESED did not keep subsidiary records nor prepare a reconciliation to differentiate USAID/Egypt funds available from other sources. As a result, ineligible expenses could be disbursed with project funds and not be detected on a timely basis. The Standard Provisions for non-US Grantees, Section 01.0 Payment - Periodic Advance states that all AID funds shall not be commingled with other grantee owned or controlled funds. USAID funds should be kept in a separate bank account.

We recommend that ESED establish separate bank accounts for USAID/Egypt project funds.

Finding No. 3 Ineligible and Unsupported Expenses Reimbursed with Project Funds

As discussed in Finding Nos. 1 and 2 of the Fund Accountability Statements - Finding Section, the Project was reimbursed for ineligible expenses such as advertisement unrelated to the project, fines, tips, tea and coffee. As cited in OMB Circular A-122 these type of expenses are

unallowable. The Financial Manager was not aware that these expenses were unallowable, and ESED agreed to ensure that in the future they are funded by other than USAID/Egypt sources. In addition, ESED management stated that they are in the process of hiring an internal auditor.

We recommend that ESED Financial Manager review the expenses billed to USAID/Egypt to ensure they are in compliance with agreement terms and adequately supported. In the case that the internal auditor is hired, he/she should verify that ESED complies with these requirements.

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

For the Period from June 1, 1991 to August 31, 1994

Management Comments

الجمعية المصرية لمساعدة صغار الصناع والحرفيين
EGYPTIAN SMALL ENTERPRISE DEVELOPMENT FOUNDATION

December 13, 1995

Allied Accountants/Arthur Andersen, Egypt

Subject: Documented response to draft Audit findings-report dated July 27, 1995 covering the period June 1, 1991 to August 31, 1994 - Egyptian Small Enterprise Development Foundation (ESED)

Finding No.1 - Errors in Reports Submitted to USAID

ESED's Finance Manager now ensures that all USAID Financial Reports are reviewed and reconciled to projects ledgers before submission. Attached, please find the August 1995 Certified Fiscal Report to which we have attached a copy of the Financial Statements and a summary of operational costs charged to USAID - inception through August 31, 1995. (Attachment No.1)

Finding No.2 - Commingling of Operating Funds with Other ESED Sources

A separate bank account will be opened in Misr Bank for funds provided by ESED members. Amounts can be easily identified and deposited separately.

Finding No.3 - Ineligible and Unsupported Expenses reimbursed with Project Funds1. Ineligible Expenses in the amount of US\$6,165 (L.E. 20,653)

- Cafeteria Expenses in the amount of L.E. 16,327.

ESED's Management agrees to refund this amount to USAID.

- Obituary in newspaper in the amount of L.E. 1,300

ESED's Management agrees to refund this amount to USAID.

- Public notices in newspaper in the amounts of L.E. 432 and L.E. 1,080 (Total of L.E. 1,512)

Documents were retrieved from the files and were found to be advertisements related to Foundations' members. This expense should be eligible for billing to USAID as it is an integral part of ESED's activities. Copies of original documents are attached (Attachment No.2)

Ahmed

الجمعية المصرية لمساعدة
صغار الصناع والحرفيين



- Tips totalling L.E. 1,014

The listed amounts represent costs related to legal expenses incurred in relation to delinquent borrowers and therefore eligible for billing to USAID. After reviewing the documentations, we found that they are eligible but are actually unsupported by receipts due to the nature of the legal process itself in order to obtain the required forms and locate the delinquent borrowers.

2. *Unsupported Expenses in the amount of US\$ 6,243 (L.E. 20,914)*

- Telephone bill in the amount of L.E. 2,000

The actual cost of this transaction was L.E. 2,743.90 and was erroneously charged to USAID as L.E. 4,743.90 in the January 1994 Certified Fiscal Report (Attachment No.3). This error was corrected in the August 1995 Certified Fiscal Report (Attachment No.1).

- Petty Cash advances totalling L.E. 9,000

ESED Petty Cash fund is an imprest fund. All advances are settled by the end of each Calendar Year. Therefore, all amounts were expended on various expense line items. Petty Cash settlements at the end of each Calendar Year are attached as well as the related USAID Fiscal reports which show that while the advances were charged, the actual disbursements were not and therefore, there were no double-billings made to USAID (Attachments No.4). Effective January 1, 1995, ESED started charging the actual expense disbursement and not the advance amount as done previously. Attached is the January 1995 Fiscal Report with no charge for advances made to Petty Cash since decision was made to charge the actual expenses as they are incurred. (Attachment No.5).

- Petty Cash advances totalling L.E. 5,000 (last two listed) dated January 1991 and January 1995)

These two amounts happen to fall outside the period under audit and therefore should be removed from the findings. We have also attached the Petty Cash settlement and related USAID Fiscal Report for the month of December 1991 to settle the January 1991 finding amounting to L.E. 3,000. (Attachment No.6). As for the January 1995, finding in the amount of L.E. 2,000, please refer to Attachment No.5 which shows no amount being charged to USAID as a Petty Cash advance during this period.

- Social Insurance-employer share for Ashraf Mekawy, from 1/91 to 4/94 in the amount of L.E. 4,914

A. Hamed



Amounts were actually paid by the employee to the public accounting firm (Nabil Abdel Salam El Meazawy Office) but were classified incorrectly under social insurance while charge should have been made to the salaries general ledger account. We attach Application Forms No.2 for the years 1991, 1992 and 1993 with Ashraf Mekawy's name as insured as well as a receipt showing the remittance to the Social Insurance Organization. We also attach the Application forms 1 and 6 covering the periods referred to and forms 1 dated March 1, 1994, the effective date of including the employee in the Foundation's file at the Social Insurance Organization. (Attachment No.7).

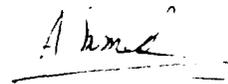
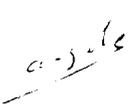
In light of the above, please find below a summary of amounts to be refunded and amounts we request that you remove from your final report:

	<u>Agreed</u>	<u>Disagreed</u>
1. Cafeteria Expenses	16,327	
2. Obituary in newspaper	1,800	
3. Public notices in newspaper		1,512
4. Tips		1,014
5. Telephone bill		2,000
6. Petty Cash Advances		9,000
7. Petty Cash Advances		5,000
8. Social Insurance		4,914
	<u>L.E. 18,127</u>	<u>L.E. 23,440</u>
	L.E. 41,567	
	=====	

We hope that the above response and attachments satisfy your requirements and look forward to our continued cooperation.

Sincerely,


Mostafa Yassin
Executive Director

Attachments as stated.

Egyptian Small Enterprise Development Foundation

Audit of Expenditures Incurred under
the Small and Micro Enterprise Development Project
Cooperative Agreement No. 263-0212-A-00-9064

Auditors' Response to Management Comments

Our comments below address the Egyptian Small Enterprise Development Foundation's (ESED) responses regarding the questioned costs as identified in the findings on the Fund Accountability Statements and the findings on Compliance with Laws and Regulations relating to our audit of the Small and Micro Enterprise Project. We deleted questioned costs that were adequately supported by ESED. For those findings for which insufficient supporting documents were provided or for which we did not agree with the adequacy of the ESED response, the findings remain the same or have been modified as discussed below.

The ESED management response is presented in Appendix A. Please note that ESED's response uses finding numbers in our report on Compliance with Laws and Regulations. We have included the ESED numbers in parenthesis following our finding number.

Fund Accountability Statement

Finding No. 1 Ineligible expenses (See Appendix A - ESED Response - Finding No. 3)

ESED provided sufficient evidential matter to support US \$451 (LE 1,512) of the ineligible expenses. Ineligible expenses of US \$5,714 (LE 19,141) remain as questioned costs. ESED has agreed to refund USAID/Egypt US \$5,411 (LE 18,127) of expenses in this finding. Insufficient evidential matter was provided for the remaining amount of US \$303 (LE 1,014). The finding has been modified accordingly.

Finding No. 2 Unsupported expenses (See Appendix A - ESED Response - Finding No. 3)

ESED did not provide sufficient evidential matter to support the questioned costs. This finding remains unchanged.

Compliance with Laws and Regulations

Finding No. 1: Errors in Reports Submitted to USAID/Egypt (See Appendix A - ESED Response - Finding No. 1)

ESED did not provide sufficient evidential matter to support their representation that adjustments have been made to the reports submitted to USAID/Egypt, and that the adjusted reports now reconcile to the project records. This finding remains unchanged.

Finding No. 2: Commingling of Operating Funds with other ESED Sources (See Appendix A - ESED Response - Finding No. 2)

No documents were provided to evidence the opening of a separate bank account. As a result, this finding remains unchanged.



UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

Appendix C

CAIRO, EGYPT

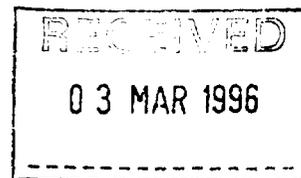
February 29, 1996

MEMORANDUM

TO : Lou Mundy, RIG/A/C

FROM : Shirley Hunter, OD/FM/FA 

SUBJECT : Financial Audit of the Egyptian Small Enterprise Development Foundation (Cooperative Agreement No. 263-0212-A-00-9064) - Draft Report dated January 15, 1996.



Mission is working with the implementing agency to resolve and close Recommendation No. 1 under the subject audit, and has no comments to offer at this time.

Please issue the final report.