

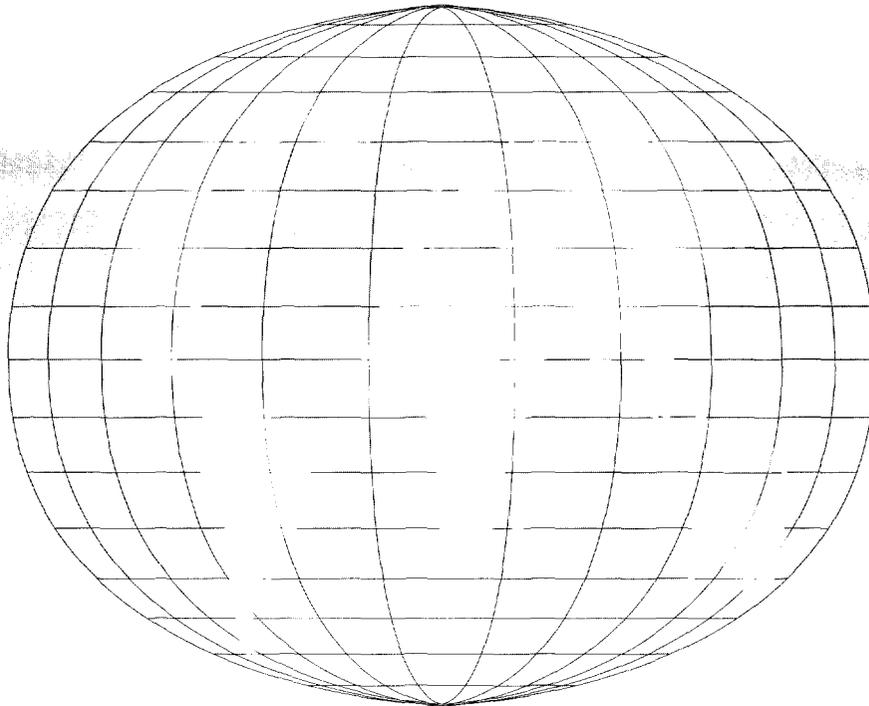
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Report of Audit

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**Financial Audit of Arthur Andersen & Co.,
Expenditures Incurred Under Contract
No.263-0238-C-00-5061-00
(USAID/Egypt Privatization Project No. 260-0238)**

**Report No. 6-263-97-029-N
July 21, 1997**



**FINANCIAL INFORMATION CONTAINED
IN THIS REPORT MAY BE PRIVILEGED.
THE RESTRICTION OF 18 USC 1905 SHOULD
BE CONSIDERED BEFORE ANY INFORMATION
IS RELEASED TO THE PUBLIC.**

**Regional Inspector General for Audit
Cairo, Egypt
OFFICE OF INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT**

USAID



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

CAIRO, EGYPT

July 21, 1997

MEMORANDUM

TO : DIRECTOR USAID/Egypt, John R. Westley
FROM: RIG/A/C, Lou Mundy *Lou Mundy*
SUBJECT: Financial Audit of Arthur Andersen & Co., Expenditures Incurred Under Contract No. 263-0238-C-00-5061-00 (USAID/Egypt Privatization Project No. 263-0238)

The attached report, transmitted on March 13, 1997, by KPMG Hazem Hassan, presents the results of a financial audit of Arthur Andersen & Co. (AA&Co), as it pertains to Contract No. 263-0238-C-00-5061-00 (USAID/Egypt Privatization Project No. 263-0238). The purpose of the contract is to provide technical assistance services to organizations involved in implementing the Government of Egypt's state enterprise privatization program.

We engaged KPMG Hazem Hassan to perform a financial audit of AA&Co's direct cost expenditures of \$4,415,256 (equivalent to LE 15,011,870) for the period April 1, 1995 to August 31, 1996, and an audit of AA&Co's indirect costs of \$1,696,000 for the period September 1, 1995 to August 31, 1996. The purpose of the audit was to evaluate the propriety of costs incurred during these periods and to determine the indirect cost rate. KPMG Hazem Hassan also evaluated AA&Co's internal controls and compliance with applicable laws, regulations and agreement terms as necessary in forming an opinion regarding the Fund Accountability Statement.

The audit report questions \$73,257 (equivalent to LE 249,074) in direct costs billed to USAID/Egypt under the contract. These questioned costs related to ineligible subcontractor salary payments that were in excess of the maximum allowable. The report also questions \$101,551 (equivalent to LE 345,273) charged to the contract's indirect cost pool. These questioned costs relate to unsupported costs in the "practice management"

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account and to unallowable entertainment charges. In addition, the auditors noted no material weaknesses in AA&Co's internal control structure, but did identify two material instances of noncompliance with applicable laws, regulations, and agreement terms.

In response to the draft report, AA&Co officials provided additional explanations to the report findings. KPMG Hazem Hassan reviewed AA&Co's response to the findings and where applicable made adjustments to the report or provided further clarification of their position (see Appendices I and II).

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

Recommendation No. 1: We recommend that USAID/Egypt make a management decision on the ineligible costs of \$73,257 detailed on pages 14 through 16 of the KPMG Hazem Hassan audit report, and recover from Arthur Andersen & Company the amounts determined to be unallowable.

Recommendation No. 2: We recommend that USAID/Egypt determine Arthur Andersen & Company's final indirect cost rate for the period September 1, 1995 to August 31, 1996 for Contract No. 263-0238-C-00-5061-00 based on the consideration of questioned overhead costs detailed on pages 17 and 21 of the KPMG Hazem Hassan audit report.

Recommendation No. 3: We recommend that USAID/Egypt obtain evidence that Arthur Andersen & Company has addressed the material noncompliance issues (lack of prior USAID/Egypt approval when engaging consultants and when paying subcontractor salaries in excess of the maximum allowable) detailed on pages 29 and 30 of the KPMG Hazem Hassan audit report.

For Recommendation No. 1, the Mission determined that \$31,379 of the \$73,257 in questioned costs were allowable; however, the remainder of the questioned costs, \$41,878, were sustained and deducted from a June 1997 voucher. Recommendation No. 1 is therefore closed as of the issuance of this report.

For Recommendation No. 2, the Mission requested documentation from Arthur Andersen & Company in order to determine the final indirect cost rate. As such determination is pending the receipt and review of the requested documentation, the recommendation remains unresolved.

For Recommendation No. 3, the Mission cited the resolution of Recommendation No. 1 as addressing this Recommendation. However, AA&Co's establishment of policies,

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procedures and controls to ensure that USAID/Egypt's approval is obtained prior to engaging consultants--or prior to hiring Egyptian subcontractors at rates in excess of those specified in the Contract--was not addressed in the Mission's response. As the establishment of such controls is the crux of Recommendation No. 3, the recommendation remains unresolved.

The reportable conditions identified by the auditor's review of AA&Co's internal control structure (detailed on pages 24 to 26) are handled directly by Mission and AA&Co officials, and are not included in the Office of the Inspector General recommendation follow-up system.

Please advise this office within 30 days of any further actions taken to close Recommendation Nos. 2 and 3. 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

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Financial Audit of
Arthur Andersen and Company
(AA)
Contract for Technical Assistance Services,
Egypt Privatization Project
USAID/Egypt Contract No. 263-0238-C-00-5061-00
for the period from April 1, 1995 through
August 31, 1996

Financial information contained in this report may be privileged. The restrictions of 18 USC 1905 should be considered before any information is released to the public.

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Financial Audit of
Arthur Andersen and Company
(AA)
Contract for Technical Assistance Services,
Egypt Privatization Project
USAID/Egypt Contract No. 263-0238-C-00-5061-00
for the period from April 1, 1995 through
August 31, 1996

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

March 13, 1997

Dear Mr. Mundy,

This report represents the results of our financial audit of Arthur Andersen and Company (AA) related to expenditures under USAID/Egypt Contract No. 263-0238-C-00-5061-00 for the period from April 1, 1995 through August 31, 1996.

Background

The purpose of the contract is to provide technical assistance services to organizations involved in implementing the Government of Egypt State enterprise privatization program. The contract's effective date is, March, 30th, 1995 and its expected completion date is March 30, 2000. We have been engaged to audit the project's financial activity for the period beginning April 1, 1995 and ending August 31, 1996.



Member Firm of
Klynveld Peat Marwick Goerdeler

Audit Objectives and Scope

The objective of this engagement was to conduct a financial audit of USAID/Egypt's resources managed by AA under Contract No. 263-0238-C-00-5061-00. The audit covered the period from April 1, 1995 through August 31, 1996. The audit encompassed an examination of AA's expenses, billed to USAID/Egypt, in order to determine whether they were in compliance with the terms and conditions of the contract, and applicable USAID/Egypt rules and regulations. We also reviewed internal controls associated with AA's management of the contract.

The specific objectives were to:

1. express an opinion on whether the fund accountability statement for the USAID-financed contract of AA presents fairly, in all material respects, revenues received and costs incurred for the periods under audit, in conformity with generally accepted accounting principles or other comprehensive bases of accounting;
2. determine whether the costs, reported as incurred under the contract, are, in fact, allowable, allocable, and reasonable in accordance with the terms of the contract;
3. evaluate and obtain sufficient understanding of the internal control structure of AA, assess control risk, and identify reportable conditions, including material internal control weaknesses;
4. perform tests to determine whether AA complied, in all material respects, with the terms and conditions of the contract, and with applicable laws and USAID/Egypt rules and regulations; and
5. perform an audit of the indirect cost rate.

The scope of our audit was limited to expenditures incurred and disbursed by AA in Egypt, and expenditures incurred and disbursed in Egypt under the Arthur Andersen Egypt, OSAF and FIANI subcontracts. Expenditures incurred and disbursed by

Arthur Andersen and Company in the United States, and expenditures incurred and disbursed by U.S. based subcontractors to the prime contract were not audited by us because we did not have access to the supporting documentation for such costs.

The scope of our work also included the audit of the Arthur Andersen Egypt overhead rate for the year ended August 31, 1996 (the first complete accounting fiscal year of the contract). We did not audit the Arthur Andersen and Company overall U.S. based overhead rate nor the general and administrative rate because such rates are subject to audit by the U.S. Defense Contract Audit Agency (DCAA) in the United States where the supporting documents for overhead and general and administrative costs are maintained.

We also reviewed internal controls associated with AA's management of the contract. This included a review of AA's policies, procedures and controls associated with the management of subcontracts.

Preliminary planning and review procedures started in August 1996 and consisted of:

- discussions with RIG/A/C officials;
- a review of the contract and subcontracts;
- interviews and discussions with AA's key personnel concerning the status of the contract, accomplishments during the period, the statutory reporting requirements, the contract budget, and procedures governing actual expenditures incurred by AA and billed to USAID/Egypt; and
- a review of the AA organizational structure and AA's established policies and procedures and controls related to personnel, procurement, financial accounting and reporting, and billing to USAID/Egypt.

The field work segment of our audit was completed on March 4, 1997. We tested expenditures of \$2,516,057 out of total expenditures incurred locally in Egypt amounting to \$4,415,256 for Contract No. 263-0238-C-00-5061-00.

Our tests of expenditures included, but were not limited to, the following:

1. Reconciling AA's accounting records to invoices issued to USAID/Egypt and testing costs for allowability, allocability, reasonableness, and adequate supporting documentation;
2. Determining whether payroll costs were appropriate and consistent with the terms of the contract and applicable rules and regulations, and were adequately supported and approved;
3. Determining whether other direct costs and subcontractor costs were appropriate and consistent with the terms of the contract and were adequately supported and approved; and
4. Determining the actual overhead rate for the Arthur Andersen Egypt subcontract and the propriety of costs included in the related allocation bases and cost pools.

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 statement is 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, because no such quality control 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 have participated in the KPMG worldwide internal quality control program. This program requires our office to be subjected, every two years, to an extensive quality control review by partners and managers from other KPMG offices.

Results of Audit

Our audit identified questioned costs totaling \$73,257 which represent ineligible costs amounting to \$73,257. We determined Arthur Andersen Egypt's actual overhead rate, for the year ending August 31, 1996, to be 105.31%. Our audit of the AA-Egypt subcontract's overhead rate for the year ending August 31, 1996 identified questioned costs totaling \$101,551 which represent ineligible costs amounting to \$1,551 and unsupported costs amounting to \$100,000.

Internal Control

Our audit identified four reportable conditions which were not considered to be material weaknesses associated with the Project's internal control structure. These reportable conditions in the internal control structure were in the areas of 1)Project Billing, 2)Time Reporting - AA-Egypt Subcontract, 3)AA-Egypt's Accounting and Reporting of Overhead Costs. These matters are described in our Report on Internal Controls.

Compliance with Laws and Regulations

Our audit identified two instances of material noncompliance that are required to be reported in accordance with Government Auditing Standards. First, we noted several occasions in which AA entered into consultant contracts without obtaining prior approval from USAID/Egypt. Second, during the course of our audit, we identified \$73,257 in ineligible costs which AA billed USAID/Egypt.

Management Comment

We have reviewed Management's response to the questioned costs identified as a result of our audit, which is included in Appendix I. Where applicable, we have made adjustments in our report on provided further clarification of our position in Appendix II. For those items not adjusted in our final report, the responses provided by Management have not changed our report on the fund accountability statement, our report on internal controls, or our report on compliance with laws and regulations.

This report is intended for the information of the United States Agency for International Development and AA's management and others within the organization. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink, followed by the letters "KPMG" and a circled "B" to its right, all underlined.

KPMG Hazem Hassan & Co.
Cairo, Egypt

FUND ACCOUNTABILITY STATEMENT

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Report on the Fund Accountability Statement
Independent Auditor's Report

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

We have audited the accompanying fund accountability statement of funds received and costs incurred locally in Egypt by Arthur Andersen and Company (AA) related to Contract No. 263-0238-C-00-5061-00 for the period from April 1, 1995 through August 31, 1996. The fund accountability statement is the responsibility of AA's management. Our responsibility is to express an opinion on the fund accountability statement based upon our audit.

Except as discussed in the following paragraphs, 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 statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the presentation of the overall fund accountability statement. We believe that our audit provides a reasonable basis for our opinion.



We were engaged to audit locally incurred costs. Other direct and indirect costs were incurred under the contract in the United States by Arthur Andersen & Co. LLP and the records supporting such costs were not available for us to audit. The records maintained locally in Egypt were not sufficient to permit us to apply other auditing procedures to these costs.

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, because no such quality control 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 have participated in the KPMG worldwide internal quality control program. This program requires our office to be subjected, every two years, to an extensive quality control review by partners and managers from other KPMG offices.

The aforementioned fund accountability statement does not include the cost of USAID/Egypt's direct procurement of vehicles, equipment and technical assistance provided by USAID/Egypt directly to AA nor the total revenues and costs incurred by AA on an organization-wide basis.

As described in Note 1, the fund accountability statement has been prepared on the cash basis which is a comprehensive basis of accounting other than generally accepted accounting principles. Included in the fund accountability statement are questioned costs of \$73,257. The basis for questioning these costs is described in the Details of Questioned Costs section of this report.

In our opinion, except for the effects of adjustments, if any, as might have been determined to be necessary had we been able to apply other auditing procedures referred to in the third paragraph above and the effects of questioned costs referred to in the preceding paragraph, the fund accountability statement presents fairly, in all material respects, the amounts received and costs incurred pursuant to USAID/Egypt Contract No. 263-0238-C-00-5061-00 for the period beginning April 1, 1995 and ending August 31, 1996.

Our audit was made for the purpose of forming an opinion on the fund accountability statement taken as a whole. The Schedule of Computation of Overhead Rate-Arthur Andersen Egypt is presented for the purpose of additional analysis and is not a required part of the fund accountability statement. Such information has been subject to the auditing procedures applied in the audit of the fund accountability statement and, in our opinion, is fairly presented, in all material respects in relation to the fund accountability statement taken as a whole.

 KPMG

KPMG Hazem Hassan & Co.
Cairo, Egypt

March 6, 1997

Arthur Andersen and Company (AA)
Fund Accountability Statement
Contract No. 263-0238-C-00-5061-00
For the Period from April 1, 1995 through August 31, 1996

| | | | | | | |
|--|---------------------------------------|---|--------------------------|---|---------------------------|--------------------------------------|
| USAID/Egypt Funds Received | | \$ | 5,076,080 | | | |
| | | | <u>5,076,080</u> | | | |
| <u>Expenditures</u> | <u>Costs Incurred in Egypt</u> | <u>Costs Incurred in the United States (Unaudited)</u> | <u>Total</u> | <u>Questioned Costs Ineligible</u> | <u>Unsupported</u> | <u>Finding No. & Pg.</u> |
| | \$ | \$ | \$ | \$ | \$ | |
| Salaries and Related Costs | _____ | 458,667 | 458,667 | _____ | _____ | |
| Overhead and General & Administrative Costs | _____ | 552,265 | 552,265 | _____ | _____ | |
| Other Direct Costs including Subcontractor Costs | 4,415,256 | 1,620,475 | 6,035,731 | 73,257 | _____ | |
| | <u>4,415,256</u> | <u>2,631,407</u> | <u>7,046,663</u> | <u>73,257</u> | <u>_____</u> | Finding No. 1a) & b) pg.14,15 and 16 |
| Excess (deficiency) of Revenues over Expenditures | | | <u><1,970,583></u> | | | |

* The accompanying notes are an integral part of the fund accountability statement.

Schedule of Computation of Overhead Rate
Arthur Andersen-Egypt Subcontract
USAID/Egypt
USAID/Egypt Contract No. 263-0238-C-00-5061-00
For the Period from September 1, 1995
through August 31, 1996

| | <u>Questioned Costs</u> | | | <u>Correct Pool</u> |
|-----------------------------------|---------------------------|-------------------|--------------------|---------------------|
| | <u>Total Expenditures</u> | <u>Ineligible</u> | <u>Unsupported</u> | |
| <u>Overhead Costs</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> |
| People Support | 189,000 | | | 189,000 |
| Training | 137,000 | | | 137,000 |
| Practice tools | 12,000 | | | 12,000 |
| Practice Management | 1,041,000 | | 100,000 | 941,000 |
| Facilities | 113,000 | | | 113,000 |
| Communication | 78,000 | | | 78,000 |
| Marketing | 122,000 | 1,551 | | 120,449 |
| Other | 96,000 | | | 96,000 |
| Expatriate | 129,000 | | | 129,000 |
| Rate Variance-Indirect Labor | (119,000) | | | (119,000) |
| Unpaid Overtime | (29,000) | | | (29,000) |
| Partner Profit Adjustment | (73,000) | | | (73,000) |
| Total Overhead Costs | 1,696,000 | 1,551 | 100,000 | 1,594,449 |
| <u>Direct Costs</u> | | | | |
| Direct Labor | 1,678,000 | | | |
| Bid and Proposal | 66,000 | | | |
| Partner Profit Adjustment | (51,000) | | | |
| Rate Variance-Direct Labor | (179,000) | | | |
| Total Direct Costs | 1,514,000 | | | |
| Overhead Rate Calculation: | | | | |
| <u>Total Overhead Costs</u> | <u>1,594,449</u> | = | 105.31% | (2) |
| <u>Total Direct Costs</u> | <u>1,514,000</u> | | | |

(1) See details of Questioned Costs section of this Report for description of the ineligible and unsupported amounts reflected in this schedule.

(2) AA-Egypt's provisional overhead rate as set forth in the USAID/Egypt approved subcontract is 125%.

Arthur Andersen and Company
(AA)
Fund Accountability Statement
USAID/Egypt Contract No. 263-0238-C-00-5061-00

Notes to the Fund Accountability Statement

Note 1: Accounting Basis

The fund accountability statement has been prepared on the basis of cash receipts and disbursements. Consequently, revenues are recognized when they are actually received and expenditures are recognized when they are actually paid.

Note 2: Contract Costs Incurred in the United States

Expenditures, included in the fund accountability statement and not audited by KPMG Hazem Hassan, represent costs, incurred and disbursed by Arthur Andersen & Co. LLP in the United States, and costs, incurred and disbursed by the U.S. based subcontractors, for the period beginning April 1, 1995 and ending August 31, 1996.

Note 3: Contract Costs Incurred Locally in Egypt

Expenditures, included in the fund accountability statement and audited by KPMG Hazem Hassan, represent costs, incurred and disbursed by Arthur Andersen & Co. LLP in Egypt, and expenditures, incurred and disbursed under the Arthur Andersen Egypt, OSAF and Fiani subcontracts, for the period beginning April 1, 1995 and ending August 31, 1996.

Note 4: Disallowed Costs

Project costs which were billed to USAID/Egypt and disallowed by the USAID/Egypt Project Officer (i.e.

costs questioned by USAID/Egypt and not reimbursed to the Project) during the period covered by our audit have not been included in the Fund Accountability Statement if Project Management has agreed with USAID/Egypt's basis for disallowing such costs. Project costs, which have been disallowed by the USAID/Egypt Project Officer and for which Project Management does not agree with USAID/Egypt's basis for disallowing such costs, have been included in the fund accountability statement.

Note 5: **Questioned Costs**

Questioned Costs are presented in two separate categories - ineligible and unsupported - and consist of audit findings made on the basis of the terms of the contracts and related regulations, which prescribe the nature and treatment of reimbursable costs. Costs in the column labeled Ineligible are supported by vouchers or other documentation but are ineligible for reimbursement because they are either unreasonable, not contract related, or are prohibited by the contracts or applicable laws and regulations.

Costs in the column labeled Unsupported are also included in the classification of Questioned Costs because they are not supported by adequate documentation. All questioned costs are detailed in the Details of Questioned Costs section of this report.

Details of Questioned Costs-
Fund Accountability Statement

Arthur Andersen and Company (AA)
Egyptian Privatization Project
Contract No. 263-0238-C-00-5061-00
Fund Accountability Statement
Details of Questioned Costs

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|---|-------------------------|--------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| 1) <u>Subcontractor Costs</u> | | |
| a) Based upon our audit of subcontractors costs, we noted that the daily billing rate used for the partner in charge of Fiani & Partners, one of the subcontractors, exceeds the maximum allowable daily salary rate for FSN-12 and no waiver was obtained from USAID. The daily billing rate is \$273 and the maximum FSN-12 rate is \$122.90. The excess equals \$150.10. AA billed USAID/Egypt for 132 days during the period covered by our audit, therefore the total amount billed in excess of the FSN-12 rate is \$20,473. According to clause B.6.a.1 in the contract, reimbursable salaries are limited to the Foreign Service National class 12 (FSN-12). Any excess should be approved, in writing, from the USAID/Egypt Contracting Officer. Therefore, this amount is considered to be unallowable. | 20,473 | |

Arthur Andersen and Company (AA)
Egyptian Privatization Project
Contract No. 263-0238-C-00-5061-00
Fund Accountability Statement
Details of Questioned Costs

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|--|-------------------------|--------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| 1) <u>Subcontractor Costs (cont.)</u> | | |
| b) Based upon our audit of the subcontractors costs, we noted that the daily billing rate, used for an employee at the Office for Studies and Finance (OSAF), one of the subcontractors, exceeds the maximum allowable daily salary rate for FSN-12 and no waiver was obtained from USAID. The daily billing rate was \$293 for the period from April 1, 1995 to December 31, 1995 and \$374.56 for the period from January 1, 1996 to August 31, 1996. The maximum FSN-12 rate is 122.90. The excess was 170.10 for the first period and \$251.66 for the second period. AA billed USAID 152 days for the first period and 107 days for the second period. As a result, the total amount billed in excess of the FSN-12 rate is \$52,784. | | |

Arthur Andersen and Company (AA)
Egyptian Privatization Project
Contract No. 263-0238-C-00-5061-00
Fund Accountability Statement
Details of Questioned Costs

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|--|-----------------------------|---------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| <p>According to clause B.b.a.1 in the contract, reimbursable salaries are limited to the Foreign Services National Class 12 (FSN-12). Any excess should be approved, in writing, by the USAID/Egypt Contract Officer. Therefore, the amount is considered to be unallowable.</p> | <p><u>52,784</u></p> | |
| <p>Total line item</p> | <p><u><u>73,257</u></u></p> | |
| <p>Total Questioned Costs</p> | <p><u><u>73,257</u></u></p> | <p><u>-----</u></p> |
| | <p><u>\$73,257</u></p> | |

Details of Questioned Costs-
Schedule of Computation of Overhead Rate

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Details of Questioned Costs
Contract No. 263-0238-C-00-5061-00
Arthur Andersen Egypt - Subcontract
Schedule of Computation of Overhead Rate

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|--|-------------------------|--------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| 1. <u>Training</u> | | |
| a) Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |
| b) Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |
| Total line item | | ===== |

Details of Questioned Costs
Contract No. 263-0238-C-00-5061-00
Arthur Andersen Egypt - Subcontract
Schedule of Computation of Overhead Rate

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|---|-------------------------|--------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| 2. <u>Practice Management</u> | | |
| <p>a) Based upon our audit of the overhead cost pool, we noted that the cumulative balance of account No. 725 (Practice Personnel Management), included in the overhead cost rate computation, amounted to \$167,000, while the balance supported by the accounting records is \$67,000. A request to the Management did not elicit the additional supporting documentation necessary to substantiate the inclusion of these costs in the overhead pool. According to the FAR, Part 31.201, a reimbursable cost should be allowable, reasonable and allocable. In order to assess these elements, the costs should be supported by the accounting records. Thus, this amount is considered to be unsupported and, accordingly, should be excluded from the overhead cost pool used to compute the overhead rate.</p> | | 100,000 |

Details of Questioned Costs
Contract No. 263-0238-C-00-5061-00
Arthur Andersen Egypt - Subcontract
Schedule of Computation of Overhead Rate

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|--|-------------------------|-----------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| b) Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |
| c) Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |
| Total line item | | <u><u>100,000</u></u> |
| 3. <u>Facilities</u> | | |
| Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |
| Total line item | ----- | |

Details of Questioned Costs
Contract No. 263-0238-C-00-5061-00
Arthur Andersen Egypt - Subcontract
Schedule of Computation of Overhead Rate

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|--|-------------------------|--------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| 4. <u>Marketing</u> | | |
| a) Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |
| b) Based on documents and clarifications provided to us subsequent to the issuance of our draft report, this finding has been removed. | | |

Details of Questioned Costs
Contract No. 263-0238-C-00-5061-00
Arthur Andersen Egypt - Subcontract
Schedule of Computation of Overhead Rate

| <u>Item Description</u> | <u>Questioned Costs</u> | |
|---|-------------------------|--------------------|
| | <u>Ineligible</u> | <u>Unsupported</u> |
| | <u>\$</u> | <u>\$</u> |
| c) Based upon our audit of the costs charged to the overhead cost pool, we noted that an amount of \$1,551, representing costs of a Ramadan Iftar dinner , was charged to USAID/Egypt. According to our interpretation of the FAR, Part 31, 30,609.14, entertainment costs of this nature are unallowable. Therefore, this amount is considered to be unallowable and, accordingly, should be excluded from the overhead cost pool used to compute the overhead rate. | 1,551 | |
| Total line item | <u>1,551</u> | |
| Total Questioned Costs | <u>1,551</u> | <u>100,000</u> |
| | <u>\$ 101,551</u> | |

INTERNAL CONTROL STRUCTURE

21a



Hazem Hassan

Public Accountants & Consultants

72 Mohi Eldin Abul Ezz Street
Mohandseen, Cairo
Egypt

Telephone: (202) 3499588 - 3499677
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Report on the Internal Control Structure
Independent Auditor's Report.

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

We have audited the accompanying fund accountability statement of Arthur Andersen & Co. LLP (AA), related to funds received and locally incurred costs under USAID/Egypt Contract No. 263-0238-C-00-5061-00 for the period beginning April 1, 1995 and ending August 31, 1996, and have issued our report thereon dated March 6, 1997.

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 statement is 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, because no such quality control 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 have participated in the KPMG worldwide internal quality control program. This program requires our office to be subjected, every two years, to an extensive quality control review by partners and managers from other KPMG offices. In addition, we are subject to a quality control review by the USAID/Egypt.



The management of AA 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. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that the transactions are executed in accordance with the management's authorization and recorded properly to permit the preparation of fund accountability statements in accordance with the cash basis of accounting. Because of the 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.

In planning and performing our audit of the fund accountability statement of Arthur Andersen and Company (AA), related to funds received and locally incurred costs, under USAID/Egypt Contract No. 263-0238-C-00-5061-00 for the period beginning April 1, 1995 and ending August 31, 1996, we obtained an understanding of the internal control structure associated with AA's operations in Egypt. We were not engaged to obtain an understanding of the internal control structure associated with AA's operations in the United States and, therefore, did not do so. With respect to the internal control structure associated with AA's operations in Egypt, we obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation, and we assessed control risk, in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statement but not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under the standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters, coming to our attention, relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Our audit disclosed the following reportable conditions:

1. Project Billing

During our audit, we reviewed AA's monthly invoices, submitted to USAID/Egypt. As a result of our review of these invoices, we noted that AA had, in several instances, billed USAID/Egypt in error. The first error related to the billing of subcontractor salaries at rates above the contractually allowable rate, without prior USAID/Egypt written approval. When we brought this matter to the attention of AA Management, we were informed that they would obtain USAID/Egypt approval for these costs. We recommend that AA Management obtain approval, in writing, from USAID/Egypt prior to billing personnel costs at levels in excess of the authorized limits set forth in the contract.

The second error related to the billing of costs which are unallowable as defined in the Federal Acquisition Regulations Part 31.201 and in the Standard Provisions of the Contract. During our audit, we noted approximately \$17,000 in unallowable costs which AA Management agreed were billed in error. Accordingly, AA Management credited subsequent billings to USAID/Egypt for these unallowable costs originally billed in error. We understood, from our discussions with AA Management, that those errors occurred as a result of Management's unfamiliarity with the applicable regulations and with the terms and conditions of the contract. We recommend that AA Management review the Federal Acquisition Regulations and the terms and

conditions of the contract in order to familiarize themselves with the type of costs which are allowable for reimbursement under the contract. In addition, we recommend that AA Management establish policies, procedures and controls necessary to effectively track unallowable costs in the accounting system in a manner necessary to ensure that they are not billed in error to USAID/Egypt.

The third error related to the AA's use of a standard cost system associated with the billing of personnel costs under the AA Egypt subcontract. During our audit, we noted that certain employees were incorrectly classified into standard labor cost categories for the purpose of billing USAID/Egypt. These classification errors occurred as a result of human error at the time the employees were added to the standard labor costing system. Based upon our discussions with Management and the performance of certain follow-up auditing procedures, we noted that AA Management had corrected these classification errors, beginning with the issuance of Bill Number 10 to USAID/Egypt. We recommend that management implement policies and procedures necessary to ensure that employees are properly classified in the standard labor cost system prior to billing USAID/Egypt.

2. Time Reporting - Arthur Andersen Egypt Subcontract

During our audit of personnel costs associated with the Arthur Andersen Egypt subcontractor, we noted that original time reports for employees, whose time was billed to USAID/Egypt, were forwarded to AA Regional office in Riyadh, Saudi Arabia for input and processing into AA's Regional Accounting System. Upon our request for the original time reports, for the purpose of performing certain auditing procedures, we were informed that the originals are not maintained but rather destroyed after a period of 2 to 3 months. Although we were able to perform alternative auditing procedures necessary to substantiate the time and effort billed to USAID/Egypt, it is necessary

for Arthur Andersen Egypt to maintain original time reports in order to comply with the record retention requirements of the contract and, also, in order to provide adequate supporting documentation to substantiate personnel costs billed to USAID/Egypt. We were informed by Management that the corrective action, necessary to ensure that original time reports are maintained in a manner necessary to comply with the record retention requirements of the contract, has been taken.

3. Arthur Andersen Egypt - Overhead Costs

During our audit of overhead costs associated with the Arthur Andersen Egypt subcontract, we noted \$101,551 in questioned costs. Nearly all of these costs were questioned because of the absence of adequate supporting documentation. The most significant cost questioned in this regard included Practice Management Costs of \$100,000 which were not recorded in the accounting general ledger. In accordance with FAR, Part 31.201, a reimbursable cost should be allowable, reasonable and allocable. The supporting documentation, provided to us by Management, did not allow us to make such a determination. We recommend that AA - Egypt Management establish and implement policies, procedures and controls necessary to ensure that all costs recorded in the accounting system are supported by adequate documentation.

A material weakness is a reportable condition, in which the design or operation of one or more of the specific internal control 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.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly would not necessarily disclose all reportable conditions that are also considered to be material weaknesses, as defined above. However, we do not believe that the reportable conditions described above are material weaknesses. These conditions were considered in determining the nature, timing and extent of the procedures to be performed in our audit of the fund accountability statement of AA.

We also noted other matters, involving the internal control structure and its operation, that we have reported to the management of AA in a separate letter dated March 6, 1997.

This report is intended for the information of AA's management and others within the organization and the United States Agency for International Development. However, this report is a matter of public record, and its distribution is not limited.



KMPG Hazem Hassan & Co.
Cairo, Egypt

March 6, 1997

COMPLIANCE WITH LAWS AND REGULATIONS

27a



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Report on Compliance with Laws and Regulations Independent Auditor's Report

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

We have audited the fund accountability statement of Arthur Andersen & Co. LLP (AA), related to funds received and locally incurred costs, under USAID/Egypt Contract No. 263-0238-C-00-5061-00 for the period beginning April 1, 1995 and ending August 31, 1996, and have issued our report thereon dated March 6, 1997.

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 statement is 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, because no such quality control 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 have participated in the KPMG worldwide internal quality control program.



This program requires our office to be subjected, every two years, to an extensive quality control review by partners and managers from other KPMG offices. In addition, we are subject to a quality control review by the USAID/Egypt.

We were engaged to audit locally incurred direct costs associated with AA's operations in Egypt. Other direct and indirect costs incurred by AA in the United States were not subject to our audit. Therefore, we were unable to determine the effects of noncompliance, if any, associated with direct and indirect costs, incurred by AA in the United States.

Compliance with laws, regulations, contracts, and grants, applicable to AA, is the responsibility of AA's management. As part of obtaining reasonable assurance about whether the fund accountability statement is free of material misstatement, we performed tests of AA's compliance with certain provisions of laws, regulations, contracts, and grants. However, it was not the objective of our audit of the fund accountability statement to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed the following material instances of noncompliance that are required to be reported herein under Government Auditing Standards:

1. Prior Approval for Consultant Contracts

During our audit of consultant costs billed to USAID/Egypt, we noted several instances in which consultants were engaged by AA without obtaining prior approval from USAID/Egypt, as required by section B.6 of the contract. When we brought this matter to the AA Management, we were told that they believed that the approval of USAID/Egypt was not necessary because they considered that the Project was procuring a commodity necessary for carrying out its activities, rather than engaging a consultant. However, they were not consistent in this belief because, in cases of consultants providing

similar services, approval was obtained for some but not for others. We recommend that Management consult with the Contracting Officer of USAID/Egypt to obtain clarification of the contractual requirement with regard to engaging consultants. Should the contracting officer disagree with Management's position, we recommend that policies, procedures and controls be established in order to ensure that USAID/Egypt's approval is obtained prior to engaging consultants.

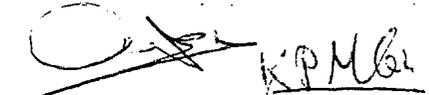
2. Ineligible Direct Costs - Billed to USAID/Egypt

During our audit, we noted (as more fully described in the Details of Questioned Costs section of this report) \$73,257 in questioned costs. These questioned costs represent amounts billed for personnel costs of Egyptian based subcontractors at levels in excess of the maximum daily rates set forth in section B.b.a.1 of the Contract. Personnel costs in excess of these limits should be approved in writing by USAID/Egypt prior to being billed for reimbursement. Discussions with Management revealed that no approvals had been obtained for the amounts questioned. We recommend that Management attempt to obtain retroactive approval from USAID for such costs. If Management is unsuccessful in obtaining retroactive approval, we recommend that the questioned costs be reimbursed to USAID/Egypt.

We noted certain immaterial instances of noncompliance that have been reported to AA's management in a separate letter dated March 6, 1997.

We considered these instances of noncompliance in forming our opinion on whether the Fund Accountability Statement, related to USAID/Egypt Contract No. 263-0238-C-00-5061-00, presented fairly in conformity with the cash basis of accounting, and this report does not affect our report, dated March 6, 1997 on the fund accountability statement.

This report is intended for the information of AA's management and others within the organization and the United States Agency for International Development. However, this report is a matter of public record, and its distribution is not limited.

A handwritten signature in black ink, appearing to be 'KPMG', is written over a circular stamp or mark.

KPMG Hazem Hassan & Co.
Cairo, Egypt

March 6, 1997

APPENDIX I
MANAGEMENT RESPONSE

Partnership in Development Project

Appendix I
page 1 of 5

A project led by
ARTHUR
ANDERSEN

Partnership in Development Project

World Trade Center - 16th Floor
1191 Corniche El Nile Street
Cairo 11221, Egypt
(202) 579 0971 Telephone
(202) 773 983 Facsimile
E-mail: PIDP@ritsecl.com.eg

May 22, 1997

Ali G. Salama
Hazem Hassan & Co.
72 Mohi El Din Abul Ezz Street
Mohandiseen, Cairo

Subject: Reply to KPMG March 13, 1997 Draft Audit Report

Dear Ali,

Enclosed please find our reply to KPMG's March 13, 1997 Draft Audit Report of Contract No. 263-0238-C-00-5061-00. Also enclosed are the representation letters requested by KPMG.

We would like to take this opportunity to compliment the KPMG audit team on its professional and objective manner in auditing this contract. A number of their comments and observations on our procedures have been quite helpful to the Privatization Project's accounting department.

Very Truly Yours,

ARTHUR ANDERSEN LLP

By


Curt Beech

ARTHUR ANDERSEN REPLY TO DRAFT EXTERNAL AUDIT REPORT

Arthur Andersen LLP

Fund Accountability Statement - Details of Questioned Costs

1. *Subcontractor Costs*

- a) Fiani & Partners - Pursuant to this finding the Project management has formally requested a retroactive waiver from USAID on April 28, 1997 (Attachment 1).
- b) OSAF - Pursuant to this finding the Project management has formally requested a retroactive waiver from USAID on May 11, 1997 (Attachment 2).

2) *Independent Consultants*

This issue has been resolved in consultation with the audit team. There is no impact to costs invoiced to USAID. For contractual reasons, it is important to note that the Project subcontracted with a *firm of lawyers* and not an independent consultant.

Arthur Andersen Egypt

Schedule of Computation of Overhead Rate

1. *Training*

- a) This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.
- b) This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.

2. *Practice Management*

- a) In conjunction with the modifications made to Project management in May through August 1996, costs were incurred in respect of professional staff enhancing the services and otherwise propelling the Project forward to match the dramatic change in the Government of Egypt's privatization program. Of the costs incurred, the subcontractor Arthur Andersen Egypt was determined to be responsible for out-of-pocket expenses and other expenses incurred by the visiting consultants performing the tasks. These out-of-pocket expenses include airfares, hotels, per-diem costs and similar expenses. At 31 August 1996, this amount was estimated to approximate US\$ 100,000. Accumulation of costs documented at that date are included in Attachment 3.
- b) This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.
- c) This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.

3. *Facilities*

This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.

4. *Marketing*

- a) This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.
- b) This issue has been resolved in consultation with the audit team. There is no repayment required in respect of the costs invoiced to USAID.
- c) Includes LE 5.273 (US\$ 1,550.88) for Ramadan Ifar for our firm employees. It is our firm policy to celebrate, every year, the Holy month of Ramadan with a breakfast (Ifar). These expenses are allowable according FAR 31.205.

REPORT ON INTERNAL CONTROL STRUCTURE

Introduction:

The Privatization Project is a *project office* of Andersen Worldwide established solely for the purpose of carrying out USAID Contract No. 263-0238-C-00-5061-00. Pursuant to this Andersen Worldwide (the Firm) has developed an Operations Manual (OM) that established practices and procedures for the management and administration of the Project. These practices and procedures were developed in order to assure compliance by the project with the terms of the contract and the FAR. The Project OM mirrors the Firm's worldwide policies and procedures except in those instances where the FAR and the AIDAR require deviation, such as for travel, per diem, salary increases, and subcontracting. In these instances the OM follows US government regulations rather than Andersen's established procedures.

1. *Project Billing*

Since September 1996 the Project has not billed any salary rates in excess of the waivers granted by USAID. Prior to that period the instances where salaries (for national staff) in excess were billed were for certain individuals with waivers pending. In one instance (Fiani) we believed that a waiver had been granted at the time of and by means of USAID's acceptance of our BAFO offer. We have subsequently been advised in the course of the audit that this was not the case and so we applied for a waiver.

During the course of the audit the KPMG noted some costs that were billed in error. Per our standard procedures, we credited USAID these expenses on our next invoice. The Project adopted the OM policies and procedures before the KPMG audit began but only during the end of the period under review.

As noted by KPMG, the inaccuracy in the way standard costs were previously billed have been corrected. Since that time the improved methodology referred to above has been applied to billing using the standard cost system.

2. *Time Reporting*

The subcontractor Arthur Andersen Egypt has been instructed to retain all original time sheets in the future.

3. *Procurement of Professional Consulting Services*

This issue has been resolved in consultation with the audit team. There is no impact to costs invoiced to USAID.

4. *Overhead Costs*

This issue has not been resolved with the audit team. This expense is an inter-company transfer between the various Andersen affiliates involved. We are of the opinion that the ledgers showing the expenses on our books and the evidence of payment being transferred from AAE to the UK (see Attachment 3) are enough to document that the expenses have been incurred, and are supported by the job summaries and ledgers of AAE and AA London office.

The supporting documentation to this entry has to be obtained from Andersen offices in the US, UK, and Sweden. This necessarily takes time. In addition, the UK tax authorities will not allow us to send the actual originals out of the UK. Certified copies will have to be made and sent, again taking additional time.

Senior Project Management met with the Senior Management of AAE to discuss the continued need to maintain the documentation of costs as required by USAID regulations.

REPORT ON COMPLIANCE WITH THE LAWS AND REGULATIONS

1. Prior Approval for Consultant Contracts

The Project OM Procurement policy indicates that if possible, *firm fixed price subcontracts* are the preferred subcontracting vehicle for Project procurement. Under the terms of the prime contract, the Project is not required to obtain prior approval for Firm Fixed Price Contracts under \$25,000. The *subcontracts* in question were issued in accordance with the Project OM. These were firm fixed price purchase orders for the delivery of well defined specific deliverables. This issue has been discussed with the CO and she advised us to continue to follow our own procedures per the OM.

2. Ineligible Direct Costs - Billed to USAID Egypt

These costs have now been resolved with USAID as detailed in "Fund Accountability Statement - Details of Questioned Costs" Nos. 1 and 2. As part of our efforts to insure that this issue does not arise again, we instituted three procedures. The first is the utilization of a reference numbering system on all such requests. The second is the routine copying of all communication to the PO to the CO and vice versa. The third was inclusion, in contract Amendment No. 7, of a clause requiring USAID to reply to such requests in ten days, and urgent requests in five days.

APPENDIX II
AUDITOR'S COMMENTS

Auditor's Comments on
Fund Accountability Statement
Details of Question Costs

Finding No. 1a

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, the correct number of days billed to USAID for this subcontractor in 132 days. Therefore, the questioned costs have been reduced to \$20,473. In addition, Management's response did not include the additional documentation required to approve the excess of the daily billing over the maximum allowable daily salary rate for FSN-12 i.e., A waiver from the USAID/Egypt Project Officer. Therefore our position remains the same.

Finding No. 1b

Management's response did not include the additional documentation i.e.,. A waiver from the USAID/Egypt Project Officer required to approve the excess of the daily billing over the maximum allowable daily salary rate for FSN-12. Therefore our position remains the same.

Finding No. 2

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Auditor's Comments on
Schedule of Computation of Overhead Rate
Details of Questioned Costs

Finding No. 1 a

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 1 b

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 2 a

Management's response did not include the additional supporting documentation necessary to substantiate the inclusion of these costs in the overhead pool. We were not provided a reasonable basis for allocating such costs to the AA-Egypt indirect cost pool. Also, we were not provided response to our inquiry of why such costs which could not be billed to the contract as a direct cost have been charged to the contract as indirect cost.

Finding No. 2 b

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 2c

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 3

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 4

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 4a

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 4b

Based on documents and clarifications provided to us, subsequent to the issuance of the draft report, this finding has been removed.

Finding No. 4c

Based upon documents and clarifications provided to us, subsequent to the issuance of the draft report, an amount of \$3,039 was substantiated. Our position remains the same for the remaining \$1,551 of questioned costs associated with an Iftar dinner billed to USAID/Egypt.

Auditor's Comments on
Management Response to the
Report on the Internal Control Structure

Finding No. 1

PIDP management stated that adequate corrective action has been taken for this finding. However, these corrective actions were taken subsequent to the completion of the fieldwork segment of our audit. Therefore, this finding will remain the same.

Finding No. 2

PIDP management stated that adequate corrective action has been taken for this finding. However, these corrective actions were taken subsequent to the completion of the fieldwork segment of our audit. Therefore, this finding will remain the same.

Finding No. 3

Based upon our discussion with PIDP management and the documents provided to us subsequent to the issuance of the draft report, this finding is considered to be an isolated instance where established controls were not followed. Therefore, this finding has been removed.

Finding No. 4

PIDP management stated that adequate corrective action has been taken for this finding. However, these corrective actions were taken subsequent to the completion of the fieldwork segment of our audit. Therefore, this finding will remain the same.

cl

Auditor's Comments on
Management Response to the
Report on Compliance with Laws and Regulations

Finding No. 1

PIDP's management response did not address the issue that was raised with respect to this finding which related to the inconsistent practice of engaging consultants who provided similar services. As documented in our original finding we noted several instances in which consultants who provided similar services to the project were at times deemed to be consultants and at other times not. As a result, USAID/Egypt approval was obtained for some but not for others. Therefore, this finding will remain the same.

Finding No. 2

PIDP management stated that adequate corrective action has been taken for this finding. However, these corrective actions were taken subsequent to the completion of the fieldwork segment of our audit. Therefore, this finding will remain the same.

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APPENDIX III
MISSION'S COMMENTS



UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

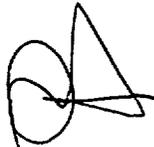
CAIRO, EGYPT

15 JUL 1997

MEMORANDUM

DATE : July 13, 1997

TO : Lou Munday, RIG/A/C

FROM : Shirley Hunter, Division Chief/FM/FA 

SUBJECT : Final Draft NFA Report of Arthur Anderson & Co., Expenditures Incurred Under Contract No. 263-0238-C-00-5061-00 (USAID/Egypt Privatization Project No. 263-0238), Expenditures Incurred from April 1, 1995 to August 31, 1996

Following are the actions taken by the Mission to resolve Recommendation No. 1 under the subject audit:

Recommendation No. 1:

We recommend that USAID/Egypt make a management decision on the ineligible costs of \$73,257 detailed on pages 14 through 16 of the KPMG Hazem Hassan audit report, and recover from Arthur Andersen & Company the amounts determined to be unallowable.

Mission Response:

Based on the Mission's review, of the \$73,257 questioned, \$31,379 is allowable and \$41,878 is sustained and was deducted from AA & Co. voucher for Log No. 7-3960 (Invoice No. 23), attachment (a).

Accordingly, Mission requests closure of Recommendation No. 1 under the subject audit report.

Following are the details of mission determination:

Findings No. 1. a. and 1.b.

The questioned costs are related to daily billing rates which exceeded the maximum allowable FSN-12 cap without USAID prior written approval.

- * Arthur Andersen & Company requested a USAID retroactive for the sub-contractors Fiani & Partners (resulting in \$20,473 of questioned costs) and OSAF (resulting in \$52,784 of questioned costs).
- * In her response to AA & Co., the Contracting Officer did not approve the Fiani's daily rate and therefore, the \$20,473 remains questioned. However, based on the Mission's computation indicated below, the correct sustained amount should read \$19,813 rather than the \$20,473 reported. Furthermore, the contracting officer approved, in a separate letter, a modified daily rate for the OSAF's employee, resulting in a balance of \$22,065 due to USAID rather than the \$52,784 initially questioned.
- * In their letter dated July 13, 1997, AA & Co. agreed to the Contracting Officer determination, attachment c.

Based on the above, the total amount sustained under recommendation No. 1 is \$41,878, computed as follows:

Computation for Fiani's employee:

| | | | | |
|-------------------------|---|---------------------|---|-----------------|
| Billed rate | : | 132 days * \$273 | = | \$ 36,036 |
| Approved rate | : | 132 days * \$122.90 | = | \$ 16,223 |
| Difference due to USAID | | | | = \$ 19,813 (a) |

Computation for OSAF's employee:

| | | | | |
|--------------------------------|---------------------------------|------------|---|------------------|
| Billed Rate: | 152 days | * \$293 | = | \$ 44,536 |
| | 107 Days | * \$374.56 | = | <u>\$ 40,078</u> |
| | | | | \$ 84,614 |
| Approved Rate: | 259 days (152 + 107) * \$241.50 | | = | \$ 62,549 |
| Difference due to USAID | | | | = \$ 22,065 (b) |
| Total Amount Sustained (a + b) | | | | \$41,878 |

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Recommendation No. 2:

We recommend that USAID/Egypt determine Arthur Andersen & Company's final indirect cost rate for the period September 1, 1995 to August 31, 1996 based on the consideration of questioned overhead costs detailed on pages 18 and 21 of the KPMG Hazem Hassan audit report.

Mission Response:

- * The audited overhead rate as included in the report, is 105.31% for the period from September 1, 1995 through August 31, 1996, compared to the provisional overhead rate of 125% rate applied to same period. Mission has requested documentation from AA in order to reach final determination of this recommendation. Mission determination is pending submission and review of the required documentation and therefore, the recommendation remains unresolved.

Following is a the Mission analysis of the findings included under the recommendation.

Finding No. 2. a. for the unsupported amount of \$100,000

- * AA & Co. have responded, during a meeting held on July 7, 1997, that the amount represents charges from AA London headquarters for General Administration costs. AA provided informal Job Summary computation sheets issued by the headquarters, in support of their justification. However, Mission was unable to make a determination due to ambiguities and lack of details in these sheets. Mission has requested a formal billing by the headquarters which is properly detailed and tied to the questioned amount, as well as the internal policy governing such billings accompanied by a certification by the headquarters that the billing complies with AA general practice and is not double billed to other parties.

Finding No. 4.c. for \$1,551 under "Marketing"

In their response dated July 13, 1997, AA & Co. agreed to the finding.

Recommendation No. 3:

We recommend that USAID/Egypt obtain evidence that Arthur Andersen & Company has addressed the material non-compliance issues (Lack of prior USAID/Egypt approval when engaging consultants and when paying subcontractor salaries in excess of the maximum allowable) detailed on pages 29 and 30 of the KPMG Hazem Hassan audit report.

Mission Response:

This finding is related to the Recommendation No. 1 addressed above. Since the findings under recommendation No. 1 are resolved and corrective actions are already taken. Mission requests closure of Recommendation No. 3.

*** Internal Control:**

The report identified four reportable conditions. These are not reported as material conditions and therefore, will not be included in the RIG/A/C tracking system rather, will be included in the Mission's tracking system. However, Mission will work with the auditee to address these weaknesses to ensure proper management of USAID funds.

Thank you for your cooperation.

Att: a/s