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Auditor General

AUDIT REPORT
ON
INTERNAL OPERATING PROCEDURES
APPLICABLE TO PROJECT-LIKE ACTIVITIES
OF THE COMMODITY IMPORT PROGRAMS OF EGYPT
AID LOANS NO.263-K-(026),(027),(029),(030),(036)
(038),(045A),(045B),(052)
AND
GRANT NO.263-0119

Audit Report Number 6-263-81-2

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Area Auditor General EGYPT
Agency for International Development

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## EXECUTIVE SUMMARY

### Introduction

At the time of our review, there were nine loans and one grant signed that obligate $1.54 billion for the Commodity Import Program (CIP) in Egypt. A significant part of total U.S. economic assistance to Egypt, the CIP was initiated during 1975 to address the short-term needs of Egypt. To assist Egypt in meeting hard currency costs of imported commodities and commodity-related services as needed, the program is designed to (a) relieve the serious foreign exchange shortage, (b) achieve development objectives, (c) improve the standard of living, and (d) maintain political stability.

Of the $1.5 billion obligated, about 95.5% (over $1.4 billion) has been allocated to Egypt's public sector. The remaining balance, about $68.5 million, has been allocated to Egypt's private sector, and is the subject of AAG/E Audit Report No. 80-10 dated August 10, 1980. This report covers the results of our examination of procedures and controls used to administer seven project-like activities financed under the CIP. These activities include: a railway traffic control system, 14 ice making plants, boilers and sugar mill equipment, rotary hearth calciner furnaces, a microwave system, a vessel traffic management system, and 39 automatic bakeries. This is the third report in a series of six to be issued covering the CIP in a comprehensive manner. For better perspective, the reader may wish to obtain this entire series of six CIP reports (listed on page 2 in this report).

### Audit Purpose and Scope

We reviewed the management operating procedures and controls applied to seven project-like activities included in sampled commodity transactions financed through the CIP. Costs and financial data of the CIP were reviewed from program inception, February, 1975 through July 31, 1980. For CIP management policies and practices, coverage extended to report preparation. Primary audit purposes for this specific review were to: (a) evaluate the bases for financing the project-like activities through the CIP rather than as independent projects; (b) determine and evaluate the status of the project-like activities; (c) analyze the individual activity as well as the implications of patterned problems of a crossectional nature; and (d) determine and evaluate problem causes and origins.

To accomplish these objectives we examined procedures and systems in place and planned, reports, activity files, planning and implementing documents, contracts, letters of credit, and referred to pertinent regulations, handbooks, laws, and other criteria. We also held meetings with USAID/E and various involved GOE officials and visited project sites of some activities.

## Conclusions

### A. Financing and Managing Project-Type Activities through the CIP

Project-like activities financed through the CIP have not been planned and implemented effectively. Routine CIP procedures of "shifting" fund allocations between loans/grants and "switching" funds between transactions are not suitable for project-type activities; these flexible funding procedures do not assure fund availability at all times and most of these activities sampled were not fully funded. Financing project-like activities through the non-project CIP program is not the preferred mode set forth in Agency policy; i.e., to finance activities as distinct projects. These long-term project-like activities, financed through the CIP, were managed as routine commodity imports. Project management procedures, controls, and monitoring were not implemented--the source of funding rather than the nature of the activity was the governing factor. In short,USAID/E followed routine CIP managerial procedures and practices for commodity imports despite the project aspects and needs of these long-term activities. This managerial concept was the basic cause for the problems that later developed.

The seven project-like activities reviewed will exceed $142 million in costs (exclusive of host country contributions in local currency); as of our cut-off date of July 31, 1980, however, funds sub-allocated under the CIP for these activities totaled only about $112 million. They are under-funded by about $30 million, then, because of the common USAID/E practice under the CIP of "shifting" fund allocations. Although the CIP assistance is directed toward short-term economic impact with "quick disbursement" of funds an essential program feature, these project-like activities are long-term and fit the AID Handbook definitions for assistance that should be treated as separate projects. These activities do not fit the CIP concept of quick disbursement of funds and require application of project management controls and procedures, including stable, budgeted funds to cover activities from inception through completion. Other problem areas noted are highlighted below.

- Project plans were often incomplete and the full extent of all phases and all costs of the projects have not been determined.

- The Activity Justification Papers (AJP) of some activities were either incorrect or misleading. In one instance, for example, the AJP justified an activity costing $7.5 million at a time when a contract for $9.6 million was in-process for signing; this same activity will actually cost over $21 million.

- The activities were financed through the CI Program to emphasize expeditious implementation time and support CIP objectives to meet Egypt's short-term balance of payment problems. Experience shows that three and four years have gone by and implementation of most project-like activities has either not taken place or completion is far down the road.

- Only partial financing (equipment)--not the complete project package--can be made through the CIP. The best way to control the direction and efficiency of overall project implementation is to finance the activities as distinct projects.

- B/G contracts being signed for the activities are not always in line with the best contracting procedures. Excessive advances and undesirable methods of disbursements are provided by some contracts; liberal, multi-million dollar progress payments have also been provided without any linkage to work performance or percentage of work completion.

- Of the seven activities reviewed, six (about $94 million) were financed through the Bank Letter of Commitment (L/Com) procedure which is costly in bank charges and interest and does not afford controls such as the Direct L/Com. In line with Agency policy, in these cases the Direct L/Com is the best and preferred method. The Direct L/Com procedure entails effective internal controls over the propriety of payments and over the receipt of goods and services since it requires certification by an AID project officer knowledgeable of all project activities.

- Suppliers have been successful at controlling the direction, scope, and cost of the activities. Consequently, the fairness of costs and the efficiency of project implementation have not been assured. Equally important, supplier control encourages proprietary procurement and eliminates competition.

- Project files, in both AID/W and USAID/E, were found to be incomplete. At the USAID/E, files were in disarray; basic contract documents for multi-million contracts were missing, records of meetings were not in the files and project history was difficult to reconstruct. There is also confusion regarding whether official files for these activities are maintained by the USAID/E or in AID/W.

- Monitoring of project-like activities was deficient. Concepts that are more identifiable with CIP importations--rather than for Capital Assistance--are being used. Moreover, coverage is based on reaction to problems rather than on progress of project implementation. In short, the monitoring concepts routinely applied to straight commodity imports under the CIP are not sufficient for effective management of project-type activities financed through the CIP.

We are recommending that AA/NE review USAID/E project-type activities financed through the CIP and determine whether more specific criteria is needed in routinely selecting the preferred financing mode--project assistance--stipulated in Agency policy and advise the USAID/E of any procedural changes needed in the application of non-project CIP financing. We are also recommending that the AA/NE establish groundrules, criteria, and delegated funding limitations, if needed, for application to project-type activities under the CIP. Recommendations are also directed toward the USAID/E to cover management concerns and responsibilities for those project-type activities under the CIP; i.e., a policy needs to be delineated for planning, managing, administering, and monitoring these activities financed under the CIP; procedures need to be established to ensure sufficient CIP funds are initially obligated and sub-obligated to cover total project costs under the CIP and such funds remain available for the activity and are not later actually shifted to other commodity imports, thereby leaving the project activities insufficiently funded for successful completion; program managers need to be specifically appointed and made responsible for project-type activities; and monitoring, to include periodic site visits, is needed (pages 5 - 15).

Part A above covered discussions and conclusions regarding CIP management concepts applied to project-type activities generally. Part B discussions and conclusions address situations related to the specific project-type activities reviewed.

B. CIP Specific Project-type Activity Situations

1. The Railway Traffic Control System (RTC) was to have been financed by the GOE with its own funds at a cost of $5.6 million in 1976. But, no feasibility study or survey had been made to analyze parameters and issues of the project. As a result, when financing was later obtained through the CIP, the Activity Justification Paper (AJP) was not factual in several significant areas and undesirable contractual terms were included in the supplier's contract.

To illustrate, the AJP discussed an activity costing $7.5 million but the contract signed 20 days later was for $9.6 million in addition to L.E.975,000 (equivalent to $1.4 million); it made no mention of a survey by the supplier or related cost increases; it indicated installations by the GOE but the negotiated contract provided a "turn-key" project, a more expensive proposition and not preferred in AID regulations; it also stated that civil construction would be minimal, which now seems inaccurate. In short, it is our opinion that the USAID/E, in preparing the AJP, did not have a full grasp of the project to be financed. The effect has been that within three years, costs of the project have sky-rocketed to $21.2 million, yet reasonableness of costs is unknown. Also, the supplier seems to have control over direction, scope, and costs of project; this single activity is now being implemented in three phases, based on the supplier's survey; the supplier has received $5.8 million up front already, and can draw up to $7.8 million under contract amendments, before constructing a single piece of equipment; the GOE is now bound by a signed contractual document for a $21.2 million program but only has AID commitments for $13.3 million; and, AID has been placed in an awkard position of having to finance the remaining $8.0 million as a sole-source procurement after the fact, from this same supplier without competition, or leave the project incomplete.

We believe this activity should have been financed as a non-CIP long-term project rather than through the CI Program. It has the characteristics of a project and is not merely an equipment import. Yet, at the initial stages of this activity, the project planning and development was incomplete. To assure successful implementation, the USAID/E should have been involved in basic project management functions of planning, implementation and monitoring, and reviewing results. Since this activity was financed and managed as a commodity under the CIP, however, project management concepts and procedures have not been applied. We are recommending that AID financing of the additional sole-source $8 million costs be deferred until it has been determined that they are reasonable, competitive, and in line with a sound implementation plan; the reasonableness of $300,000 for a "Guarantee Engineer" also needs to be determined. We are also recommending that the propriety of paying for the guarantee engineer in U.S. dollars be documented since this was intended as a buyer local currency cost. USAID/E should also withhold further financing of this activity until the contract is amended to require partial payments (and advance payments for the guarantee engineer) be linked to contractor performance, actual costs incurred, and percent of work completed; a recommendation is directed toward this (page 15).

2. In February, 1977, an agreement was reached between the GOE and AID to finance through the CIP fourteen ice making plants at a cost of $6.6 million. Well over three years have gone by and from a financing viewpoint the activity is almost exactly where it started; in fact, from the standpoint of CIP funding allocations, the activity has lost ground--as at July 31, 1980, there were only $1.9 million of CIP funds available, as compared with the $6.6 million needed; subsequent to July, 1980, we understand CIP loan funds sub-obligated to this activity were reduced even further, to less than $1 million, yet USAID/E comments indicate that this activity is one of the highest priorities of the GOE. We understand that additional funds will again be sub-obligated from a new CIP grant. At this point in time, the equipment has not yet been purchased, nor have the specifications been written. Intended economic impact objectives for this project-type activity have not been realized in Egypt, to date. During the interim, concepts of needs in this project area have evolved which could be more effectively pursued by the USAID/E if the activity were financed as a project rather than as a commodity import under the CIP. Since the USAID/E comments show that this project-type activity will continue under CIP financing, we can make no further useful recommendation specifically; however, we believe that Recommendation No. 1 addresses this issue (page 22).

3. The Boilers and Sugar Mill activity has made little progress in three years. In 1977, the GOE and AID reached an agreement to finance equipment for this project-type activity; financing through the CIP was requested by the GOE and approved by AID. After three years, the transaction is still in process, the specifications have not been fully clarified, and the activity has not progressed beyond the Invitation For Bid (IFB) stage. An Activity Justification Paper (AJP) covers an activity estimated at $12 million; after revisions in project scope, another AJP for an additional $15 million was submitted and required five months for AID/W approval, primarily because of insufficient economic justification. These two AJPs are not cross-referenced, however, and each suggests an independent activity--one for $12 million and one for $15 million--although there is actually one activity totaling $27 million. As in the case of other project-type activities, prices have escalated due to inflationary pressures during the delay in implementation; objectives of the CIP are not being fully realized; and the desired economic benefit to Egypt from the project is not being achieved. Primary factors contributing to the delays include: approval procedures of the Agency; stringent terms and conditions set by the GOE buyer; changes in activity locations by the buyer; and unfamiliarity of the buyer with up-to-date equipment in the U.S. market. We are recommending efforts be continued for expeditious completion of the

activity and buyer's needs be reconciled to equipment availability through visits to the U.S. by appropriate ESC personnel (page 27).

4. In the latter part of 1976, the GOE General Organization for Industrialization (GOFI) and AID agreed to finance rotary hearth calciner furnaces at a cost of $6.7 million. Procurement problems have been a major cause for delays--furnace operations were planned for the end of CY 1980, but installation has not yet taken place. At the time of our review, AID had disbursed the funds and the equipment had apparently been shipped. Reportedly, the equipment has arrived in country but this has not been verified through end-use reports; i.e., no reports were available covering this procurement. In summary, four years after the initial request for CIP funding, the plant is not yet operational and the USAID/E has not visited the project site to determine actual problems or progress. Although furnace operation has now been rescheduled for the first quarter of CY 1981, there is little evidence of firm knowledge that this new target date will be met. We are recommending that the USAID/E assess the current status of this $6.7 million procurement, including site visits and end-use coverage, and document the files with the results (page 31).

5. The Greater Cairo Microwave System is being implemented by the Arab Republic of Egypt Telephone Co. (ARETO) in three phases at an estimated cost of $46.1 million. Two phases have been financed through the CIP. AID financing of the first phase enabled U.S. industry to gain a foothold in the future expansion of the network. The second phase was financed through the CIP over the objection of the USAID/E. But, as in the case of the Railway Traffic Control System, the supplier seems to be controlling the direction, scope and cost of the activity. The supplier has introduced a proposal to finance an additional phase (Phase III) through the CIP. The supplier is, in effect, writing the scope of the network in time-phases to match the completion of one phase and the beginning of another. This control by the supplier is not in the interest of either the Agency or of the host country. More to the point, phases are being proposed on a piecemeal basis and all procurement is a sole source, i.e., without competition, from the same U.S. supplier. Consequently, the extent of ARETO's total needs is unknown and there is no assurance on the reasonableness of the project costs. We are recommending the complete remaining needs of the ARETO system be determined prior to, and as a basis for, reaching a decision on whether further CIP financing or separate project financing is more appropriate; also, the USAID/E, in conjunction with AID/W, withhold a decision on financing the contractor-proposed Phase III of this system through the CIP from this same contractor as sole source procurement, without competition, until determinations have been reached regarding ARETO needs and appropriate financing mode (page 33).

6. The Vessel Traffic Management System (VTMS) is a navigational control system, one of the most sophisticated technological advancements in the field, designed specifically for the Suez Canal. Financing of this project under the CIP, at about $17.1 million, was requested by the Suez Canal Authority (SCA) in December, 1977. Most of the equipment has arrived in-country and the installation is progressing. However, the SCA does not have the technical expertise to maintain the system (and sub-systems); training is needed and this will require some type of financing. We are recommending an assessment of training requirements for Phases II and III of this project and assistance, if needed, from non-CIP funding (page 36).

7. Since February of 1977, little progress has been made toward the installation of automatic bakery lines. Thirty-nine lines of automatic bakeries will be financed through the CIP at a cost of $18.1 million. Although a contract with a supplier has been signed, little substantial progress has been made after some 40 months. Primary problems involved specifications and the hesitance of the GOE to accept supplier bonds as performance guarantees. The USAID/E is working on a resolution of the problems (page 38).

Overall, we believe that the examples discussed show that project-type activities should be financed as separate, distinct projects and not through the CIP. As in the case of the calciner furnace, had the activity been financed as a separate project, the USAID/E would have been closely involved in the planning from a total project standpoint and GOE assumptions on in-country capabilities could have been resolved prior to entering into a contract. The USAID/E would also have been aware of contract amendments before execution and monitoring would have been the responsibility of a designated project manager. The various problems encountered in the other sample cases discussed in this report illustrate other reasons for financing and managing project-type activities outside of the CIP.

## INTRODUCTION

### 1. Description of the CI Program

Since resuming diplomatic relations with Egypt, in 1973, the U.S. Government has been providing assistance programs which are directed towards promoting economic and political stability of the country. From a development point-of-view, AID has followed, according to stated policy documents, an economic strategy which encompasses dual objectives:

(a) to maintain a large net inflow of U.S. and other foreign resources in the short-run; and,

(b) to achieve a lower need for foreign resources inflows over the medium and long-run through expansion of Egypt's productive capacity.

Two of AID's programs, the Commodity Import Programs and the P.L. 480 Programs, are designed to address the short-term needs of Egypt. The medium and long run requirements are being addressed through numerous bilateral projects and programs.

This report limits its coverage to the Commodity Import Program (CIP) and more restrictively to the internal operating procedures and controls used in the different phases and systems when "project-like" activities are financed through this program. Background information on the CIP is treated in greater detail in Appendix I.

In brief, there have been nine CIP loans and one grant signed since 1975 when economic assistance was initiated. Through the time of the audit, these agreements obligated $1.54 billion for the CIP. The funds are appropriated through the Economic Support Fund (ESF) as authorized under Section 532 of the Foreign Assistance Act (FAA).

Of the total $1.54 billion obligated funds, about $1.472 billion was allocated to Public Sector organizations (Ministries and Agencies) of the GOE. A small percent ($68.5 million) was allocated to the Private Sector to encourage free enterprise and private participation as part of AID's continuing commitment to comply with the intent of Section 601 of the FAA. Reviews have been made covering the procedures used in managing the funds processed by both the Public and Private Sectors. The results of this comprehensive CIP audit coverage are being reported in series. For better perspective, the reader may wish to obtain this entire series of six reports, identified below:

| Audit Report No. | Date | Title |
|---|---|---|
| 6-263-80-10 | August 10, 1980 | The Private Sector Allocations of the Commodity Import Programs of Egypt. |
| 6-263-81-1 | November 30, 1980 | The Financial Procedures and Controls of the Commodity Import Programs of Egypt. |
| 6-263-81-2 | December 21, 1980 | Internal Operating Procedures. Applicable to Project-Like Activities of the Commodity Import Programs of Egypt. |
| 6-263-81-3 | o/a Dec. 30, 1980 | Internal Operating Procedures. Applicable to Non-Durable and Durable Commodities of the Commodity Import Programs of Egypt. |
| 6-263-81-5 | o/a Dec. 30, 1980 | Internal Operating Procedures for Arrival Accounting and End-Use as related to the Commodity Import Programs of Egypt. |
| 6-263-81-6 | o/a Jan. 10, 1981 | An Overview of the Commodity Import Programs of Egypt. |

Exhibits A and B show the breakdown of the CIProgram loans and grants with allocations, as approved by the GOE. The financial information contained in the exhibits is not exact, as stated in the foot-note on Exhibit A. The figures in Exhibit A, and in other Exhibits appended, should not be considered a measure of actual CIP expenditures. To illustrate, under Agency accounting definitions, disbursements include advances; but, advances are not actual expenditures. Audit Report No. 81-1 covers advances and progress payments and adds perspective on this. The accounting and information system section of Audit Report 81-1 also addresses difficulties encountered during the audit in attempting to determine the actual disbursement and expenditure status of these CIP obligations. For this reason, the figures should not be considered as a true measure of impact on the Egyptian economy.

This report, as mentioned earlier, covers the results of our review of procedures and controls used when project-like activities are financed and managed under the CIPrograms. The procedures used in the case of seven such activities were examined. These seven activities will eventually cost over

$142.8 Million, exclusive of GOE contributions. At our cut-off date, however, sub-obligations of the USAID/E under the current active loans and grants amounted to only $112.4 million. In other words, there is a difference of $30.4 million between the total costs of the activities and sub-obligated funds. There are several reasons for this difference, but primarily, it is due to (a) insufficient funds to cover the cost of the activity or (b) the USAID/E and GOE had not yet reached agreement on how the remaining amount of an activity was to be funded.

## 2. Scope of Audit and Purpose

This is the third audit report by the AAG/E of the CIP. The series of six reviews contribute, individually or collectively, towards attaining comprehensive audit objectives listed in Appendix I. For this review, our audit objectives were to : (a) determine and evaluate the status of the seven activities; (b) determine and evaluate the procedures used in relation to advertising, bidding, contracting, receipt, usage; (c) evaluate impact on the GOE economy; (d) determine whether procedures used to plan and implement activities were both economical and efficient; (e) evaluate the role of USAID/E management in the entire process; and (f) evaluate the role of involved GOE and contractor management.

Our examination covered the procedures used by the USAID/E, AID/W, and the particular GOE organization or Ministry. The period covered in this audit was from program inception, February, 1975 to July 31, 1980 for the financial data. Status of the activities and CIP management policies and practices were reviewed up to the most recent date possible. Historical transactions were examined to gain perspective and to analyze origins of problems. The review was conducted in accordance with sound auditing principles and standards. Accordingly, we examined, to the extent deemed necessary, historical files, computer runs, transaction support data, cables, correspondence, bids, contracts, letters of credit, handbook provisions, disbursement data, regulations, and other criteria. We visited four of the activities and discussed plans with GOE officials for the other three. We also held meetings and interviews with various officials and employees of the GOE and with cognizant managers and involved USAID/E personnel.

## 3. USAID/E Comments

During the audit, Record of Audit Finding (RAF) procedures were followed. RAFs were prepared and submitted to allow USAID/E written response and further discussion, if desired, before submission of the total draft report for written comments to be considered in the final report issued. The USAID/E was furnished the draft of this report and an extension of time was agreed to by the AAG/E. We were advised that the report raised fundamental issues which the USAID/E found difficult to resolve within the extended time frame. During processing and assembly of the final report, we received a draft response from the USAID/E and considered these comments in the final report. While these draft USAID/E comments are considered herein, they are general; more detailed comments were those responses received to RAFs during the audit. The draft USAID/E comments of general nature indicate the USAID/E is completing further internal study on several issues which will result in more comprehensive comments to the final report. The many issues involved in the internal operating procedures segment of the CIP audit were presented in a single draft report; for the best presentation, these issues are separated into three shorter final audit reports covering segments of internal operating procedures, as identified on page 2 of this report.

## AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

### 1. Project-like activities financed through the CIP have not been planned and implemented effectively

The CI Program of Egypt is a massive undertaking which is quite unlike other non-project assistance being carried out by AID in other countries. Most of the obligated funds under the loans and grants are being used to import commodities or finance activities of at least 20 public sector ministries and agencies of the Government of Egypt (GOE) (Exhibit A). Initially, the CIP was designed to finance imports needed by the GOE to (a) address Balance of Payments problems, (b) increase agricultural production, and (c) reactivate idle industrial capacity.

The parameters of the CIP have expanded to accommodate financing through the CIP about 50 percent of GOE capital imports in highly visible and durable goods. Consequently, CIP-financed importations have been a mixture of commodities; under the initial program concept--raw materials including tallow, cottonseed oil, corn, tobacco, soymeal (see Audit Report No. 81-3)--and commodities that fit program evolution to include automatic bakeries, ice making plants, sugar refineries equipment, buses, refuse collection vehicles, microwave systems, ambulances and others. In short, the CIP importations have been expanded to include the infrastructure and the basic human needs sectors of Egypt.

We reviewed the management systems in place at the different importing levels that were held accountable for about 74 percent of all commodities shown in Exhibit B. As a result we were able to analyze the activity (i.e., commodity, function, procedures, records) both as independent units and on comparative bases to other units. In the case of "project-like activities", one over-riding question encountered repetitively was whether it is prudent to continue financing "project-like activities" through the CIP. Our analysis of the broad aspects of the problem follows. Specific details related to each selected activity reviewed are stated in Sections 2 to 8 of this report.

With the concurrence of AID/W, the USAID/E has been financing through the CIP an increasing amount of capital goods. These types of commodities are eligible for CIP financing under Regulation No. 1. The project-like activities are needed to reactivate some of the archaic industrial plant and equipment. They are financed through the CIP to effect a quick impact on Egypt's economy. Our examination of seven project-like activities totaling $112.4 million disclosed patterns of deficiencies at every stage of the process, including management planning, program management, administration, and monitoring: planning of activities is often inadequate; estimates of costs are inaccurate; costs have escalated due to inflation encountered during long elapses of time; undesirable features have been included in contracts; activities seem to be controlled by suppliers; program files are not being properly maintained; project-like activities have not been visited; and such activities have not been completed in the most efficient, timely, and economical manner.

At least seven project-like activities have been financed under the CIP, as listed below. Detailed discussions follow later in this report.

| Activity | Current Fund Allocation ($000) |
|---|---|
| Railway Traffic Control System | $ 9,690 |
| Ice Making Plants | 1,885 |
| Boilers and Sugar Mills | 22,000 |
| Rotary Hearth Calcining Furnace | 6,675 |
| Greater Cairo Microwave System | 36,920 |
| Vessel Traffic Management System | 17,060 |
| Automatic Bakeries | 18,126 |
| Total | $ 112,356 |

AID Handbooks stipulate a preference of financing activities as projects

AID Handbook No. 1, in part, states the following:

> "Project and sector assistance are currently the preferred modes of Agency activity. Both can provide materials, training, advice, and research, but project aid supports a more discrete activity than sector assistance. Aid to a specific number of interrelated activities within a particular LDC sector should be treated as project assistance; and if these activities are separately identifiable and sufficiently large to make separate consideration of them worthwhile, each should be treated as a separate project. If, however, in consideration of certain LDC commitments, the aid is used primarily to increase the total resources devoted to a sector, it should b treated as non-project assistance.
>
> "Non-project (program) assistance, formerly used when the LDC's primary need was for U.S. commodities to maintain or increase over-all economic activities and when the LDC's economic policies were judged sound, is now used primarily for emergency (or near emergency) balance-of-payments or budget support, often justified on political/security grounds, or to focus aid on a particular sector requiring commodity inputs (e.g., fertilizers for agriculture)."

In sum, the preferred mode is to finance activities as distinct projects. However, in 1976, the USAID/E began to finance capital type equipment and equipment to be incorporated into or utilized in connection with particular physical facilities. By State Cable No. 022218, dated January 27, 1978, AID/W authorized the USAID/E to review transactions not exceeding $10 million.

To distinguish between financing as non-project assistance under the CIP and financing as a distinct project, AID Handbook 3 provides the following paradigm:

| | PROJECT ASSISTANCE | NON-PROJECT ASSISTANCE |
|---|---|---|
| OBJECTIVE | To increase the well being of a specified, identifiable portion of the population through the creation or transfer of knowledge, creation or modification of facilities or institutions, or modification of policies and programs. | To increase the supply of resources. The volume of assistance is dependent upon the adequacy of supply and economic variables rather than impact upon specified beneficiaries. |
| MEASURABLE RESULT | Generally a long range change in the condition of the target population takes place. | Generally short-term relief from macroconstraints and changes in the general economy takes place. |
| ANALYSIS | Depends upon demonstrated linkage between the project inputs and the target group; essentially by micro-economic analysis. | Depends upon linkage between the resource supply and the inputs; essentially by macro-analysis. |

When compared with factors and definitions shown in the HB 3 paradigm, these activities fit the classification of Project Assistance. Specifically, they are not designed merely to increase the supply of resources, or for a short-term relief from macroconstraints Rather, these activities address the long-term, and are directed toward modification of facilities, institutions, and the transfer of technical knowledge. There is no question, for example, that the Greater Cairo Microwave System should have been financed as a project; the USAID/E was reluctant to finance one phase through the CIP. The Vessel Traffic Management System will replace completely out-dated equipment which is currently in place and will produce long-term revenue for the GOE as vessels are processed through the Suez Canal. The Boilers and Sugar Mills activity is another example where 50-year old equipment, currently in place, will be replaced and the long-range needs of a segment of the economy will have been addressed.

Handbook guidelines and Agency policy in Handbook 1 indicate these seven long-term activities should have been financed as individual projects. However, the decisions were made to finance them through the CIP. But, project management procedures and monitoring were not implemented--the source of funding rather than the nature of the activity was the governing factor. In other words, the USAID/E followed routine CIP managerial procedures and practices for commodity imports. This managerial concept was the basic cause for the problems that later developed.

The USAID/E CI Office has not been able to provide adequate project management for project-like activities. The following examples illustrate the types of problems involved in the various management functions of planning, implementing, monitoring and evaluating.

Project plans

The plans are often incomplete and the full extent of all phases and all costs of the project have not been determined. For example, planning of the Railway Traffic Control System (RTC System) began in 1976, but no feasibility study or survey had been made at the time the plans were presented to the Mission for approval. Consequently, an ambiguously worded scope of work in the supplier's contract was included and a survey was then made later. As a result, estimated costs for this activity have sky-rocketed from $5.6 million to $21.2 million. The microwave system, ice making plants, and automatic bakeries are examples of other project-like activities where planning was incomplete.

Activity Justification Papers (AJP)

Some of the AJPs are either incorrect or misleading. In the case of the RTC System, for example, the AJP justified a project costing $7.5 million at a time when the parties were in the process of signing a contract for $9.6 million. The AJP for the Boilers and Sugar Mills does not provide a clear picture of the magnitude of the project; for instance, the initial plans of the GOE requested financing of equipment valued at $27.0 million, not a $12.0 million activity as shown in the initial AJP.

Implementation Time

State cable 022218, which authorized the USAID/E to implement project-like activities, emphasized that two reasons for requiring simple reviews were "...to support CIP objectives to meet Egypt's short-term Balance of Payments problems and to provide materials and equipment on an expeditious basis..." The individual activities show, repetitively, that three and four years have gone by and the implementation of the project has not taken place. Oftentimes, as in the case of ice making plants, funds are obligated under one loan, deobligated, used for other purposes, and reobligated under a subsequent loan or grant. Thus, the short-term economic impact intended for these activities is not being realized; the quick disbursement feature of non-project assistance does not necessarily hold true for project-like activiites; and, the equipment is not being supplied much faster than had it been financed as a project.

### Complete Project Package

Financing of a complete package can best be done when the activity is financed as a distinct project. In some of the activities financed through the CIP, the needs were for building construction and engineering services. The correspondence with the host country restricted AID's participation to the financing of equipment. But, the ground rules in at least one case (Railway Traffic Control System) were circumvented and the equivalent of a feasibility study was financed from CIP funds.

### B/G Contracts

The contracts signed by the host country are not always in line with the best contracting procedures. The RTC System is a good example: the contract benefits the supplier almost exclusively--in the form of advances, progress payments, and methods of disbursements. The contract also requires AID financing of an additional $8 million as sole source procurement since it was signed by the GOE before the last $8 million was committed by AID.

### Financing Methods

Of the seven activities, six (about $94 million) were financed by AID through the Bank Letter of Credit (L/Com) procedure in lieu of the Direct L/Com procedure. But, the Direct L/Com procedure enables more effective controls over activities and is less costly. The Direct L/Com procedure entails effective internal controls over the propriety of payments and over receipt of goods and services since it requires certification by a project officer knowledgeable of all activities to protect AID's interests. The Bank L/Com does not require these close controls by an AID project officer and is more costly since interest and bank charges are financed under the agreements. (Methods of Financing under the CIP are discussed in detail in Audit Report No. 81-1).

### Control of Project

Suppliers have been successful at controlling the direction, scope, and cost of the activities. For instance, the supplier of the RTC System first proposed a $5.6 million price tag; then increased the price to $9.6 million; then made a survey which in effect designed and determined the needs of the host country; then signed a $21.2 million contract with the host country, and placed the USAID/E in an awkard position of committing additional funds to finance a huge cost increase, after the fact, as a sole source procurement from this supplier. In the case of the Cairo Microwave System, basically the same pattern can be seen: the system is being implemented on a piecemeal basis and, indications are that the increments are designed to match the completion of on-going work of the supplier.

Project Files

There is confusion as to whether the official files for project-like activities are maintained by the USAID/E or by AID/W. Contradictory statements have been made by both offices: the USAID/E told us that the official files are in AID/W; the AID/W SER/COM informed our AAG/W auditors that the official files are in the USAID/E. Files in both locations were incomplete. In the case of USAID/E, the files were found in quite a state of disarray; the extent depended on the program manager and was true in many respects for both project-like and regular non-project assistance commodities. For instance, records of meetings were not always in the files. Copies of the contracts for a $9.6 million and a $28.7 million activity were not found in the files. The history of the activities, particularly if there were minor complications, was difficult to reconstruct from the files.

In sum, project managerial concepts are not being observed when project-like activities are financed through the CIP.

Project-like activities are being monitored under concepts that are more identifiable with CIP importations

There is a gap in USAID/E monitoring procedures covering the project-like activities. This has reduced the Mission's assurance that the capital goods have been used with reasonable efficiency and effectiveness and for authorized purposes. Although these capital imports are projectized in character, project management requirements for controls and monitoring have not been applied because the source of funds--the CIP "program"--has been the determining factor for management needs rather than the actual project nature of the activity.

Monitoring coverage of commodity imports is based on reactions to problems as they occur; i.e., CI program managers take remedial actions based on problems or discrepancies uncovered through functions performed by other offices--arrival accounting, port monitoring, and end-use checks. These remedial actions entail a series of notifications to the importer or user about problems. The importer or user is permitted a period of up to 90 days for responding.

In the event corrective actions are reported by the importer or user, CI managers are required to coordinate with the Office of the Controller and make such site visits as may be necessary to verify that reported corrective actions have been taken. These steps are delineated in Mission Order 15-3 dated March 30, 1979.

While the prescribed monitoring coverage works well for commodity imports that normally are disbursed quickly from point of arrival to importer or user, the steps do not include preventive oversight of project-like capital goods that are geared to become integral elements of an industry's operations.

Generally, the capital goods-for-industy importations are one-time procurements and target dates set for their operational use may exceed one year. Further, the priority given them for selected end-use checks is low when compared to recurring and voluminous importations such as corn and tallow. Thus, an essential monitoring feature for capital goods-for-industry involves determining whether planned targets are being met.

To illustrate, the concerned GOE Ministry set a target of the first quarter of 1981 for the operation of the CI-financed rotary hearth calciner furnace. The CI files showed no correspondence on the procurement after August of 1979. The CI manager of this activity had made no site visits nor contact with the concerned Ministry as to progress. As a result, although months had passed since commodity arrival, the USAID had no basis to determine whether efficient and effective progress in installing the furnace had taken place. (Subsequent to our interview with the CI program manager we were informed that, based on a telephone call to the concerned Ministry, it had been determined that the furnace was 90 percent complete.)

In sum, the monitoring concepts normally applied to true CIP commodities are not sufficient for effective management of project-like activities funded through the CIP.

<u>CIP funding procedures are geared toward routine commodity imports and not suitable for project-like activities</u>

As shown in the list on page 6, funds sub-obligated for these seven project-like activities total over $112 million; but activity costs will eventually total over $142 million. The difference of over $30 million between total activity costs and sub-obligated funds is due to several reasons but, in many cases is primarily due to insufficient funds to cover the costs of the particular activity. While these funding procedures may be adequate for routine commodity imports under the CIP, they are not the best approach for project-like activities. This can be illustrated by several specific examples. The ice making plants are shown on the list at the total sub-obligated amount of CIP funds--$1.9 million; but, only $869 thousand is actually sub-obligated at this time (under CIP <u>Loan</u> - 052) for this activity. The planned activity, however, totals $6.6 million to meet GOE assistance requirements. We were told that additional funds will be sub-obligated for this activity in a new CIP <u>grant</u> being processed. Agreement to fund this activity was reached between the GOE and AID back in February, 1977 and funds were sub-obligated under CIP Loan - 038; funds were used for other purposes and funding for this activity was again sub-obligated under CIP Loan - 045; funds were again used for other imports and funding was again sub-obligated under CIP Loan - 052; since these funds have again been used for other imports, there are insufficient funds sub-obligated for this activity. Since February, 1977, then, this activity has not progressed. Had the decision been made to finance this activity as a distinct project, and not through the CIP, planning would have been required, to include project costs, and funds would have been obligated and assured for completion of this specific activity. In another case, the RTC System, the list shows $9.69 million in CIP funds sub-obligated. But after the contractor performed, a "survey" (equivalent to a feasibility study), project costs sky-rocketed up to $21.2 million; the additional $11.5 million will have to be financed through a new CIP loan (or grant); the contractor, however, has been paid $5.8 million although no equipment has yet been shipped; and $8.0 million of the increased costs were contracted for by the GOE before AID had made any fund commitments to cover them. The huge funds paid the contractor could be jeopardized if the increased millions in project costs are not funded by AID to complete the activity. As late as October, 1980, we understand the final $8.0 million was covered by a sub-obligation of CIP funds for this sole source procurement. Had the decision been made to finance this activity as a distinct project, and not through the CIP, the feasibility study and project planning, to include total project costs, would have enabled a firm obligation of required total project costs; moreover, it would have enabled competition rather than sole source procurement, and project costs might have been reduced.

Funding under routine CIP procedures is not suitable for project-like activities since sufficient funds are not available either initially, or during progress of the project, to assure timely and successful completion. These CIP funding procedures create a somewhat tenuous financial situation for these project-like activities. They have more complex requirements than routine CIP imports of commodities; e.g., planning, including feasibility studies, cost proposals, long-term implementation periods, and the need for continuing, project management, including monitoring. Under CIP procedures, these project-like activities are being partially funded through a series of sub-obligations, shifted between loans and/or grants , and complete funding is not assured; it is possible that an anticipated CIP loan or grant may not materialize in the expected amount (or not at all); if this happened, these unfunded parts of project-like activities are not certain of completion and funds already spent might be of little benefit. In short, the "flexible" funding procedures that may work well for routine CIP commodity imports do not meet the needs of the project-type assistance; this is only one of the reasons we believe project-type activities should not be funded through the CIP.

Audit Conclusions and Recommendations on CIP Project-like Activities

When the project-like activities were reviewed as a group, they disclosed patterns of deficiencies at all stages of the process, including planning, management, administration, and monitoring of the activity.

We believe these activities should have been financed as long-term project assistance rather than through the CI Program. They have the characteristics of projects and are not merely commodity imports. Had the USAID/E financed them as individual projects, planning and development would have addressed needs of the total project. Active, experienced project management would have determined more accurately the project needs, costs, implementation procedures, time-frames, responsibilities, and real progress or problems. As recommended in this report, we believe that some of these activities should still be transferred from the CIP and financed as individual projects.

As the program expanded into areas not normally considered under non-program assistance, so should management concepts have evolved. But, there has been a continuing tendency to classify a commodity import according to the source of funding rather than according to the nature of the assistance. Thus, the USAID/E has been inconsistent in its treatment of similar capital goods. Two identical capital goods can receive different treatment at all phases of the process, depending on whether the activity was financed as a project or through the CI Program. The source of funding, in our opinion, is irrelevant and effective management concepts should have followed the nature of the assistance.

In part, past deficiencies reflect adversely on the current capability of the USAID/E CI Office to implement and handle project-like activities through the CI Program. We believe that the CI Office was neither originally organized, nor has it evolved to the extent necessary--either in assignment of personnel or organizational structure--to manage the CIP as it has now developed. But, the CI Office has been placed in a predicament: it has the responsibility for meeting short-term economic impact objectives of the CIP through relatively quick disbursements of the huge amount of funds yet does not have established project management procedures applicable to non-CIP projects; conversely, it must adhere to procedures that specifically apply in the case of this program. In short, while attempting to effect the "quick disbursement" objectives of this sizeable program of commodity imports, the CI Office is funding expanded activities that do not lend themselves to quick disbursements of funds and, in fact, require planning, implementation, monitoring, and evaluation functions be handled by CI commodity import managers; i.e., those functions performed by project managers of distinct, long-term projects.

The basic issue to address at this point is whether it would be prudent to continue to finance project-like activities through the CIProgram. The history of these seven activities would lean heavily in favor of not financing or implementing project-like activities through the CIP. As discussed earlier in the report, Agency policy in Handbook 1, the preferred mode of financing activities is the distinct project. AID Handbook 3, also discussed earlier, sets forth guidance regarding the objectives, measurable results, and analyses for project and non-project assistance. Under AID Regulation No.1, many types of commodities are included in eligibility lists; but, the actual use and purpose of these commodities in assistance to the GOE public sector must have a bearing on whether or not they are imported under the CIP as non-project assistance.

Activities discussed, involving engineering services, extensive contractor involvement, building construccion, the need for feasibility studies, long implementation periods, and the need to obligate firm amounts of funds to cover costs through completion, fall within the definition of project assistance in AID regulations. Such activities are of benefit over the long-term and should be financed and managed as distinct projects rather than as routine commodity imports through the CIP. Such activities do not address the short-term needs of Egypt as intended for routine commodity imports through the CIP; nor do they meet the definition of non-project assistance in AID regulations.

Recommendation No. 1

AA/NE review the USAID/E project-like activities financed through the CIP and (1) determine whether more specific criteria is needed in routinely selecting the preferred financing mode (project assistance) stipulated in AID Handbook 1 policy and defined in AID Handbook 3 for long-term project-like activities, and (2) based on this determination, advise the USAID/E of any procedural changes needed in the selection of activities for non-project CIP financing.

In some specific, extraordinary cases, circumstances may call for financing of project-like activities through the CIP to meet specific needs and objectives. In such extraordinary cases, the USAID/E should apply the same ground rules for these activities as followed in the case of non-CIP projects. Basically, then the required expertise must be either assigned to or obtained for the CI Office; full parameters of the project and all costs must be determined; technical issues must be resolved; program managers must be appointed to manage the project; contracts must be reviewed; files must contain an accurate history; and all related documents of transactions, visits, projects, and monitoring results must be prepared ar . maintained. The following recommendations address management concerns involved.

Recommendation No. 2

AA/NE review its delegation of authority to USAID/E, as set forth in cable number STATE 022218, and, if needed, amend the referenced cable to establish groundrules, criteria, and delegated funding limitations that apply when project-like activities are financed through the CIP.

Recommendation No. 3

USAID/E amend the applicable Mission Order to delineate a policy for planning, managing administering, and monitoring of project-like activities which may be financed under the CIProgram.

After analysis of such USAID/E comments as received to date, we believe the USAID/E funding procedures for CIP of routinely shifting or switching funds already sub-obligated can adversely affect successful completion of multi-million dollar project-like activities and the following recommendation is needed.

Recommendation No. 4

USAID/E establish procedures to ensure (a) that sufficient CIP funds are initially obligated and sub-obligated to cover total costs of project-like activities under the CIP and (b) that such funds remain sub-obligated for the activity and are not later actually shifted to other commodity imports thereby leaving the project-like activities in a situation of insufficient funds for successful completion.

With respect to project-like activities currently on the books, we believe that the ice plants and phase III of the microwave can still be financed as non-CIP projects. Those that remain within the CIP should be managed and monitored as projects.

Recommendation No. 5

USAID/E formally appoint program managers to be responsible for and manage the assigned project-like activities under the procedures and regulations that apply in the case of projects.

Recommendation No. 6

The USAID/E require CI Program managers to make periodic site visits--and documents them as a form of status report--to determine progress against targets for CI-financed capital goods imported to activate or re-activate industrial capacity in Egypt.

## 2. Railway Traffic Control System

The Railway Traffic Control System (RTC) was to have been financed by the GOE with its own funds at a cost of $5.6 million in 1976. But, no feasibility study or survey had been made to analyze parameters and issues of the project. As a result, when financing was later obtained through the CIP, the Activity Justification Paper (AJP) was not factual in several significant areas and undesirable contractual terms were included in the supplier's contract. The overall net effect has been that, within three years, costs of the project have sky-rocketed to $21.2 million, yet reasonableness of costs is unknown. There seems to be a cost disparity in one activity segment dealing with services of a "Guarantee Engineer". Also, the supplier seems to have control over direction, scope and costs of the project; e.g., based on the supplier's survey; the supplier has received $5.8 million up front already, and can draw up to $7.8 million under contract amendments, before constructing a single piece of equipment; the GOE is now bound by a signed contractual document for a $21.2 million program but only has AID commitments for $13.3 million; and, AID has been placed in an awkard position of having to finance the remaining $8.0 million as a sole-source procurement, after the fact, from this same supplier without competition, or leave the project incomplete.

USAID/E funding decisions and other involvement appears untimely as well as inconsistent. We believe that the $8.0 million should not be financed by AID until the reasonableness and fairness of costs have been determined. This matter was specifically addressed with a recommendation in our draft audit report. We understand that the USAID/E has gone ahead with financing the $8.0 million project increase. It is not clear whether our recommendation was implemented in arriving at this decision.

The Egyptian Railway System (ERS) began planning the installation of communications networks during 1976. ERS officials told us that although at the time they had knowledge of the broad aspects of the system needed, they had not made a feasibility study or survey. Yet, ERS proceeded to issue an international tender for the system during 1977 and received several offers from Germany, Japan and other countries, and a single offer from a U.S. supplier. ERS awarded this tender to the U.S. supplier (Aydin Monitor) on the basis of Aydin's lowest responsive bid of $5,603,843 excluding spare parts. ERS approached AID to obtain the financing for the project; but, AID refused because the award had been made on the basis of an international tender. As a result, ERS cancelled the international tender, issued a new tender that excluded non-U.S. suppliers, and formally requested AID financing of the activity. After the USAID/E had been approached by ERS with a request to finance the RTC System, there was some reluctance to finance it through the CIP. In a cable to AID/W, the USAID/E stated, in part: "...we have expressed reservations about project-type nature of this activity which would tend to make it inappropriate for CIP financing. However, at insistence of ERS Chairman, we have agreed to present the case to AID/W..." In turn, AID/W also seemed hesitant to make a decision in this respect.

The files do not show who made the final decision. But, the $9.6 million was earmarked by the USAID/E under CIP loan 038.

Two suppliers submitted bids, but only one was responsive. The IFB for the new tender, using AID rules and regulations, was issued on August 31, 1978. Reflecting the incomplete planning by ERS, the tender documents did not provide sufficient details regarding local conditions, type of equipment desired, or the exact topography to allow the complete systems engineering to be accomplished during the bidding phase. Two bids were submitted by two different suppliers. These bids were opened on November 6, 1978, and, according to ERS, only one bidder (again Aydin Monitor Systems Inc.) was responsive. A fixed price contract was awarded, on April 3, 1979, to this supplier for $9.6 million to be financed from CIP funds and L.E. 975,431 to be financed by the host country government. In other words, the cost of the activity increased by $4.0 million, from $5.6 million to $9.6 million in a space of 15 months.

## The Activity Justification Paper (AJP) was deficient

The AJP was signed by the USAID/E Director on March 12, 1979. In our opinion, the AJP did not give the complete story on the intent of this activity. For instance:

- The AJP discussed an activity that would cost about $7.5 million. The contract that was signed twenty days later was for $9.6 million and L.E.975,000.

- The AJP did not mention that a survey by the supplier would be made and that further increases to the total cost of the contract could be expected.

- The AJP gave the impression that all installations would be made by ERS personnel. The contract that was negotiated is a "turn-key" contract where the project will be turned over to the GOE after it is effectively operating.

- The AJP stated that civil construction would be minimal. After completion of the survey by the U.S. Supplier, this statement now seems inaccurate.

In sum, it is our opinion that the Mission, in preparing the AJP, did not have a full grasp of the project that was to be financed.

## The scope of work of the contract was ambiguous

Since the ERS was not clear on its specifications, the contract called for a survey to be undertaken by the supplier. Such a survey, in our opinion, is similar to a feasibility study and not a proper item to be financed under a CI Program. In any event, the site survey was conducted by the contractor to determine what was needed for the RTC System. In effect, the equipment contractor designed the system for ERS and established all equipment requirements for this system. The design stage for this system was completed by the contractor on November 1979 and submitted to the parties on February 13, 1980.

The site survey determined that the equipment in the technical specifications would not be sufficient for the operation of the seven centers. In addition, the initial contract had assumed the existence of buildings that would be suitable to house and protect the microwave and VHF repeaters with reliable commercial power. These facilities were found either unsuitable in some places or non-existent in the remote locations. It was decided to shelterize the remote repeater locations and provide the diesel power as an integral part of the shelter configuration where no commercial power existed. The site survey also established the need for two additional repeater sites and additional equipment for ten other sites as well as installation of mobile stations in locomotives. Total costs for the additional requirements established by the site survey are as follows:

| | |
|---|---|
| Increased amount of equipment listed in the contract | $ 3,609,356 |
| Additional equipment and services required as determined by the site survey: | |
| 1. 59 shelters to replace rooms required for installation of equipment | 1,425,000 |
| 2. Refurbishing of centers | 140,000 |
| 3. Installation of main and standby power supply | 2,511,260 |
| 4. Interconnection between centers | 1,906,237 |
| 5. Erection of 312 mobile stations in locomotives | 1,899,456 |
| | $ 11,491,309 |

The concept of the project evolved into "phases"

Whereas in the all previous planning, meetings, and correspondence ERS and AID had discussed the project as one activity, the site survey of the U.S. supplier first introduced the concept of accomplishing the project by phases:

| Phase | Work | US $ Million |
|---|---|---|
| I | Survey and initial proposal | $ 10.0 |
| II | Additional equipment and shelters | 5.0 |
| III | Back-up power and added locomotive radio equipment | 6.5 |
| | Total | $ 21.0 |

Financial terms placed ERS and AID at a disadvantage

As of July 31, 1980, AID has disbursed $5.8 million and no equipment has been shipped. After contract amendment increases, the U.S. supplier could draw down up to $7.8 million of contract funds without having to furnish a single piece of equipment. These "advance payments" total 60 percent of the contract, before and after amendment.

The subject of advances and progress payments and their adverse effects are discussed in detail in Audit Report No. 81-1 covering Financial Procedures of the CIP. Extensive criteria and regulations are cited in that report.

For purposes of this limited section, brief excerpts from AID regulations follow:

- In part, Chapter 9E2 of Handbook 15 states:

"(a) Advance payment means any payment to a supplier under a contract made prior to, or without reference to, progress on the completion of the performance of the contract."

AID Regulation 1, Section 201.25 limits initial advance payments to 10 percent. Beyond this, responsible ERS officials informed us that ERS policy forbids advance payments exceeding 30 percent. AID Cash Management Procedures require advance payments be limited to "immediate disbursing needs" defined as 30-days. Thus, advances to the U.S. supplier exceed both AID and ERS limitations. Yet, responsible ERS officials informed us that AID had requested ERS to permit advance payments as high as 80 percent for this particular U.S. supplier.

The contract also provides for the assignment to ERS of a "Gurantee Engineer" by the contractor during the two-year guarantee period. The total cost for this engineer is $300,000 for the two years to be advanced to Aydin nearly two years before the engineer's services are rendered. Duties of this engineer are to instruct ERS personnel in the maintenance and repair of the equipment and to establish an equipment report system. But this situation is not clear: Cognizant ERS officials were not able to explain the basis for the relatively high cost ($300,000) for this engineer for a 25-month period; on the contrary, we were told that the U.S. supplier (Aydin) had offered ERS the services of an Egyptian engineer for only L.E. 6,250 (equivalent to about $8,900) for the same period. This falls in line with file documents showing that this engineer was initially intended to be financed by the buyer (ERS) from local currency rather than U.S. dollars. However, CI records showed no evidence that the USAID had questioned either (a) the financing of this engineer from U.S. dollars, or (b) this inordinate cost disparity ($300,000 vs. $8,900) for the services of a "Guarantee Engineer," to be provided by Aydin. In fact, all available information indicates that the USAID may not have known about the lower offer. If so, it further supports the need for project management, planning, administration and monitoring features of project-like activities funded through the CIP. In this case the resultant potential savings of U.S. public monies would be $300,000, if funded by ERS from local currency, as intended.

In sum, the contractual terms are too liberal and permit the transfer of substantial amount of funds to the supplier in the form of advances, progress payments, and pre-payments for engineering services. The proprietary procurement procedures involved, especially after the fact, result in loss of control.

<u>The status of $8.0 million needed to complete the project is unclear</u>

After the survey by the U.S. supplier, the contract was amended between ERS and Aydin Monitor System to the new ceiling of $21.2 million. The USAID/E does not seem to have participated in the drafting of this contractual amendment. The amended contract was submitted to USAID/E for approval, but the Mission was hesitant to approve such a radical increase on the basis of "proprietary procurement." The eventual approval was for only $3.6 million to be financed by AID. The new contract ceiling is about $13.3 million with the basic contractual terms remaining unchanged.

There are $8.0 million in contractual obligations which still need to be covered. This amount should have been advertised and gone out for competitive bids. The ERS was reluctant to do so because it wanted to deal with only one prime contractor who would supply all material, supervise, build and install this system on a turn-key basis; the contract was awarded on this basis. AID regulations state that contractor should not be awarded on a turn-key basis, unless properly justified. This type of contract is generally more expensive than contracting separately for design and construction.

USAID/E has been reluctant to approve financing of the $8.0 million. On August 3, 1980, the USAID/E approved the financing of the $3.6 million, but informed ERS that it was unable to approve the remaining amount at this time because it involved a substantial increase in contract value without benefit of the competitive process. It also would require AID/W review and determination of the competitive issue.

As of July 31, 1980, then, ERS has contractual obligations to the supplier for $21.2 million. AID has agreed to finance only $13.3 million. The fairness of the costs related to $8.0 million has not been tested and "Phase III" of the activity remains uncertain.

Monitoring by USAID/E of this activity has not been timely nor consistent

The USAID/E has been reacting to actions taken by ERS in connection with this activity rather than actively monitoring the project and heading off problems on a timely basis. Some examples: the GOE first issued the international tender in 1977, then asked USAID/E to finance the transactions. The international tender was cancelled and bids were submitted under the rules that were acceptable to the Agency. The USAID/E proposed an activity costing $7.5 million, only to approve twenty days later an activity contract for $9.6 million. The GOE signed the contract for $21.2 million and in effect bound the USAID/E to project costs that nearly tripled from those approved in the justification paper. Although AID is financing this multi-million dollar contract, a copy could not be located in CIP files.

Audit Conclusions and Recommendations

This activity should have been financed as a non-CIP long-term project rather than through the CI Program. It has the characteristics of a project and is not merely an equipment import. Yet, planning was inadequate at the time this project was initiated; the contractor's survey controlled development. To assure successful implementation, the USAID/E should have been involved in basic project management functions of planning, implementation, monitoring and reviewing or evaluating results. The absence of USAID/E involvement can be seen in the current status of this CIP activity. Although ERS planning of this activity began back in 1976, an initial contract was signed with CIP financing of $9.6 million before "activity" needs were actually known. Based on the contractor's survey, ERS signed a contract amendment increasing the contract total to $21.2 million in addition to the local currency costs; but, ERS does not have sufficient foreign exchange to finance the significant increases in this contract. Significant contract increases for equipment and related items were determined by the contractor supplying the equipment under the initial contract. The actual costs of the contractor's "survey" are not clear from available files. There is no assurance that the new costs are reasonable since there was no apparent competition in arriving at this huge increase in activity costs. At this point, AID is bound to disburse funds under a contract which is highly favorable to the supplier with very little leverage over performance by either ERS (or AID). The supplier has obtained $5.8 million from AID--and can obtain an additional $2.4 million--without delivery in Egypt of a single piece of equipment, under payment terms allowing 60% of total contract costs as advance payments. The supplier will also be able to draw down $300,000 for the "Guarantee Engineer" nearly two years before services are rendered. The extended services of a "Guarantee Engineer" for a CIP import of commodities seems unusual since the timing of these services extend well beyond the TDD of the CIP loan involved. The fairness of $8.0 million of the increased costs is unknown and a decision must be made regarding whether to finance this amount as "proprietary procurement" or leave the Phase III of this activity without CIP financing.

From the sequence of events and available files and information, it seems that this activity was first financed from CIP funds with planning and determination of needs to follow later. At this point, in the interests of successful completion, it seems the USAID/E needs to initiate actions to gain some control over this project-like activity and the sizeable CIP funds involved. Reasonableness of costs should be determined.

Recommendation No. 7

USAID/E determine and document the propriety of including U.S. dollar payment for the "Guarantee Engineer" in the ERS-Aydin contract for financing by AID since this was intended as a buyer local currency cost.

Recommendation No. 8

USAID/E withhold a decision regarding commitment of additional CIP funds until (1) ERS and Aydin can furnish justification for (a) the $8.0 million additional costs contained in Phase III of this activity as reasonable, competitive, and in line with a sound implementation plan, and (b) the reasonableness of the $300,000 amount for the Guarantee Engineer (in view of the alternative Egyptian Engineer offered ERS at L.E. 6,250 for the same time period), and (2) the USAID/E has determined that (a) the $8.0 million additional costs are fair, reasonable and competitive and (b) the $300,000 costs for a Guarantee Engineer are reasonable.

The ERS-Aydin contract should be amended to afford better terms to ERS and necessary leverage to ERS and AID to assure satisfactory contractor performance and successful project completion. The following recommendation addresses this situation.

Recommendation No. 9

USAID/E withhold any further financing of the activity until the ERS-Aydin contract is amended to relate partial payments and the advance payments for services of a Guarantee Engineer to contractor performance, actual costs incurred, and percent of work completed.

3. Ice Making Plants

In February 1977, an agreement between the GOE and AID was reached to finance through the CIP fourteen Ice Making Plants valued at $6.6 million. Well over three years have gone by and, from a financial point-of-view, the activity is almost exactly where it started; the equipment has not been bought nor the specifications written; and, the economic objective for this activity in Egypt has not been realized. On the other hand, there has been an evolution in the project concept which could be pursued best by the Mission if the activity were financed as a project.

Past implementation delays involving this activity are due to multiple reasons:

A. GASC had other higher priorities and insufficient funds for its share of the activity. AID's share of the activity costs (procurement of equipment) was sub-allocated initially under Loan No. 263-K-038 (038). During the year that followed, GASC had greater priorities for perishable commodities (corn, tallow, etc.) and apparently could not budget its share of the activity (costs of engineering design, system integration, etc.). In any event, it used the funds from 038 for perishable items. The funds were again sub-allocated under Loan 045. The same priority problems occurred and again the funds were used for perishable commodities. The funds were again sub-allocated under Loan 052. Once more, the sub-allocation was used by GASC for higher priority requirements. As of our cut-off date, only $1.9 million remained of these sub-allocated CIP funds--this was insufficient for the required number of plants. We were told that additional funds will be sub-allocated from a new CIP grant being processed at the current time.

B. AID and GOE did not reach agreement as to specifications of ice making plants. Specifications concerning the technical aspects of the proposed ice making plants were first submitted to AID/W for review during December 1977. AID/W responded, with modifications to some specifications during March 1978. GASC accepted most of the proposed modifications during June 1978. From June 1978 through March 1979 the CIP files show no activity. GASC received additional specifications during June 1979 but returned them to the USAID/E the day following receipt, stating that further modifications were required. Other modifications to specifications were made during October and November 1979. In short, at least two years have elapsed dealing with specifications on the technical aspects of the ice making plants. According to CIP records, this aspect has not yet been resolved.

C. AID and GOE did not reach agreement as to the type of procurement to be used. Differences of opinion existed between AID/W and GASC as to the method of procurement to be used. GASC preferred the negotiated procurement procedure. AID/W did not agree and insisted on the formal competitive bid procedure. AID subsequently introduced the "two-step" bid and award procedure. However, evidence indicates that responsible GOE representatives were not fully knowledgeable of this procedure. Nevertheless, we have been informed that the GOE insists on the negotiated procurement procedure. Thus, as of July 31, 1980, the AID and GOE stances are at an impasse.

D. There were contradictory policy positions on whether the plants should be financed by Public or Private Sector. GOE officials, in a statement published by the newspapers, stated that procurement of ice making plants would be left entirely to the private sector--in direct conflict with GASC initiatives to obtain financing from AID through the public sector. A USAID/E inquiry, made to the GOE in December 1979 concerning this statement, was answered in April 1980. The GOE response indicated that financing of ice making plants would be made through the public sector. In the interim the USAID/E had been placed in an awkard position and project implementation delayed.

E. Interested U.S. suppliers resisted requirements determined to be needed by GOE. Four suppliers showed interest in exporting ice plants to Egypt Only one, apparently, had the capability to furnish ice making plants that could produce blocks of ice. Reportedly, the remaining suppliers considered such a production method out-dated. They recommended equipment capable of producing crushed ice as being technologically up-to-date and apropos. Egypt is a developing country, has a warm climate and less than adequate and desirable refrigeration. Crushed ice, as recommended by some of the suppliers, may not be best suited for Egypt's domestic consumption simply because it melts faster. The primary purpose of the ice making plants was to meet domestic consumption. It is probable that the out-dated block ice method would be best suited for Egypt's needs.

In sum, the ice making plants activity has not achieved the originally desired objectives under the CIP. Specifications have not been written and agreed upon. Funding levels of sub-allocations under the CIP are insufficient at the present time to complete the planned activity.

On the other hand, the planned activity under the CIP will not meet all needs identified in a 1978 study of this area. A report furnished the USAID in January 1979 identified the need for both ice making plants and cold storage facilities in Egypt. The report included information that showed that Egypt: had a total of 29,890 metric tons of cold storage facilities as of November 1978; would need an additional 12,000 metric tons of cold storage facilities by 1980; would require another 70,000 metric tons of cold storage facilities by the year 2000. However, the report did not indicate whether AID assistance for cold storage facilities was requested. Egypt is heavily dependent on imports of various perishable goods such as beef, fish, chicken, cheese, butter, as well as vegetables and fruits--in addition to Egypt's domestically raised perishable goods. Thus, cold storage facilities are an essential element in improving Egypt's capacity to meet the food requirements of its rapidly increasing population.

Audit Conclusions and Recommendations

Based on facts involved, the decision to continue funding this activity through the CI Program--rather than as a distinct project--is questionable. The inactivity of the past three years fully supports this conclusion. From the beginning, the ice-making plants revealed characteristics which can be more closely identified to those of a project rather than a commodity import which permits "quick disbursement" of CIP funds. Specifically, the ice plants activity would increase the well-being of a specified and identifiable portion of the population; it was not designed merely to increase supply of resources. It addressed a long range change in the condition of the target population (storage facilities for food) and not a short-term relief from macro-constraints. Requirements were for equipment, engineering design, system integration, training and similar technical services; under the CIP, only the equipment could be financed.

Financing through the CIP involved an additional problem in the case of this project. CIP funds had been sub-obligated for the ice making plants, but there was no firm written agreement that the funds would be used--and in fact, have not been used--for the activity.

As mentioned previously, the activity has evolved to a stage where the USAID/E might now want to finance it as a distinct project rather than continue trying to finance it under the CIP. This financing mode is preferable if the Mission is to direct some effort at meeting the Congressional mandate to attempt to reach the "poorest of the poor". Financing of cold stores, rather than only ice making plants would probably be more appropriate in meeting this mandate. It is more essential that the preservation of basic perishable foodstuffs be guaranteed than the introduction of an end product that largely may be used for necessary but less essential human consumption. In any event, the 1978 study provides sufficient information for the Mission to make an informed judgment on this.

During the audit fieldwork, our RAF on this issue included a recommendation to consider the current financing status, loss of quick disbursement and short-term economic impact, and whether project assistance rather than CIP financing should be used, also considering needs set forth in this 1978 study.

USAID/E Response to the RAF

In its response, USAID/E pointed out that the decision to finance the equipment through the CIP was made by the host country and that the project-like activity is earmarked to replace some 1906 equipment and therefore it is more similar to CIP financing. Its response is quoted below:

"The subject draft report confirms the need for greater ice making and cold storage facilities in Egypt. Given the fact that GASC has established an internal committee comprised of the three chairman of the public sector ice making firms; and will shortly request the necessary funding under the recently signed CIP loan No. 263-K-053, it is evident that this requirement continuous to be a high GOE priority."

"The decision to seek CIP assistance as opposed to project-type assistance for this activity was made by the GOE. Once the funds are earmarked, most of the equipment will be used to replace 1906 vintage machinery in many of the present sites, and therefore, the activity lends itself more to CIP than project financing."

"Most of the points raised in the draft report are correct, although they tend to ignore some of the specific issues regarding GOE's priorities, specification development, procurement procedures, and type of financing. USAID believes that closer examination of each reason cited in the report to describe implementation delays, will strengthen the objective review of this activity:

"GASC had other higher priorities and insufficient funds for its share of activity".

Eventhough the funding for this particular activity shifted among different sources due to greater short-term priorities, the recognition of the need of ice plants never waivered. In fact, as far as equipment procurement activities for GASC are concerned, the requirement for ice plants was second only to the one for bakery equipment. With the latter requirement now entering the implementation phase, recent pronouncements from GOE officials with regard to making greater quantities of meat, fruits, and vegetables available to the consumer, show that ice plants now command the highest priority, (as far as equipment purchases are concerned), within GASC."

"AID and GOE did not reach a consensus as to the type of procurement to be used."

In informal discussions with the Chairman of the General Engineering and Refrigeration Company (GERCO), the Mission made it clear that if AID financing is provided, the procurement procedures would be formal. The Chairman accepted this position and stated that he would review the specifications carefully to ensure that they met the requirements of GASC so that the lowest responsive bidder would be in a position to provide equipment not only responsive to the tender specifications, but also deemed satisfactory to GASC.

"Interested US suppliers resisted requirements determined to be needed by GOE."

"It is true that US suppliers were reluctant to offer block ice technology for this activity. However, contrary to the statement in the subject draft report, it is our understanding that several US firms can provide the technology if required.

"This conflict of opinion boiled down to the question of how the ice will be ultimately marketed. Interested US suppliers argued that flaked ice was the preferred ice form when perishables are marketed by trucks over great distances. However, most ice in Egypt is sold to consumers to refrigerate goods at home, and according to GASC, consumers as well as distributions prefer clear block ice which is easier to handle, requires no bagging, and can be divided more easily.

"We believe that AID/W, as well as interested suppliers, are now fully aware of the need to provide block ice making equipment to Egypt. It is also our understanding that GASC will include in its new ice making requirements, the need for one chipped or flaked ice plant to provide ice to preserve fish, meats and fruits transported from the delta region to Cairo."

Response to USAID/E comments on the RAF

The USAID/E comments point out two reasons for financing this activity through the CIP: (a) because the GOE made the decision to seek CIP assistance rather than project funding; and (b) because the equipment will replace 1906 vintage machinery.

Neither the initial decision nor the USAID's reaffirmation to finance this activity through the CIP seem to fit the circumstances involved and the objectives of the CIP. For example, USAID/E comments do not address the need to actively monitor a long-term project such as to this to assure successful use of the AID-financed equipment through timely engineering design, system integration, and other technical services provided by the GOE. (Non-use of AID-financed equipment and project delays have occured previously in USAID/E programs due to the lack of timely completion of project elements not financed by AID.) In fact, the experienced delays (over three years now) in implementing this particular activity under the CIP tend to raise some doubt as to the "high priority" given this activity by the GOE, as set forth in USAID/E comments; in turn, this situation supports the conclusion that the activity is long-term, in the nature of a project as opposed to a short-term, quick disbursement of CIP funds for commodity imports.

With regard to the GOE decision to obtain CIP financing, the question arises as to the actual role of the Agency in providing assistance. We cannot agree that the decision to commit.specific U.S. assistance funds can be made by any other party but the Agency. The Agency has established development program objectives for the short-term CIP assistance and different development programs and objectives for long-term assistance. These Agency objectives could be undermined or prove unsuccessful in the long-run if long-term activities are financed from those resources planned for short-term activities with different Agency objectives. Since it is apparent, from the USAID/E comments, that this activity will continue to be funded through the CIP, we are making no specific recommendation for this activity. We believe that this area can be best addressed in Recommendation No. 1. As noted earlier, however, this activity has greater potential to impact on needs if financed and managed as a distinct project rather than through the CIP.

4. Boilers and Sugar Mill Equipment

The Egyptian Sugar Company (ESC), the eventual recipient and user of boilers and sugar mill equipment, first approached USAID/E, through GOFI, on April 9, 1977 to request CIP financing of equipment totalling $27.0 million. This equipment included seven boilers, costing about $12.0 million, to be placed at separate locations and crushing equipment, costing about $15.0 million, to upgrade their close to 50-year old obsolete equipment at two locations: Ermant and Kom Ombo.

Over three years have now gone by and the transaction is still in process; the specifications have not been fully clarified and continue to the changed; terms and conditions of the procurement are not conducive to competition and the transaction has not effectively progressed much beyond the Invitation For BID (IFB) stage. As in the case of the other project-like activities, equipment prices have escalated due to inflationary pressures, the objective of the CI Programs are not being fully realized, and the desired economic benefit to Egypt is not being achieved. The factors that have contributed to this delay include (a) Agency approval procedures; (b) buyer's stringent requirements; and (c) buyer's (ESC) unfamiliarity with the most up-to-date equipment in U.S. market.

Initially, only seven boilers were to be financed. Briefly, the transaction files of the CI Office show these facts: GOFI, on behalf of ESC, first approached the USAID/E on the April, 1977 requesting CIP financing to upgrade their equipment in the two locations and the boilers at seven locations. Initially, only the seven heavy duty boilers and ancillary equipment were to be financed at a cost of $12.0 million. Since the amount exceeded $1.0 million, an Activity Justification Paper (AJP), for this project-like transaction, was sent to AID/W on May 16, 1978; it was approved by AID/W on June 22, 1978. The first publication of an IFB for the "boilers" took place about this time. Six suppliers submitted bids ranging from $7.3 million to $14.2 million. All six were declared non-responsive by GOFI or ESC, generally because the equipment did not meet published specifications or price escalations were included in the bids. Attempts were made to re-bid the transaction, but specifications and terms (20% Performance Bond and a delayed final payment) created a situation which virtually decreased all chances to attract competition.

The scope of activity was increased. The initial plans were revised around July 1978. It was then decided that CIP financing would be made of (a) seven heavy duty boilers; (b) two unloaders; (c) two sugar cane mills; and (d) related services to the equipment. The cost of this activity is estimated at $27.0 million. Of this amount, $12.0 million was allocated through Loan No. 263-K-038. The remaining $15.0 million was first allocated under Loan 045. However, this amount was transferred to the Ministry of Supply for the procurement of more rapidly disbursed bulk commodities. In the response to our RAF, the Mission pointed out the following:

> "The shifting of allocations for slow moving transactions to future year loans/grants is a common practice. It reflects a firm understanding between CI and Min/Econ on the importance of utilizing authorized funding in an expeditious manner to meet the balance of payments objectives of our program. With approximately $1.4 billion out of CIP program of $1.5 billion in letters of credit and another $100 million committed as published IFB's or awaiting L/C's there is simply no justification for implying that the basic purpose of the CIP is not being met."

On the other hand, this procedure is somewhat tenuous for sound planning of project-like activities since funds, previously sub-allocated for the activity, are used for other purposes; this leaves the project-type activity without funding or only partially funded yet events could dictate a need for the funds when they are not available. There are a variety of possibilities from the standpoint of project costs and successful completion. Inflation alone could affect project success if time elapses and condition changes produce highly escalated prices before "shifted" CIP funds are again available. Stable availability of funds sub-allocated or sub-obligated for an activity could be very critical when other project segments are funded elsewhere and coordination of progress is necessary. In short, the "flexible" funding procedures that may work well for routine CIP commodity imports do not meet the needs of project-type assistance; this is only one of the reasons we believe project-type activities should not be funded through the CIP.

At the time of our review, $10 million had been re-allocated under Grant 119 and the needed additional amount of $5 million is intended to be financed through the forthcoming FY 1981 CIP.

There is no cross-referencing in the Activity Justification Papers. As a result of the revision in plans, another Activity Justification Paper was submitted to AID/W on November 22, 1978. The AJP did not include sufficient economic justification, and pending this and other data, AID/W did not approve financing until April 20, 1979. This approval process, then, took nearly five months and contributed to the delay. But, eventually, the project-like transaction was deemed to be in line with the GOE five-year development plan and accepted for CIP financing. However, there is no cross reference to the previously signed AJP. In other words, each suggests a totally independent activity rather than the true implementation plan. One suggests a cost of $12.0 million and the other $15.0 million; in reality, the total cost of the activity is $27.0 million.

Specification requirements have been confusing. However, since rejection of the bids (July 1978), the files show a great amount of cable traffic, letters, and management efforts between the three parties (ESC, USAID/E, and AID/W). Most of this document traffic dealt with attempts to reconcile the specification requirements of the buyer (ESC) with availability of equipment in the U.S. market and to improve terms and conditions so as to attract competition. Here are some examples of differences shown by correspondence dated March 7, 1980:

-- ESC initially requested that the moisture content in bagasse (dry pulp of sugar cane remaining after extraction) had to be extracted by 48%, i.e., a 52% moisture retention. After the Agency (AID and USAID/E) canvassed prospective suppliers, it was found that maximum offers would be between 53-54% moisture retention. We have been told that suppli rs could possibly provide equipment which can extract up to 50%, but want a safety margin to hedge against the penalty clause required by ESC. In any event, ESC accepted this in 1977; but by 1980, ESC had again reverted back to this uneconomical (about $1.0 million extra) specification requirement.

-- ESC still wanted extraction of sugar cane juice to be between 60% to 70%. Maximum extraction available in the U.S. market is, according to AID/W, about 60%. We have been told that this requirement will be dropped from the IFB.

-- Perhaps the major point of dispute between parties centers on penalties and guaranties which go hand in hand with specifications. ESC wanted to include penalties in the IFB and subsequent contracts which amounted to 19.5% for items earmarked for Ermant, and 10% for Kom Ombo. AID/W and Mission believed these were too steep.

Delays, then, are due to a series of factors. Approval procedures of the Agency have played a role. ESC's contribution to the delay seems to be three-fold: (a) their stringent agreement terms and conditions, (b) changes in location of the activity, and (c) their contradictory changes to equipment specifications, which may be due to the possibility that ESC is not really up-to-date with modern technology. For example, a recent AID/W cable (May 17, 1980), in part stated "...that brush lifters are not now offered nor have they been used by U.S. motor manufacturers in recent history because U.S. manufacturers provide more effective sophisticated methods of maintenance, repair..." This indicates that the motors requested by ESC have been obsolete for a long time.

Consequently, the buyer and suppliers continue to have different points of reference and the Agency is caught in the middle. In this instance, the buyer (ESC) needs to become familiar with the latest evolution of technology changes. But the files indicate that insufficient efforts are being made in this direction. For instance, in a letter from SER/COM to the USAID/E CI Office, dated March 7, 1980, the following point is made:

> "It is always difficult to correspond by cable and reach a meeting of minds. Therefore it has perplexed us that, in view of the very large sums and long period of time involved, the Sugar Companies have not sought to visit U.S. vendors and factories to discuss the equipment they plan to buy. It is our experience that such personal contact vastly informs and reassures Egyptian buyers about U.S. products and reduces impossible demands and paper guarantees. If such a visit is feasible we hope you will urge it on ESC as probably the best way to shorten this too lengthly procurement."

The Agency and ESC will be making use of the "two-step" bid and award procedure. According to the USAID/E, this technique was first suggested by GOFI, which has used it frequently for non-AID financed procurement. Under this approach, the IFB will invite prospective suppliers to submit information on equipment specifications that can be supplied to ESC. From this long list of suppliers, ESC is to eliminate those suppliers who will clearly not be able to supply the desired equipment. Such eliminations will result in a "short list" of acceptable suppliers. The suppliers on the short list will then be asked to submit price quotations and the lowest bidder will be accepted. There are indications, in the files, that AID/W misinterpreted desires of ESC. For instance, a cable interchange between USAID/E and AID/W shows that there was a desire to include language in the IFB that would require suppliers of the mills and unloaders to consult during the first step of the two-step procedure, on "suitability of unloading system". ESC's intent was probably to ensure compatibility between two independent systems (unloaders and mills) which might be provided by two different suppliers. The AID/W response seemed to question ESC knowledge of the two-step procedure. But the confusion seemed to have been cleared up only to be replaced by other aspects and lingering doubts by ESC. At one point, very recently, ESC expressed desires to buy (and has bought three boilers) from Japan who apparently can provide better terms through procedures involving less "red-tape".

The reason why "Invitational Travel" was not extended to sugar companies' officials and/or engineers was not clear. With over $27.0 million expected financing out of Agency funds, it would seem that such visits would be "...to the interest of the Agency". (AID Handbook 22, Chapter 7B). Such visits could be funded from the "Transfer of Technology" project; this has been done in the past. In talking to the CI officials, we were told that the Program Office controlled this project and were always hesitant to fund such trips because a sale might not take place. The CI Office also stated that under the CI Programs such trips were normally undertaken after the award had been made.

On the other hand, the USAID/E Program Office said they had not been approached by the CI Office on this particular transaction. But they were also not altogether clear whether such trips could be financed through invitation.

According to the USAID's response to the RAF, tangible progress in the issuance of the IFB is being achieved. In part, the USAID/E response stated that the two-step procedure had, in fact, resulted in:

> "...the issuance on May 21, 1980, of RTO/IFB No. ESC/107-79/ARE for boilers. As to the crushing equipment and unloading systems, ESC has changed the proposed location from Ermant and Kom Ombo to Naga Hammadi. This change results from a recent decision to award contracts for Ermant and Kom Ombo to non-U.S. firms under a 3-year old international tender. Specifications for the new location require certain modifications, and accordingly, four ESC engineers are scheduled to visit AID/W at the end of this month to finalize the 2-step IFB."

In view of the extensive delays which have retarded implementation of this transaction and have had adverse effects on prices and economic benefits to Egypt, we believe it is in the best interest of all concerned that this importation be consumated as accurately and as expeditiously as possible. But this means that the buyer must be brought up-to-date in a short time with current technological changes; specifications will then be clearer, more definite, and consistent with availability of equipment in U.S. market. Also, this could help allay fears of ESC and the penalty and guaranty provisions could be made more reasonable. We believe the "two-step" approach will certainly help narrow down some confusion. But, we also feel that the USAID/E should reconcile buyer's needs and supply availability through actual visit by ESC officials to the short-list of suppliers.

<u>Recommendation No. 10</u>

The USAID/E continue every effort to complete this project-type activity as expeditiously as possible, using the "two-step" approach now in-place, in combination with visits by appropriate ESC personnel to the U.S. so they may become quickly familiar with the latest technology.

## 5. <u>Rotary Hearth Calciner Furnaces</u>

On November 14, 1976, the Egyptian Aluminum Smelter Company, a public sector firm under GOFI, requested the USAID/E to finance a rotary hearth calciner to increase aluminum production from 100,000 to 166,000 tons per year by 1980. The furnaces are used in the process of producing aluminum which includes calcinating (heating at extremely high temperature) petroleum coke to purify it of volatile matter and lower its sulfur content. The petroleum coke is then mixed with tar pitch to form a mixture called anode paste. Anode paste is a basic raw material of aluminum.

Nearly four years have passed since GOFI first approached the USAID/E and this $6.7 million purchase follows the same pattern of importations of other capital-type equipment purchases under the CIP; i.e., procurement has been slow. However, the underlying reasons were different--the GOE miscalculated its ability to provide certain ancilliary commodities and services. As a result, the original target date set for furnace operation--the end of calendar year 1978--has been rescheduled for the first quarter of 1981. At the time of our review, the Agency had disbursed most of the funds and apparently the commodities had been shipped. But monitoring of project progress by the USAID/E was not evident--the status of commodities and the project were not known.

The type of calciner furnace needed was patented by two American companies and manufactured solely by one U.S. firm, the Salem Furnace Company. Accordingly, GOFI requested and received a proprietary waiver from AID/W; SER/COM during February 1977. Subsequently, GOFI and Salem entered into a contract during December 1977 for delivery of the calciner furnace at a contract total of $5.7 million.

A GOFI assumption was that some of the ancilliary parts for the calciner, including detail drawings and steel, could be produced in-country. Thus, the contract scope of work excluded these items and services. Realistically, GOFI found that the items and services could not be produced in-country to full satisfaction. As a result, in May 1979--17 months after entering the contract--GOFI and Salem signed a contract addendum at an additional cost of $1 million for the items and services to be procured from the U.S. and performed by Salem.

GOFI informed the USAID of the contract addendum a month later and requested another proprietary procurement waiver. Based on USAID advice and the potential for an additional 4 to 6 month slippage in meeting the target date, if competitive bidding procedures were used, the AA/SER approved the additional proprietary waiver during August 1979.

No follow-up has been made for one year. The CI files showed no correspondence since AA/SER's second proprietary waiver in August 1979. We were informed that no site visits had been made to check progress. CI financial reports, based on arrival accounting, show that the $5.9 million for the calciner furnace and for the additional services have been disbursed. There are no end-use reports covering this procurement. In short, there is little evidence that the USAID has knowledge whether the target date set for the first quarter of calendar year 1981 will be met for this project-like activity. In order to ensure that the USAID meets minimum monitoring requirements of this procurement it should consider: a site visit; end-use coverage; and contacts with GOFI. These and other alternatives are available to the USAID in order to correct the apparent one-year monitoring lapse.

This situation illustrates another basic reason for not financing project-type activities through the CIP, since USAID/E concerns are then limited to the equipment needs. Had this been financed as a distinct project, the USAID/E would have been closely involved in the planning from a total project standpoint and GOFI assumptions on in-country capabilities would have been resolved prior to entering into the contract. The USAID/E would also have been aware of contract amendments before execution. Monitoring would be a project manager's responsibility. In this specific case, our recommendation follows.

Recommendation No. 11

The USAID/E assess the current status of the $6.7 million rotary hearth furnace procurement and document its official files accordingly.

## 6. The Greater Cairo Microwave System

The Greater Cairo Microwave System is being implemented by the Arab Republic of Egypt Telephone Co. (ARETO) in three phases at an estimated cost of $46.1 million. Two phases have been financed through the CIP. AID financing of the first phase enabled U.S. industry to gain a foothold in the future expansion of the network. The second phase was financed through the CIP over the objection of the USAID/E. But, as in the case of the Railway Traffic Control System, the supplier seems to be controlling the direction, scope, and cost of the activity. The supplier has introduced a proposal to finance an additional phase (Phase III) through the CIP. We believe Phase III financing through the CIP as proprietary procurement should be withheld until remaining ARETO needs have been determined and a study of the most appropriate and economical system can be obtained. Financing mode should be determined after such study has been completed.

In 1976, ARETO had plans to finance the Cairo Microwave System with its own funds. The system was needed because of the deteriorating conditions of the plants relating to trunk cables between exchanges, a secondary distribution system and a subscriber equipment and facilities. Two phases were contemplated for the project.

Phase I - A star network connecting the local exchange to the tandem stations at Ramses and Abbassia.

Phase II - A ring network connecting together the local exchanges belonging to each tandem station.

U.S. telecommunications industry informed the Mission that they were at a disadvantage with the financial arrangements which the European and Japanese firms were able to offer. Since ARETO had already advertised for two Phases of the microwave system, the USAID/E persuaded ARETO to make some modifications to the original tender. The effect of the terms of the international tender document and addendum taken together made this transaction a "negotiated procurement." The bids were opened January 3, 1977 and Raytheon International Inc. was declared the lowest responsive bidder.

Thus, the Agency financing of Phase I, for $20 million, assisted U.S. industry attempts to gain a foothold in the future expansion of the Egyptian telephone network. However, this initial decision also contributed to the following:

- the additional CIP financing, over the Mission's strong objections, of Phase II, at a cost of $16.9 million, as proprietary procurement;

- a proposal, currently in circulation and not yet approved, that a Phase III, estimated to cost $10.0 million, be financed through the CIP and again as proprietary procurement.

An Activity Justification Paper was not in the files. Our review of the files also showed that no AJP appears to have been prepared for this project-like activity. The USAID/E officials pointed out that the circumstances surrounding the activity made the preparation of such a paper irrelevant.

Construction of Phase I has been completed. AID/W authorized negotiated procurement in line with the tender document and the initial contract between ARETO and the U.S. supplier was signed in August 1977 for $11.2 million. This initial amount was subsequently increased to $20 million by means of three different contract modifications. The supplier delivered the Phase I works on schedule o/a December 1978.

ARETO requested, in June 1978, CIP financing of about $11.9 million for Phase II of the microwave system. The proposal called for the same supplier to continue under this second phase; thus proprietary procurement was indicated. But, the USAID/E was reluctant both to finance it as proprietary procurement and under the CIP. The USAID/E felt that Phase II should be financed as a project.

To resolve the difference in positions (project versus CIP), there were a series of meetings held and correspondence and cables interchanged, during the period of June 1978 and January 1979, between USAID/E, ARETO, the Ministry of Economy, and AID/W. Finally, in October 1978, the USAID/E requested the services of a communications expert from AID/W to review the options available to the Agency. His recommendation was that financing should be through the CIP, but the issue of whether it should be advertised for competitive bidding or contracted under proprietary procurement remained unresolved. On December 29, 1978, the Deputy Administrator of AID made the final decision to finance this phase of the activity under the CI Program and as proprietary procurement.

As of July 31, 1980, Phase II is on schedule and is expected to be completed in December of 1980.

The decision on how to finance Phase III of the microwave system is still pending. Eight months after the decision was made to finance Phase II under the CIP, ARETO once again, on August 16, 1979, requested $10.0 million to finance Phase III of the microwave system, again through the CIP and as proprietary procurement from the same U.S. supplier. This phase consists of establishing a link between Cairo and the City of Alarish in the Sinai. This link can be either by coaxial cable or through a microwave system; ARETO preferred the microwave system.

Once again, the USAID/E felt that this phase should be financed as a project and that a study was needed to determine the most economical system. The files indicate that some pressure is being placed on the Agency for continued financing of the transaction under the CIP. For instance, correspondence from ARETO insisted that there is no other alternative than the microwave system and a law firm representing the U.S. supplier inquired as to the status of AID financing for Phase III.

As of July 31, 1980, the USAID/E had allocated $10.0 million under the new CIP loans and grants (No. 054, 057 and 602); these were recently signed. However, no final decision has been made by USAID/E, as of August 30, 1980, on how this procurement will be financed.

Audit Conclusions and Recommendations

The decision to finance Phase I of this activity under the CIP was consistent with the political realities of the time. However, this decision opened the door to events which are no longer in the interest of the Agency. At this juncture, the full scope of ARETO's needs have not been determined through a systematic study covering a country-wide network and the most economical way of accomplishing the desired end. As a consequence, the U.S. supplier has been, in effect, guiding and determining the needs of the Egyptian telephone company--rather than the other way around. The supplier is, in effect, writing the scope of the network in time-phases to match the completion of one phase and the beginning of another. This control by the supplier is not in the interest of either the Agency or of the host country. More to the point, phases are being proposed on a piecemeal basis and all procurement is a sole source, i.e., without competition, from the same U.S. supplier. Consequently, the extent of ARETO's total needs is unknown and there is no assurance on the reasonableness of the project costs.

It does not seem in the best interests of the Agency or the GOE to finance Phase III under the CIP as another proprietary procurement transaction, and as proposed by the same supplier. Further study seems prudent. We believe that the complete country-wide needs of the Egyptian telephone company should be determined at this time. Phase III and the reamining needs of ARETO should then be financed as a distinct project.

Recommendation No. 12

USAID/E coordinate with ARETO and (a) determine the country-wide communication requirements, and (b) obtain a study to determine the most appropriate and economical system to meet these remaining needs of ARETO.

Recommendation No. 13

Based on the determinations and study obtained in Recommendation No. 12 above, USAID/E determine whether remaining needs of ARETO are more appropriately financed through the CIP or as a separate, distinct project and act accordingly.

Recommendation No. 14

USAID/E, in conjunction with SER/COM, withhold a decision on financing the contractor-proposed Phase III of the microwave system through the CIP as proprietary procurement until determinations have been reached regarding ARETO needs and appropriate financing mode. (See Recommendations 12 and 13 above.)

## 7. The Vessel Traffic Management System (VTMS)

The VTMS is a unique navigational control system specifically designed for the Suez Canal. Financing of this project-like transaction under the CIP, at about $17.1 million, was requested by SCA on December 22, 1977. The contract was awarded seven months after, on July 19, 1978. When the VTMS becomes fully functional, in March 1981, SCA will be moving from a primitive method of traffic control to one of the most sophisticated technological advancements in the field. However, SCA does not presently have the technical expertise to maintain the VTMS. Specifically, only one training phase--of the three required--is currently being undertaken. Training under Phase II and III is essential to the success of this project.

The VTMS was specifically designed for the Suez Canal. The SCA recognized the need to optimize the control and flow of the traffic in the canal as an integral part of the canal overall rehabilitation and improvement scheme. In 1976, the daily number of vessels navigating the Canal was 46; in 1978 it had risen to 63 vessels daily and it is estimated that 90-100 vessels will be navigating the canal daily by 1980. This increase in traffic has posed a problem for the SCA. The current traffic control system of vessel surveillance and radio communications could not be adopted successfully to meet this increased demand. Canal congestion could lead to eventual loss of revenue and an increase in the likelihood of major vessel damage.

The VTMS was specifically designed for the Suez Canal by a U.S. supplier. The system will provide the SCA with timely information which will enable them to expedite canal transits and to maximize traffic flow while at the same time enhancing vessel safety.

The system consists of three major subsystems; a radar subsystem, a loran-C subsystem, and a communication subsystem. These systems work together to provide the electronic aids necessary in expediting Suez Canal traffic.

The overall systems will consist of equipment installed at various sites throughout the canal area to monitor, record and control vessel traffic. Systems equipment procured include diesel power generators, remote control monitor equipment, voltage regulators, fuels tanks, power sources, radar transceivers, remote radar sensors, radar tracking data processors, displays, decoders, keyboard printers, tools and test equipment and necessary spare parts. It is expected that this system will be fully operational in March 1981.

The training portion of this project has not been fully financed by either USAID/E or SCA. The plan for the proper operation and maintenance of this system calls for the training of SCA personnel in three phases. Phase I is being financed by USAID/E. Financing for Phase II and III has not been obtained by SCA.

Phase I training, which has been completed, consisted of transfer of technology and equipment training. The training of 20 SCA personnel took place in the United States prior to the shipment of the system to Egypt. The objective of this training program was to provide the students with the specific technical knowledge to insure effective installation support in Egypt and to permit the students to perform maintenance of the system under contractor supervision upon final acceptance of the system. USAID/E financed this training under grant 263-026 (Technology Transfer & Manpower Development-III) at a total cost of $379,000.

Phase II training will consist of further specialized on-the-job training with the system equipment to develop the abilities of the students to independently maintain and repair the system. This training will continue through the year following final system acceptance and will be conducted in Egypt.

Phase III training will consist of a continuation of the Phase II training into the second year following final acceptance of the system in Egypt.

SCA officials told us that Phase I training gave them the theoretical knowledge, but that this education should be augumented with on the job training. They strongly believe that Phase II and III training is needed for the successful operation of the system, and this on the job training is needed during the two year warranty period of the system.

We were told by SCA Officials that they do not have the foreign exchange to finance an additional contract with the supplier for this training. It will be requesting USAID/E to finance this training.

It is our opinion that SCA must have the required capabilities to operate and maintain, in the future, the Vessel Traffic Management System. To have this capability, the SCA personnel must be fully trained. Phase II and III training is needed to reconcile technical capabilities with the sophisticated equipment being provided, particularly since SCA is moving from a primitive method to a sophisticated method of traffic control. Therefore, a transition period should be furnished SCA before they become solely responsible for the maintenance and operation of the system. This traffic control system will be a highly visable project which may fail if provisions are not made for SCA personnel to become fully qualified and confident that they can operate this system effectively.

Recommendation No. 15

USAID/E assess training requirements of SCA for Phases II and III and assist, if required, with any financial help that can be rendered through the Transfer of Technology Project.

The USAID/E concurred with the recommendation and stated that it was in the process of reviewing SCA's training needs and it would determine the type and amount of assistance to be provided. We will retain the recommendation in open status pending the final determination.

8. Automatic Bakeries

During February 1977 GASC requested that AID finance the procurement of 39 lines of automatic bakeries. Over three years have passed and implementation of this activity is negligible. GASC plans were for 31 of these bakeries to produce "baladi" bread--a staple for the country--and for 8 of the bakeries to produce "European" bread. As in the case of the ice making plants, the question of whether this should be financed as a project or from CIP was resolved by a decision to finance the 39 lines, costing about $18.1 million, through the CIP. Following a difficult period of presenting desired specifications and obtaining a consensus of the type of procurement action, GASC signed a Purchase Agreement with the American Export Group (AEG) during November 1979--33 months after the initial request.

Since the date of the Purchase Agreement, GASC has been hesitant to accept the contractor's surety-bond as a valid instrument in the event of contractor default.

The Purchase Agreement of November 20, 1979, was superceded by a contract that formalized terms and conditions of services to be provided. USAID/E review of this contract disclosed 17 deficient areas in the contract document; one of which, according to the legal officer, would prevent contractor performance. The legal office furnished the following opinion:

"Article 9: Performance Guarantee Deposit: This may be unworkable and may prevent Contractor from ever commencing performance under the contract for being unable to obtain either a surety bond or a bank guarantee. For example, Article 9.1 contemplates a one year guarantee "with automatic renewal clause...for each category" (presumably each Bakery line). It is U.S. surety practice to have time limited surety bonds, available for the contemplated life of the project, but not automatically renewable ad infinitum. Additionally the automatic deduction provisions for amounts Contractor may become liable to GASC under the contract, would fail to allow the surety sufficient time to get the Contractor to perform, which is the purpose of surety bond, as opposed to a bank guarantee. This article in conjunction with the penalty provisions of Article 12 (which would allow GASC to cancel and confiscate the performance bond--presumably

. all $1,812,620 of the Bond--without notice to surety and
. notwithstanding contestation by the Contractor or surety for failure of test trails of the first Balady Bread line in the U.S.) seems unduly onesided and may actually prevent performance from commencing. The amount of the performance bond has been changed from 5% as set forth in the IFB to 10% of the value of the contract at time of award. This change, however, confirms to normal GASC practice on other CIP transactions of this nature, was not prejudicial to other bidders, and appears to be a change within the general scope of the contract."

During the course of events the contractor presented two surety bonds as performance guarantees. However, GASC has been hesitant to accept the bonds, because, reportedly, they were not familiar with surety bonds as performance guarantee instruments. Consequently, as of June 1980--40 months from date of initial request, little substantial progress has been made.

We were informed that USAID and GASC representatives met (on June 16, 1980) to resolve the problems encountered during this attempted procurement and implementation. We believe the Mission is aware of the problem and is doing its best to resolve it. For this reason, we are not making a recommendation. But, the effect of reported corrective actions will not be known in the near future. Nevertheless, over three years have passed and implementation of this activity has been negligible.

# BEST AVAILABLE DOCUMENT

EXHIBIT A

USAID/EGYPT
AUDIT OF THE INTERNAL OPERATING PROCEDURES OF THE COMMODITY IMPORT PROGRAM
IMPORTATIONS AND/OR FUNDS COMMITTED BY MINISTRIES AND LOANS AND GRANTS AS OF JULY 31, 1980

| | Importations | In | U S $000 | BY | LOANS | | (263-K-XXX) | | AND GRANT | |
|---|---|---|---|---|---|---|---|---|---|---|
| Ministry or GOE Organization | 026 | 027 | 029 | 030 | 036 | 038 | 045 | 052 | 263-0119 | TOTAL |
| Supply | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | $111,500 | $90,000 | [illegible] | [illegible] |
| Industry | 25,000 | 6,400 | [illegible] | [illegible] | [illegible] | 79,500 | 95,000 | 90,000 | 5,000 | [illegible] |
| Transport | 1,400 | 600 | 47,600 | [illegible] | [illegible] | 57,750 | 24,157 | 30,000 | 6,500 | 201,953 |
| Electricity | 1,500 | 19,900 | 9,730 | [illegible] | - | - | 15,000 | - | 9,500 | [illegible] |
| Suez Canal Authority | - | 1,200 | 1,270 | - | [illegible] | 25,000 | 25,000 | - | - | 56,370 |
| G.O.F.I. | - | - | - | 12,000 | - | 24,826 | 5,000 | - | 10,000 | 51,826 |
| Information | - | - | - | 15,951 | 5,000 | 8,683 | 10,000 | - | - | 42,634 |
| Agriculture | - | - | - | - | 18,000 | - | - | 5,000 | - | 23,000 |
| Local governorates | - | - | - | 3,357 | 3,000 | 2,000 | 9,900 | - | - | 18,257 |
| Housing | 5,000 | 3,300 | - | - | 1,662 | 1,602 | - | - | - | 11,564 |
| Health | - | - | 6,000 | - | - | 3,613 | - | - | - | 9,613 |
| Trade | - | 7,500 | - | - | - | - | 843 | 1,000 | - | 9,343 |
| Press Institutions | - | - | - | - | - | - | - | 7,500 | - | 7,500 |
| Education | - | - | - | 159 | 4,140 | 317 | - | - | 17,000 | 21,616 |
| Irrigation | - | 700 | - | 192 | 3,204 | - | - | 500 | - | 4,596 |
| Canal Works Company | - | - | - | - | - | 2,008 | - | - | - | 2,008 |
| Civil Aviation | - | - | - | - | - | - | 600 | - | - | 600 |
| Development and New Com | - | - | - | - | - | - | - | 500 | - | 500 |
| Academy of Science | 1,200 | -0- | - | - | - | - | - | - | - | 1,200 |
| Cairo University | - | - | - | - | 79 | - | - | - | - | 79 |
| Sub-Total | 80,000 | 70,000 | 100,000 | 150,000 | 55,000 | 425,000 | 290,000 | 224,500 | 76,500 | 1,471,000 |
| Private Sector | -0- | -0- | -0- | -0- | 10,000 | 15,000 | 10,000 | 25,000 | 8,500 | 68,500 |
| Un-Sub-obligated | | | | | | | | .500 | | .500 |
| TOTALS | $ 80,000 | $ 70,000 | $100,000 | $150,000 | $ 65,000 | $440,000 | $300,000 | $250,000 | $ 85,000 | $ 1,540,000 |

Note: The financial information contained in this exhibit is not exact. It represents a combination of earmarked (committed) funds, which may or may not be used; and issued Letters of Credit. In the case of issued Letters of Credit, moreover, the data includes both completed transactions and items in process; the completed transactions may not have been reduced for unused amounts; and the items in process represent a maximum amount which again may or may not be used. But the information is the best available at the current time and it represents reasonably good approximations as indicators of volume of importations to the different ministries and commodities.

Audit of the Commodity Import Programs of Egypt
Statement of Importations By Different Ministries and Authorities
Together With Our Audit Coverage
U.S. $ (000) as of July 31, 1980

| Ministry of and Commodity | Commodity Audited - Type of Problem: Project-Like Activity | Other Specific | Non-Durable Items | No Significance Noted | Total Audited | Not Audited | Total Importations |
|---|---|---|---|---|---|---|---|
| Supply | | | | | | | |
| Tallow | $ - | $ - | $ 238,086 | $ - | $ 238,086 | $ - | $ 238,086 |
| Corn | - | - | 137,194 | - | 137,194 | - | 137,194 |
| Edible Oil | - | - | 96,701 | - | 96,701 | - | 96,701 |
| Frozen Poultry | - | - | 38,351 | - | 38,351 | - | 38,351 |
| Automatic Bakeries | 18,126 | - | - | - | 18,126 | - | 18,126 |
| Ice Making Plants | 1,885 | - | - | - | 1,885 | - | 1,885 |
| Others | - | - | - | - | - | 42,227 | 42,227 |
| Sub Total | $ 20,011 | $ - | $ 510,332 | $ - | $ 530,343 | $ 42,227 | $ 572,570 |
| Industry | | | | | | | |
| Tinplate | $ - | $ - | $ - | $ 62,831 | $ 62,831 | $ - | $ 62,831 |
| Coking-Coal | - | - | - | 95,026 | 95,026 | - | 95,026 |
| Cigarette Tobacco | - | - | 85,433 | - | 85,433 | - | 85,433 |
| Wood-Pulp | - | - | - | 20,705 | 20,705 | - | 20,705 |
| Acetate Tow+Cigarette Paper | - | - | 26,183 | - | 26,183 | - | 26,183 |
| Tractors | - | 17,200 | - | - | 17,200 | - | 17,200 |
| Others | - | - | - | - | - | 50,763 | 50,763 |
| Sub Total | $ - | $ 17,200 | $ 111,616 | $ 178,562 | $ 307,378 | $ 50,763 | $ 358,141 |

| Ministry of and Commodity | Commodity Audited - Type of Problem: Project-Like Activity | Other Specific | Non-Durable Items | No Significance Noted | Total Audited | Not Audited | Total Importations |
|---|---|---|---|---|---|---|---|
| <u>Transport & Communications</u> | | | | | | | |
| Traffic Control Centers | $ 9,690 | $ - | $ - | $ - | $ 9,690 | $ - | $ 9,690 |
| Trucks and Trailers | - | - | - | 28,750 | 28,750 | - | 28,750 |
| Ward Buses | - | 79,801 | - | - | 79,801 | - | 79,801 |
| Micro-Wave System I | 20,000 | - | - | - | 20,000 | - | 20,000 |
| Micro-Wave System II | 16,920 | - | - | - | 16,920 | - | 16,920 |
| Others | - | - | - | - | - | 46,792 | 46,792 |
| Sub Total | $ 46,610 | $ 79,801 | $ - | $ 28,750 | $ 155,161 | $ 46,792 | $ 201,953 |
| <u>Suez Canal Authority</u> | | | | | | | |
| Mobile Compressors | $ - | $ - | $ - | $ 850 | $ 850 | $ - | $ 850 |
| Navigational Control System | 17,060 | - | - | - | 17,060 | - | 17,060 |
| Dredger No. 1 | - | - | - | 2,000 | 2,000 | - | 2,000 |
| Dredger No. 2 | - | - | - | 2,500 | 2,500 | - | 2,500 |
| Telephone Cable & Equipment | - | - | - | 2,000 | 2,000 | - | 2,000 |
| El-Raswa Power Plant | - | 6,000 | - | - | 6,000 | - | 6,000 |
| Others | - | - | - | - | - | 25,960 | 25,960 |
| Sub Total | $ 17,060 | $ 6,000 | $ - | $ 7,350 | $ 30,410 | $ 25,960 | $ 56,370 |

| Ministry of and Commodity | Commodity Audited - Type of Problem Project-Like Activity | Other Specific | Non-Durable Items | No Significance Noted | Total Audited | Not Audited | Total Importations |
|---|---|---|---|---|---|---|---|
| G.O.F.I. | | | | | | | |
| Boilers & Sugar Mills | $ 22,000 | $ - | $ - | $ - | $ 22,000 | $ - | $ 22,000 |
| Rotary Hearth | 6,675 | - | - | - | 6,675 | - | 6,675 |
| Textile Machinery | - | - | - | 2,350 | 2,350 | - | 2,350 |
| Others | - | - | - | - | - | 20,801 | 20,801 |
| Sub Total | $ 28,675 | $ - | $ - | $ 2,350 | $ 31,025 | $ 20,801 | $ 51,826 |
| Agriculture | | | | | | | |
| Soybean Seeds & Innoculent | $ - | $ - | $ - | $ 1,220 | $ 1,220 | $ - | $ 1,220 |
| Fish Meal | - | - | - | 4,630 | 4,630 | - | 4,630 |
| Insecticide Spraying Units | - | - | - | 2,245 | 2,245 | - | 2,245 |
| Pick-Up Trucks | - | - | - | 3,127 | 3,127 | - | 3,127 |
| Utility Vehicles | - | - | - | 272 | 272 | - | 272 |
| Soybean Meal | - | - | - | 10,636 | 10,636 | - | 10,636 |
| Others | - | - | - | - | - | 870 | 870 |
| Sub Total | $ - | $ - | $ - | $22,130 | $ 22,130 | $ 870 | $ 23,000 |
| Electricity | | | | | | | |
| R.E.A. Transformers, Cable, Generators | $ - | $ 12,000 | $ - | $ - | $ 12,000 | $ - | $ 12,000 |
| EEA-Bus, Jeeps, Fire Trucks, Cranes | - | 10,000 | - | - | 10,000 | - | 10,000 |
| Forklifts, Generators | - | 10,350 | - | - | 10,350 | - | 10,350 |
| Cairo West spare parts | - | 4,650 | - | - | 4,650 | - | 4,650 |

| Ministry of and Commodity | Commodity Audited - Type of Problem: Project-Like Activity | Other Specific | Non-Durable Items | No Significance Noted | Total Audited | Not Audited | Total Importations |
|---|---|---|---|---|---|---|---|
| Electricity (cont.) | | | | | | | |
| Gas Turbine Generator | $ - | $ 4,500 | $ - | $ - | $ 4,500 | $ - | $ 4,500 |
| Mobile Diesel Generator | - | 5,000 | - | - | 5,000 | - | 5,000 |
| Others | - | - | - | - | - | 31,130 | 31,130 |
| Sub Total | - | 46,500 | - | - | 46,500 | 31,130 | 77,630 |
| Other Public Ministries | - | - | - | - | - | 129,510 | 129,510 |
| Sub Total Public Sector | 112,356 | 149,501 | 621,948 | 239,142 | 1,122,947 | 348,053 | 1,471,000 |
| Un-Sub-Obligated | - | - | - | - | - | 500 | 500 |
| Private Sector | - | 68,500 | - | - | 68,500 | - | 68,500 |
| Grand Total | $112,356 | $218,001 | $621,948 | $239,142 | $1,191,447 | $348,553 | $1,540,000 |

## ADDITIONAL BACKGROUND INFORMATION ON THE COMMODITY IMPORT PROGRAMS OF USAID/EGYPT

Since 1975, when the economic assistance was initiated, there have been nine loans and one grant signed which obligate $1.5 billion for the CIP. These funds are appropriated through the Economic Support Fund as authorized under Section 532 of the Foreign Assistance Act (FAA). The following table shows the amount of the obligated funds and their status, by loans or grant, as of July 31, 1980:

| | | Amounts in US $ Millions | | |
|---|---|---|---|---|
| Loan/Grant No. | CIP | Obligated | Disbursed | Balance |
| 026 | I | $ 80.0 | $ 79.9 | $ 0.1 |
| 027 | II | 70.0 | 69.9 | 0.1 |
| 029 | III | 100.0 | 99.2 | 0.8 |
| 030 | IV | 150.0 | 135.5 | 14.5 |
| 036 | V | 65.0 | 56.7 | 8.3 |
| 038 | VI | 440.0 | 372.7 | 67.3 |
| 045A | VII | 226.0 | 187.2 | 38.8 |
| 045B | VIII | 74.0 | 58.0 | 16.0 |
| 052 | IX | 250.0 | 154.2 | 95.8 |
| Loans Sub-Total | | 1,455.0 | 1,213.3 | 241.7 |
| Grant 0119 | | 85.0 | 4.5 | 80.5 |
| TOTAL | | $ 1,540.0 | $ 1,217.8 | $ 322.2 |

The Program Assistance Approval Document (PAAD), which is signed by the AID Administrator, presents, in capsule form, the intent of the program; this is subsequently incorporated into the loan or grant agreements.

> "The proposed loan will assist Egypt with its balance of payments deficit during the coming year. The loan proceeds will finance imports of agricultural and industrial machinery, equipment, spare parts and other essential commodities and related services. The loan will assist Egypt in its program to utilize full production capacity of existing industrial enterprises and to provide agricultural inputs essential to increase agricultural production."

The above statements have not changed significantly for the nine loans and grant, except that some loans add wording such as (a) "...and for new industrial expansion...", or (b) "...imports of food..."

The purpose of the loan or grant amounts were basically the same for the first five loans (026, 027, 029, 030, 036):

"...not to exceed...Million Dollars (the Loan) for the foreign exchange costs of commodities and commodity related services, as such services are defined by AID Regulation 1, needed to assist the Borrower to increase its industrial and agricultural production..."

The purpose of the loan or grant amounts changed somewhat for the next four agreements (038, 045A, 052 and 263-0119):

"...not to exceed...Million Dollars for the foreign exchange costs of commodities and commodity related services, as such services are defined by AID Regulation 1, needed to assist the Borrower in meeting a serious foreign exchange shortage, achieving development objectives, improving the standard of living and maintaining political stability..."

In sum, the objectives of the loans and grant are to finance types of commodities which will assist the GOE to diminish continued crisis in their Balance of Payments through maximizing production of existing or new industrial enterprises and increasing agricultural production. Importation of some food is also authorized so that political stability can continue.

About 95.5% of the obligated funds ($1.5 billion) are managed and channelled through the Public Sector of Egypt. The remaining balance, about $68.5 million, was allocated to the Private Sector.

This is the second audit report of the CIP. The series of four reviews contribute, individually or collectively, toward the following audit objectives:

To (a) evaluate the adequacy of USAID/Egypt monitoring; (b) evaluate coordination within USAID/E for the purpose of determining how CIP projects are considered in regard to the overall USAID program; (c) evaluate the progress of the CIP program toward specific objectives in industry, agriculture and the Private Sector of the economy; (d) evaluate the actual impact of the CIP program on Egypt's foreign exchange needs; (e) evaluate the extent of GOE involvement in the determination of items to be procured under the CIP program and whether the items procured are in line with the GOE economic goals; (f) evaluate the extent of coordination between the GOE ministries in the acquisition and use of the commodities imported; (g) determine the adequacy of both GOE and USAID/E arrival accounting systems; (h) evaluate whether the planned computer system will be adequate for the proper control of the CIP programs; (i) review and evaluate controls over counterpart generations; and (j) determine the extent of action taken on prior recommendations.

## LIST OF REPORT RECOMMENDATIONS

Page

Recommendation No.1
AA/NE review the USAID/E project-like activities financed through the CIP and (1) determine whether more specific criteria is needed in routinely selecting the preferred financing mode (project assistance) stipulated in AID Handbook 1 Policy and defined in AID Handbook 3 for long-term project-like activities, and (2) based on this determination, advise the USAID/E of any procedural changes needed in the selection of activities for non-project CIP financing. 14

Recommendation No.2
AA/NE review its delegation of authority to USAID/E, as set forth in cable number STATE 022218, and, if needed, amend the referenced cable to establish groundrules, criteria, and delegated funding limitations that apply when project-like activities are financed through the CIP. 14

Recommendation No.3
USAID/E amend the applicable Mission Order to delineate a policy for planning, managing, administering, and monitoring of project-like activities which may be financed under the CI Program. 14

Recommendation No.4
USAID/E establish procedures to ensure (a) that sufficient CIP funds are initially obligated and sub-obligated to cover total costs of project-like activities under the CIP and (b) that such funds remain sub-obligated for the activity and are not later actually shifted to other commodity imports thereby leaving the project-like activities in a situation of insufficient funds for successful completion. 15

Recommendation No.5

USAID/E formally appoint program managers to be responsible for and manage the assigned project-like activities under the procedures and regulations that apply in the case of projects. 15

Recommendation No.6
The USAID/E require CI program managers to make periodic site visits--and document them as a form of status report--to determine progress against targets for CI-financed capital goods imported to activate or re-activate industrial capacity in Egypt. 15

THE INTERNAL OPERATING PROCEDURES
OF THE
COMMODITY IMPORT PROGRAMS OF EGYPT

## ACRONYMS AND COMMONLY USED TERMS

| | |
|---|---|
| AA/NE | (AID's) Assistant Administrator/Bureau for Near East |
| AA/SER | (AID's) Assistant Administrator/Bureau for Program and Management Services |
| AAG/E | Area Auditor General/Egypt |
| AAG/NE | Area Auditor General/Near East |
| AAG/W | Area Auditor General/Washington |
| IIDPS | Industrial and Infrastructure Development and Program Support |
| AEG | American Export Group |
| AID | Agency for International Development |
| AID/W | Agency for International Development/Washington |
| AG/PPP | Auditor General/Office of Policy, Plans and Programs |
| AJP | Activity Justification Paper |
| A.R.E. | Arab Republic of Egypt |
| ARETO | Arab Republic of Egypt Telecommunications Organization |
| Bank L/Com | Bank Letter of Commitment |
| B/G | Borrower/Grantee (Contracts between Host Government and Supplier) |
| BOP | Balance of Payments |
| CIP | Commodity Import Program |
| Direct L/Com | Direct Letter of Commitment |
| EEA | Egyptian Electric Authority |
| ERS | Egyptian Railways System |
| ESC | Egyptian Sugar Company |
| ESF | Economic Support Fund |

| | |
|---|---|
| FAA | Foreign Assistance Act |
| CASC | (Egypt's) General Authority for Supply Commodities (Ministry of Supply) |
| GERCO | General Engineering and Refrigeration Company |
| GOE | Government of Egypt |
| GOFI | General Organization for Industralization |
| HB | The AID Handbook |
| IFB | Invitation for Bid |
| L/C | Letter of Credit |
| MF | Massey Ferguson (CI-Financed Tractors) |
| Mission | See USAID/E below |
| MO | Mission Order |
| MOE | Ministry of Economy |
| MOI | Ministry of Industry |
| MOT | Ministry of Transportation and Communications |
| M/T | Metric Ton |
| NASCO | El-Nasr Automotive Company (A Public Sector Firm under Egypt's MOI) |
| PAAD | Program Assistance Approval Document |
| PL 480 | Public Law No.480 |
| RAF | Record of Audit Finding |
| RTC | Railway Traffic Control (System) |
| SCA | Suez Canal Authority |
| SER/COM | The Office of Commodity Management in AID/W |
| USAID/E | U.S. Agency for International Dwvelopment/Egypt |
| USAID/LEG | Mission's Legal Advisor |
| VHF | Very High Frequency |
| VTMS | Vessel Traffic Management System |

# LIST OF REPORT RECIPIENTS

| | |
|---|---|
| **USAID/EGYPT** | |
| Director | 5 |
| Inspections and Investigations Staff (AG/IIS/Cairo) | 1 |
| **AID/WASHINGTON** | |
| AID Deputy Administrator | 1 |
| Assistant Administrator/Bureau for Near East (AA/NE) | 5 |
| Office of Egypt/Israel Affairs (Egypt Desk NE/EI) | 1 |
| Bureau for Near East (Audit Liaison Officer) | 1 |
| Assistant Administrator/Bureau for Program and Management Services (AA/SER) | 2 |
| Bureau for Program and Management Services (AA/SER/SA--for distribution to SER/CM, SER/COM and COM/NE) | 4 |
| Assistant Administrator/Bureau for Development Support | 1 |
| Office of Development Information and Utilization (DS/DIU) | 4 |
| Office of Legislative Affairs (LEG) | 1 |
| Office of the General Counsel (GC) | 1 |
| Office of Financial Management (FM) | 1 |
| Bureau for Program and Policy Coordination/Office of Evaluation (PPC/E) | 1 |
| Legislative and Public Affairs Office of IDCA | 1 |
| Office of the Auditor General (AG) | 1 |
| Office of Policy, Plans and Programs (AG/PPP) | 1 |
| Office of the Auditor General/Executive Management Staff (AG/EMS/C&R) | 12 |
| Office of Inspections and Investigations (AG/IIS) | 1 |
| Area Auditor General/Washington | 1 |
| **Area Auditors General** | |
| Area Auditor General/East Africa | 1 |
| Area Auditor General/East Asia | 1 |
| Area Auditor General/Near East | 1 |
| Area Auditor General/Near East--New Delhi | 1 |
| Area Auditor General/Latin America | 1 |
| Area Auditor General/Latin America--La Paz | 1 |