Regional Inspector General for Audit
Cairo, Egypt

Audit of USAID/Egypt's Management of Host Country-Owned Local Currency

Report No. 6-263-94-006
June 5, 1994

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INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID

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

June 5, 1994

MEMORANDUM FOR ACTING DIRECTOR/USAID/Egypt, Christopher Crowley

FROM : RIG/A/Cairo, Philippe L. Darcy

SUBJECT: Audit of USAID/Egypt's Management of Host Country-Owned Local Currency

Enclosed are ten copies of the subject report. We received the Mission's comments to the draft report and have considered them in preparing the final report. The report contains three recommendations which are unresolved.

On April 29, 1994, we discussed the issues raised in this audit report with the Assistant Administrator, ANE Bureau. At this meeting, I agreed to provide USAID/Egypt an additional opportunity to comment on the audit recommendations. Therefore, on May 17, 1994, I provided the Mission with a copy of our proposed final report to elicit any further comments the Mission might have on resolving the recommendations. USAID/Egypt Mission Director Bassford, by memorandum on May 24, 1994, stated the Mission had no further comments and suggested the report should be forwarded to USAID/W for further action.

Under USAID policy, Agency management officials are still responsible for responding to final audit reports within 30 days of issuance and for taking action to resolve and close audit recommendations. Therefore, we would appreciate it if you would again provide us with a written notice within 30 days of any action taken or planned to be taken to resolve and close the recommendations. Should you conclude that resolution cannot be reached at USAID/Egypt, we will then forward this report to the AA/ANE for further action.

I appreciate the cooperation and courtesies extended to my staff during the audit.

Enclosures as stated

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EXECUTIVE SUMMARY

Introduction

Section 531 (d) of the Foreign Assistance Act of 1961, as amended, specifies that, to the extent feasible, Commodity Import Programs and other program assistance should be used to generate local currency and that no less than 50 percent of these funds should be made available to support development activities. In recent years, the Congress has urged USAID to examine how these funds could be better managed to extend the development impact of such assistance, and to take all appropriate steps to ensure that local currency is used for intended purposes.

In July 1991, USAID issued guidance designed to strengthen missions' management of local currency programs. The guidance provided that local currency could be programmed to support USAID projects, to reduce government deficits (General Budget Support), to help support specific government ministries (General Sector Support) and to help defray mission operating expenses.

The 1991 USAID guidance called for (1) a thorough assessment of the host country's capability to account for local currency, (2) a specific analysis of programming options based on the results of the assessment, and (3) a range of controls, contingent on the type of programming options selected, to ensure accountability and evaluation of program impact. The results of the assessment and the analysis would provide the basis for logically selecting program option(s). Once an option(s) was selected, program agreements and related documents were to establish accounting and monitoring controls, including required audits and performance indicators to measure program impact. (See pages 1 to 3).

Report of Audit Findings

The Office of the Regional Inspector General for Audit/Cairo audited USAID/Egypt's Management of Host Country-Owned Local Currency to answer the following objectives: Did USAID/Egypt in accordance with USAID policy and supplemental guidance (1) assess the Government of Egypt's accountability environment, (2) design the grants and amendments (with necessary clauses), (3) ensure that local currency generations were deposited and quickly disbursed, (4) ensure that local currencies generated were programmed and used for intended purposes, and (5) ensure that the impact of the local currency programs would be evaluated.

We found that USAID/Egypt ensured that funds were moved quickly but did not ensure that they were properly accounted for. Specifically, in programming $307 million of local currency in 1992, USAID/Egypt (1) did not assess the GOE's accountability environment in accordance with USAID policy and supplemental guidance, (2) did not define monitoring and audit requirements in related grants and amendments, (3) did not ensure that local currency generated was programmed and used for intended purposes, and (4) did not ensure that the impact of the local currency programs could be evaluated.

The fact that the Mission did not conduct a proper assessment of the host country's capabilities had a domino effect on its ability to meet the remaining requirements of the 1991 USAID Supplemental Guidance. Without a complete assessment, it had no basis for preparing a specific analysis of programming options. Without both, it could not fully define accountability and monitoring requirements.

USAID/Egypt jointly programmed $252 million of the $307 million to support GOE ministries for fiscal year 1993. A proper assessment of the GOE's capability would have shown that, under its current accounting system, the GOE cannot identify if this local currency ever reaches the ministries. This is because, once the funds are transferred from the Special Account to the GOE general fund, they are commingled with other GOE revenues. Still, this would not be a problem if individual ministry budgets included a line item to reflect budget support received through local currency, then there would be a transaction trail showing funds disbursed against that budget item and expenditures incurred. However, GOE ministry budgets do not have such a line item. Instead budgets are categorized by expenditures for the entire ministry such as salaries, investments, and capital.

The problems we have identified regarding the fiscal year 1993 programming of $252 million of local currency cannot be corrected. Nearly all these funds were transferred to the Government of Egypt's General Revenue Account and their actual use cannot be identified. Action is possible, however, regarding the fiscal year 1994 programming of $160 million of local currency, including $127 million to support GOE ministries, which was signed in December 1993.

Accordingly, this audit report recommends that the Mission strictly adhere to USAID 1991 guidance to (1) conduct a thorough assessment of the Government of Egypt's capability to account for local currency under the four programming options authorized by USAID, (2) justify each programming option it selects based upon the results of the assessment, and (3) amend existing agreements with the GOE to reflect the programming options selected, including provisions requiring audits and the measurement of the impact of local currency programs. (See pages 4 to 19).

Management Comments and Our Evaluation

In its comments, USAID/Egypt conceded that program documents did not clearly identify the approach used by the Mission to account for and program local currency. The Mission, however, stated that this could not be construed as evidence that it was lax in its accountability for these resources. Rather, the Mission stated it was confident it had complied with the intent and the spirit of the 1991 Agency guidance on the programming of local currency, and it disagreed with the majority of the findings, conclusions, and recommendations reached in the draft audit report. Furthermore, the Mission rejected any implication that the accountability for the use of local currency resources has been compromised by the method the Mission has selected to program these resources.

The Mission referred to the nature of the Government of Egypt's budgeting process; the Mission's multiple political and development objectives; and the need to minimize the impact of monitoring local currency resources on a staff already stretched in monitoring an annual budget of $815 million. Based on these considerations, the Mission stated it had programmed local currency on a "hybrid approach"; i.e., a combination of General Budget Support and General Sector Support. To support its view, the Mission referred to decisions reached in 1987-1989 with regards to the programming of local currency.

In our opinion, the Mission's comments are not responsive to the basic issue in this audit report: the intent of the U.S. Congress that USAID take all appropriate steps to ensure that local currency is used for its intended purposes. To meet this intent, USAID issued the 1991 Supplemental Guidance to make sure its missions would use rigorous procedures to (1) conduct a thorough assessment of host country capability to account for local currency, (2) undertake a **specific** analysis of which programming option(s) to select based on the results of the assessment, and (3) establish strong management controls to ensure accountability and measurement of program impact on development assistance.

As noted in this audit report, USAID/Egypt did not comply with these procedures. The Mission claims that assessments of GOE ministries and other decisions reached in 1987-1989 constitute a continuing process that meets the intent of the guidance. This claim is not persuasive. Activities which took place several years before the Supplemental Guidance was issued might provide a starting point for later decision, but they cannot replace actions which were required by the Agency under the new guidance. This is because - in response to repeated criticisms by the IG, the GAO and key Congressional Committees for the way in which host-country owned local currency was managed - internal correspondence within USAID, shows that USAID/W clearly intended that the guidance would change the way USAID was handling local currency. As a practical consideration, as noted in an Action Memorandum for the Administrator from the AA/PPC dated August 1, 1990, the guidance was also designed because "it reduces the potential for misunderstanding and criticism from Congress, auditors, and the public concerning the management and impact of the local currency programs".

In addition to not complying with the guidance, we conclude that USAID/Egypt actions in programming local currency have increased, rather than reduced, past misunderstandings about the use of and accounting for local currency.

Considering the magnitude of the resources involved (about $252 million for fiscal year 1993 and $127 million for fiscal year 1994), we believe a more rigorous approach, as required by the USAID 1991 Supplemental Guidance, should have been used to program local currency, including a **current** and **full** analysis of all programming options within the context of what is in the best interest of the U.S Government and the GOE **in 1994**.

Finally, the Mission in its comments indicates that General Budget Support is the only option available to program local currency. We disagree. By conducting a General Assessment, as required by the Supplemental Guidance, the Mission could properly determine which options are available. And there are other options. For example, in a May 1989 memorandum addressing Local Currency, the IG suggested methodology to develop measurement indicators if USAID believed it was important to strengthen GOE ministries. The IG also suggested that the Mission may want to program local currency to "buy-in" into appealing GOE developmental programs, because this would be more consistent with USAID's statutory mission than paying GOE salaries and recurring costs.

Therefore, we stand by the recommendations made in this report. They will remain unresolved until agreement can be reached on their resolution with USAID/Egypt. (See pages 20 to 32).

Office of the Inspector General

Office of the Inspector General,
June 5, 1994

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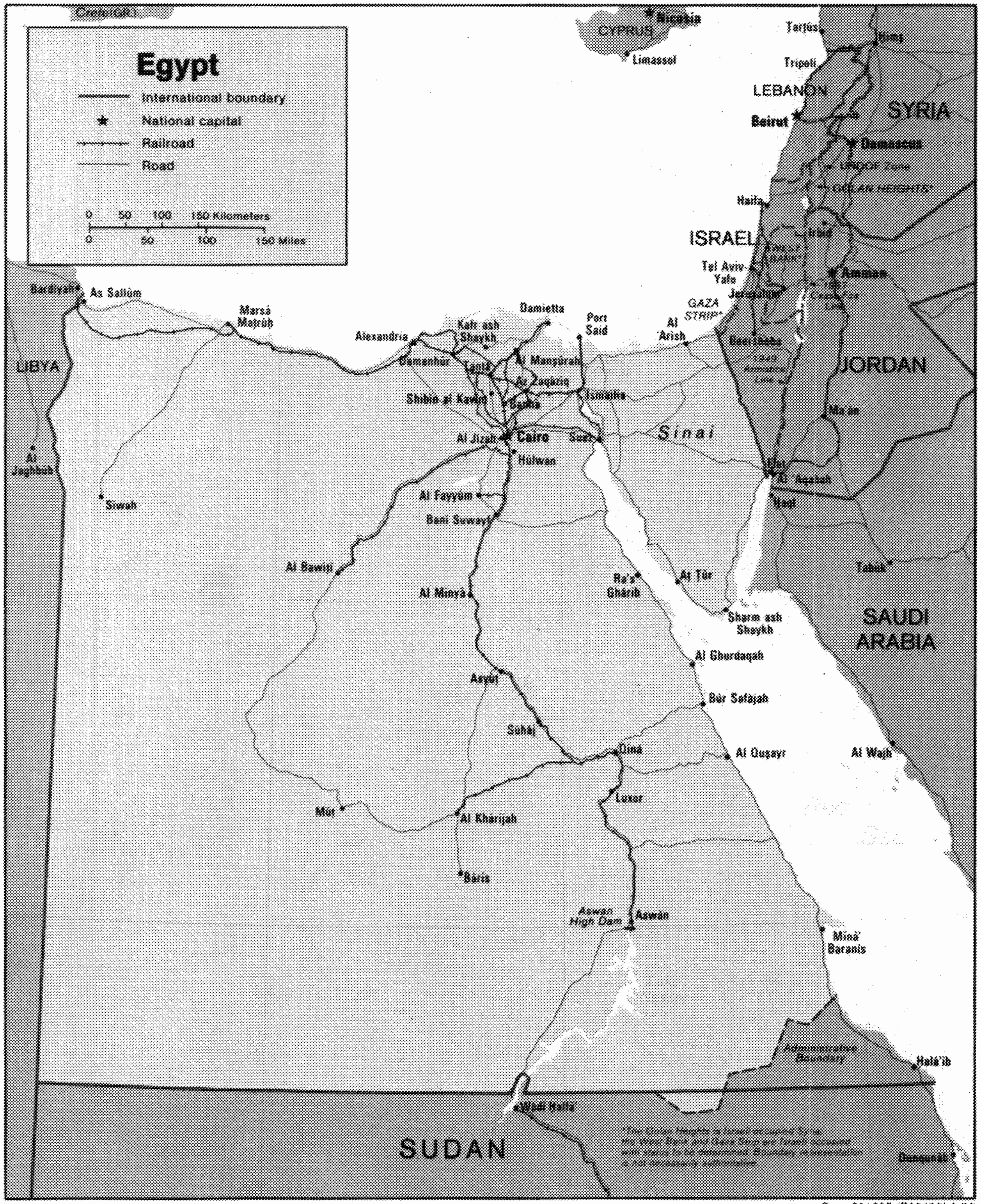
APPENDICES



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INTRODUCTION

Background

Section 531 (d) of the Foreign Assistance Act of 1961, as amended, specifies that, to the extent feasible, Commodity Import Programs and other program assistance should be used to generate local currency and that no less than 50 percent of these funds should be made available to support development activities. In recent years, the Congress has urged USAID to examine how these funds could be better managed to extend the development impact of such assistance. The Congress also has stressed, consistent with several GAO and IG audit reports, the need for USAID to take all appropriate steps to ensure that local currency is used for intended purposes.

In July 1991, in response to Congressional and other concerns, USAID issued guidance designed to strengthen missions' management of local currency programs. The guidance provided that local currency could be programmed to support USAID projects, to reduce government deficits (General Budget Support), to help support specific government ministries (General Sector Support) and to help defray mission operating expenses. The guidance also outlined accountability and monitoring requirements.

The USAID/Egypt's Office of Program Development and Support, in collaboration with USAID/Egypt's Office of Financial Management, is responsible for monitoring the local currency program in Egypt. Accordingly, these Offices oversee the generation, programming and use of local currency.

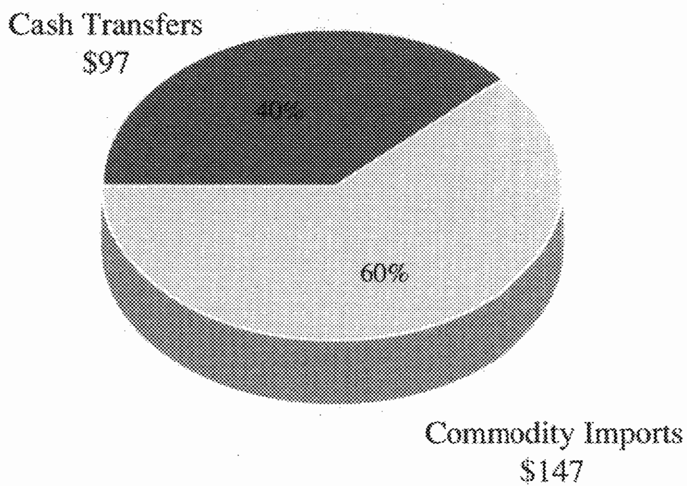
Our review focused on local currency programmed or deposited pursuant to the local currency provisions of grant agreements and amendments signed after July 1, 1991. For fiscal year 1993, 1,030 million Egyptian pounds (equivalent to $307 million) was programmed pursuant to such provisions. As of June 30, 1993, about LE816 million (equivalent to about $244 million) had been deposited pursuant to these provisions.

SOURCES & USES OF LOCAL CURRENCY

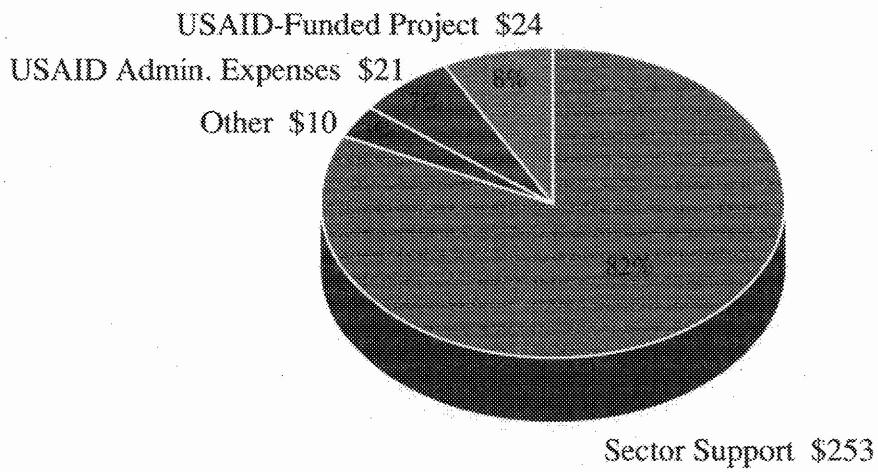
July 1, 1991 - June 30, 1993

U. S. Dollar Equivalent* (in millions)

SOURCES



USES



* $1 = 3.35 Egyptian Pounds

Audit Objectives

The Office of the Regional Inspector General for Audit/Cairo audited USAID/Egypt's management of host country-owned local currency to answer the following audit objectives:

1. Did USAID/Egypt assess the Government of Egypt's accountability environment as required by USAID policy and supplemental guidance?

2. Did USAID/Egypt design the grant agreements and amendments in accordance with USAID policy and supplemental guidance?

3. Did USAID/Egypt ensure that local currency generations were deposited and quickly disbursed as required by USAID policy and supplemental guidance?

4. Did USAID/Egypt ensure that local currencies generated were programmed and used for the intended purposes as required by USAID policy and supplemental guidance?

5. Did USAID/Egypt ensure that the impact of the local currency programs will be evaluated in accordance with USAID policy and supplemental guidance?

This audit report is one of a series of Regional Inspector General reports assessing USAID's implementation of the 1991 guidance.

Appendix I contains a complete discussion of the scope and methodology for this audit.

REPORT OF AUDIT FINDINGS

Did USAID/Egypt assess the Government of Egypt's accountability environment as required by USAID policy and supplemental guidance?

USAID/Egypt did not assess the Government of Egypt's (GOE) accountability environment as required by USAID policy and supplemental guidance.

USAID/Egypt completed a general assessment of the GOE's accountability environment in October 1992. However, the assessment did not assess the host country's capability to account for or measure the impact of local currency to be programmed for general budget support, general sector support, or USAID administrative costs. These areas accounted for about $273 million (89 percent) of the $307 million programmed for fiscal year 1993. Instead, the assessment was limited to evaluating how well GOE agencies could account for local currency programmed for USAID project support. This use accounted for only 11 percent of the local currency programmed for fiscal year 1993. With regard to local currency generated from USAID projects, the assessment concluded that the GOE had in place adequate systems, which, if followed, would properly account for the local currency.

The section below addresses our findings related to the 1992 General Assessment. In the following sections we discuss several related issues.

USAID/Egypt Did Not Adequately Assess All Programming Options

USAID 1991 Supplemental Guidance required Missions to prepare periodic general assessments of host country capability to manage local currency programs. The guidance requires that the general assessment identify which methods of financing and implementation are most suitable, given the host government's accounting and control systems and other factors. The conclusions reached are then used as the basis for deciding what uses of local currency would be most appropriate (i.e., general budget support, general sector support, support for USAID projects, or support for USAID administrative costs). However, USAID/Egypt's 1992 assessment did not reach conclusions regarding the various local currency programming options as required by the guidance. We could not identify a specific cause for this oversight, but we believe it probably occurred because USAID/Egypt, which was implementing the guidance for the first time, was not fully aware of the purpose of the general assessment. In any event, because the assessment did not meet the requirements of the supplemental guidance, USAID/Egypt programmed $252 million of local currency without proper justification, and the GOE is unable to show that these funds were used for the intended purpose. While it is too late to correct the problems affecting the programming of this local currency, an adequate general assessment is needed to justify the programming of an additional $127 million in local currency for fiscal year 1994.

> **Recommendation No. 1: We recommend that USAID/Egypt, conduct an assessment of the GOE's accountability environment - as required by USAID policy and supplemental guidance - to be used for fiscal year 1994 programming, and as the basis for specific assessments of local currency programming options in future Program Assistance Approval Documents.**

The following sub-sections discuss how the assessment should have been made, how it was actually made, and why we believe this happened.

How The Assessment Should Have Been Made

Policy Determination 18 dated July 30, 1991, and Section 2 of State Cable No. 204855, dated June 1991, entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency" require missions to prepare a general assessment of host country capabilities to manage USAID programs every five years. The guidance requires that the general assessment include all local currency programming. The emphasis in the guidance is on strategies for anticipating and overcoming obstacles to accountability, so that programs can be accomplished with as little waste, fraud, and abuse as possible.

With regard to local currency, the assessment is designed to provide a level of assurance that the host government could exercise adequate financial management over local currency resources. The questions the assessment is expected to answer can be summarized as follows:

(1) Can the host government account (budgeting and expenditure reporting) for the local currency to ensure that it is used for intended purposes?

(2) Can the host government identify the impact of the local currency program, i.e, provide performance indicators?

Section 2.0 of the Supplemental Guidance stresses that the overall purpose of the assessment is to identify which methods of implementation and financing are suitable to the host country environment. The conclusions reached in the assessment are then the basis for the planning process used to select which programming options will be used. As outlined in Policy

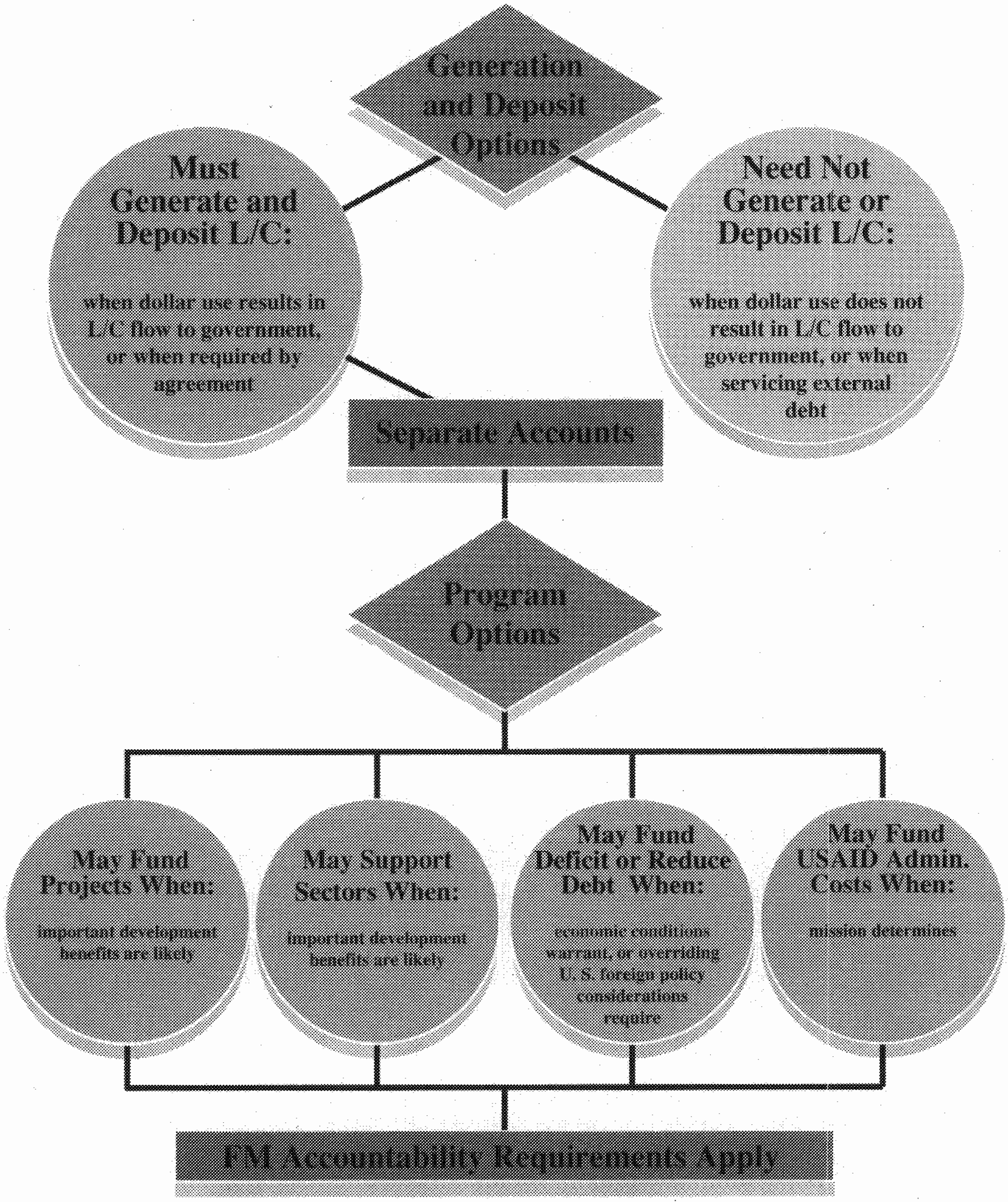
Determination 18, and its Supplemental Guidance, for local currency, four programming options can be used under Section 575 (a) of the 1991 Foreign Operations, Export Financing and Related Programs Appropriations Act (the 1991 Appropriations Act):

- general budget support,
- general sector support,
- support for USAID projects, and
- support for USAID administrative costs.

What the assessment provides is a basis to decide how best to program local currency among any or all four of these options after taking into account the host government's capability to account for them. To facilitate the assessment, the guidance outlines what USAID means by accountability requirements and for example, what level of confidence missions should have if they wish to program local currency for general budget support or general sector support. These are outlined below:

PROGRAMMING OPTION	ACCOUNTABILITY REQUIREMENT	DEGREE OF CONFIDENCE
GENERAL BUDGET SUPPORT (Support for deficit/debt reduction)	The agency managing the special account will be responsible for verifying that documentation exists demonstrating that the local currency indeed was transferred to the general fund from the special account.	A high degree of confidence is required that the host country can adequately meet the reporting standards for budget allocations and expenditures from the general fund and provide evidence that built-in controls are in place to prevent fraud or diversion of funds.
GENERAL SECTOR SUPPORT (Support for specific ministries or budget line items)	The agency managing the special account will be responsible for verifying that documentation exists demonstrating that the local currency indeed was transferred from the special account to the general fund and to a ministry's account or budget line-item. Reports should reflect both budget allocation and expenditure of funds from the general fund.	A medium to high level of confidence in the reporting mechanisms and controls of the financial and budgeting systems of the host government and of the recipient agencies.

Local Currency (L/C) Decision Tree



With regard to either general budget support or general sector support, assessing accountability involves ensuring that the host government can account for transfers from the special account to the general fund. The assessment would also cover the host government's capability to allocate local currency funds from the general fund to various uses and then account for expenditures against those budget allocations.

Section 6.2 of the 1991 USAID Supplemental Guidance provides additional guidance which can be used in conducting assessments to ensure that adequate accountability standards are in place to account for local currency. The guidance is especially clear about the need for accountability for general budget or general sector support:

> "Missions should note that while [USAID's] responsibilities for monitoring the disposition of local currency are less intensive when local currency is programmed for budget support, this does not imply that a lower standard of accountability is required for this type of programming. The contrary is true. The assumption behind budget support programming is that once the local currencies reach a designated agency or program they will be used appropriately and will have the intended development impact. If this were not true, there would be no justification for this type of programming.
>
> Thus a decision in favor of budget support programming in a host country would be based upon evidence in the general assessment of a rational budgetary allocation and expenditure system, adequate to report both budget allocations and expenditures from the General Fund, with built-in controls to prevent fraud or diversion of funds."

Thus, a trail of documented transactions showing the flow of local currency from the special account to the general fund and then to specific uses is necessary if USAID is to be assured that the funds are being used for intended purposes. A general assessment should determine whether such a trail, in fact, exists.

The assessment should also determine whether a system is in place to measure the impact of the use of local currency. For general budget and general sector support, we believe performance would likely be measured by the fact that the debt or deficit have actually been reduced, or the agreed-upon budget allocation to the ministry or budget line has been made, respectively.

The results of the general assessment are to be used in the Mission's planning process. Section 2.5 of State Cable No. 204855 requires that each Program Assistance Approval Document (PAAD) - the document upon which agreements for the use of local currency between USAID and the host country are justified - include, as part of the financial analysis section "a detailed specific assessment [akin to that used to justify a project paper] of appropriate programming alternatives available to the Mission *based on the General Assessment* (emphasis added).

In short, the 1991 Supplemental Guidance required general assessments to assess the host government's capability to account for use of local currency under four programming options.

It provides accountability and monitoring standards against which to conduct the assessment. The conclusions in the general assessment should then serve as the basis for planning individual USAID programs that will use local currency.

How the Assessment Was Actually Made

We found that USAID/Egypt did complete a General Assessment in October 1992. The assessment addressed the internal controls and accounting systems of the GOE's Ministry of Irrigation, Alexandria Governorate, the National Investment Bank, and the Schistosomiasis Research Science and Technology for Development (USAID-funded project), in areas such as the accounting ledgers, supporting documentation and records, as well as cash receipt/funding, cash disbursement and budgetary controls. The assessment was in essence similar in scope to the last General Assessment made by the Mission in 1984.

> *... the assessment did not cover whether the host government could account for local currency programmed for general sector support, for which the Mission programmed $252 million. Had the assessment looked at the movement of funds programmed for general sector support, it would have found that the GOE does not have a system to record budget allocations and expenditures of USAID program-generated local currency from the general fund to specific ministries.*

The 1992 assessment was made by a local CPA firm. Our review of the assessment, and examing its scope of work and discussions with the auditor-in-charge, disclosed the following:

1. The scope of work referred to the 1991 USAID Supplemental Guidance and asked the audit firm to determine whether host country local currency generated by USAID Programs/Projects can be programmed through budgetary support to the GOE. The assessment was to determine if the GOE's Budgeting and Financial Administration and Management Systems and procedures provided adequate internal management and accounting controls over the GOE assets.

2. The basis for the assessment was a review of accountability of four GOE implementing agencies with prior experience in managing local currency.

3. The auditor-in-charge indicated that he understood the scope of the assessment as covering the ability of GOE agencies to account for USAID projects including direct USAID project funds, and host country local currency contributions.

The General Assessment concluded that the procedures applied by the tested agencies, using GOE's Budgeting and Financial Administration and Management systems, would provide adequate internal management and accounting controls over GOE assets, including the local currency generated by USAID project/programs assuming satisfactory compliance.

In essence, what the 1992 Assessment covered was the GOE ministries accounting for project funds. Since some of these funds involve the local currency programming option for USAID projects, the assessment did cover that part of local currency programming. What the assessment did not cover was whether the host government could account for local currency programmed for General Sector Support (for which the Mission programmed $252 million) or for General Budget Support. Had accountability for these options been assessed, we believe it would have covered the movement of local currency from the Special Account to the General Fund, and to individual ministries. We also believe that most of the work involved should have been conducted at the Ministry of Finance, the GOE agency responsible for handling the General Fund, which was not visited during the assessment.

Had the assessment looked at the movement of funds programmed for general sector support, it would have found that the GOE does not have a system to record budget allocations and expenditures of USAID program-generated local currency from the general fund to specific ministries. According to the Head of the Budget Department of the GOE's Ministry of Finance, and a USAID/Egypt Financial Management official, the GOE budgetary system does not include budget line items for local currency associated with USAID programs. Therefore, the GOE cannot tell USAID how much of the local currency has been allocated to individual ministries through the budget process or how much of the local currency has been transferred from the general fund to the ministries. Instead, budgets are categorized by expenditures for the entire ministry such as salaries, investment and capital.

We asked a Ministry of Finance official whether the budgetary system could be modified to include a line item for local currency programmed as general sector support. He stated that such a line item could be included but it would require GOE legislative approval.

In essence, USAID/Egypt did conduct a general assessment, but the assessment covered only that portion of the local currency program (eleven percent) which was programmed for specific USAID projects. The general assessment did not cover the portion of the local currency program (82 percent) which was programmed for general sector support. The general assessment also did not determine whether the GOE could adequately account for any local currency that might be programmed as general budget support. Because the general assessment was not sufficiently comprehensive, USAID/Egypt was not aware that the GOE did not have an acceptable system to account for $252 million in local currency programmed as general sector support. Certainly, the assessment fell well short of meeting the Congressional intent of taking all appropriate steps to ensure that local currency is used for intended purposes.

Why This Happened

We could not specifically determine why the general assessment lacked crucial information necessary to make programming decisions. We believe the most likely reason is that this was the first time the Mission conducted an assessment under the 1991 Supplemental Guidance and therefore the Mission did not realize the importance of assessing accountability for each programming option.

Regardless of the cause, the effect was that at least $252 million of local currency was programmed in 1992 without proper justification, and the GOE did not have a system to demonstrate that the local currency was used for intended purposes. Without such a system, there was no accounting and no audit trail of transactions to show how the local currency was used.

Conclusion

The Mission completed a general assessment of the GOE accounting environment in October 1992. However, the assessment did not assess the host country's capability to account for or measure impact of local currency to be programmed for sector support, general budget support and USAID administrative costs - or most of the $307 million programmed for fiscal year 1993. USAID/Egypt should conduct another assessment in order to obtain detailed information regarding the host country's capabilities to meet the accountability requirements associated with the four programming options, with particular emphasis on how funds are allocated to individual GOE ministries and line items by the Ministry of Finance and on whether the use of the funds could be verified by documented transactions as required by USAID guidance. The assessment should then be the basis for specific assessments of local currency programming options in future Program Assistance Approval Documents.

Did USAID/Egypt design the grant agreements and amendments in accordance with USAID policy and supplemental guidance?

USAID/Egypt did not completely design the grant agreements and amendments in accordance with USAID policy and supplemental guidance. These documents (1) were not based upon a specific assessment of programming options, (2) did not include clauses for periodic audits, and (3) did not establish a basis to measure the impact of the local currency - as required by USAID 1991 Supplemental Guidance.

The agreements did limit the programming of local currency from the special accounts to the economic development options specified in USAID guidance (i.e. USAID projects, general budget support, general sector support, and USAID administrative costs) and required the GOE to deposit local currency into separate (special) accounts. These requirements, in part, meet the intent of Section 575 (a) of the 1991 Foreign Appropriations Act and Section 5.1 of the 1991 USAID Supplemental Guidance.

USAID/Egypt Needs To Amend Existing Grant Agreements And Amendments

The audit found that the grant agreements and amendments did not establish a system of controls for local currency as required by USAID 1991 Supplemental Guidance. Specifically, requirements were not adequately established for (1) reports on the allocation and expenditure of local currency for General Sector Support; (2) periodic audits; and (3) measures of the impact of local currency programs. As a result, for most of the fiscal year 1993 local currency programmed by USAID/Egypt in September 1992, USAID/Egypt had no assurance that the local currency was used for intended purposes and had the intended impact. Controls were not established in part because the planning documents for local currency programs did not include a specific assessment of local currency options. We believe another factor was that USAID/Egypt was not fully aware of the importance of these controls in ensuring good financial and program accountability for local currency.

As previously noted, it is too late to remedy these problems with regard to local currency programmed for fiscal year 1993 since most of the $252 million programmed for general sector support has already been transferred to the General Fund by the GOE and the actual use of these funds cannot be determined. However, in December 1993, USAID/Egypt signed an amendment to the Memorandum of Understanding programming about $160 million of local currency for fiscal year 1994. We believe that this programming should be justified based upon a specific assessment of programming options and appropriate clauses to ensure adequate financial and program controls over the use of this local currency.

Recommendation No. 2: We recommend that USAID/Egypt prepare specific assessments of local currency programming alternatives available to the Mission in accordance with Sections 2.2 and 2.5 of USAID 1991 Supplemental Guidance.

Recommendation No. 3: We recommend that USAID/Egypt amend existing agreements used to generate local currency to reflect the results of the specific assessment and also include provisions requiring audits and measurement of the impact of local currency programs.

The following sub-sections discuss what controls USAID requires over local currency, why the agreements and related documents between USAID/Egypt and the GOE did not meet the requirement, and why this occurred.

What Controls USAID Requires

USAID 1991 Supplemental Guidance requires controls over the programming and use of local currency. These controls are designed to ensure that local currency is used for intended purposes and that program impact can be measured. The controls required vary for each programming option. But, at a minimum, Section 4.0 of the Supplemental Guidance lists the following accountability requirements for local currency:

- The Special Account must be managed so that the local currency is deposited and disbursed in the agreed-upon manner.

- The local currency must be used for intended purposes once it is disbursed from the special account.

- The impact of the local currency programs needs to be measured. This measurement can be made through performance indicators.

USAID guidance (Policy Determination No. 18, section 4.2, and section 5.1 of State cable 204855) asks missions to include certain provisions in grant agreements that (1) require the generation of local currency into separate (special) accounts for joint programming; (2) limit programming of local currency to four options specified in USAID guidance; (3) require appropriate reports from the host government agency managing the special account; and (4) require periodic audits of special accounts.

In addition to the minimum requirements, section 5.1.A of State cable 204855 requires that USAID planning documents (Program Assistance Approval Documents, or PAADs), identify the host government agency responsible for managing the special account, and justify conclusions regarding the programming options selected by the Mission.

In summary, the mechanisms for ensuring that these basic requirements are met are (1) the general assessment which as noted earlier in this audit report defines what programming options are feasible, (2) the PAAD which provides a specific assessment of the option(s) that the mission selects, and (3) the grant agreements and related documents which provide reporting and audit requirements. To the extent that all these mechanisms are in place, adequate controls over local currency are present.

<u>Nature of Specific Assessment</u> - Sections 2.2 and 2.5 of the USAID Supplemental Guidance requires that, based on the general assessment, missions include in each PAAD a detailed specific assessment of appropriate programming alternatives available to the mission. The guidance states that the assessment should be analogous to a discussion in a project paper of the appropriateness of using the host country contracting method of implementation in a project.

While the guidance does not lay out a precise format for the specific assessment, it does recognize that the assessment will provide the basis for programming decisions between the GOE and USAID. Therefore, we believe that a specific assessment of the programming options for local currency should address at least (1) the results of the general assessment, (2) the programming options available to the mission, and (3) the rationale for the programming option(s) selected.

For example, if a mission decides to program local currency for general budget support, then the mission would provide a rationale demonstrating that (1) as required by Section 6.3A.1 of the Supplemental Guidance, the mission has a high degree of confidence that the host country has an adequate system for making budget allocations and expenditures from the general fund and has controls in place to prevent diversion of funds, (2) as required by Policy Determination No. 18, the mission can justify funding a deficit or reducing debt because economic conditions in a country warrant it or overriding U.S. foreign policy considerations require it, and (3) as required under Section 4.0 of the supplemental guidance, the impact of the general budget support can be evaluated. If a mission decides to program local currency for general sector support, we would expect the PAAD to present a rationale to justify that type of support.

<u>Nature of Reporting Requirements</u> - In essence, the reporting requirements for local currency are designed to ensure that missions can monitor that local currency (1) is used for intended purposes and (2) has the intended impact. For general budget support, reporting requirements are limited to reports showing that local currency disbursed from the special account was transferred to the host government's general fund. For general sector support, the guidance also requires reports on allocations and expenditures from the general fund to individual agencies and ministries and a measure of the impact of funds at the ministry level. For USAID project support, the monitoring would be at the project level.

In order to meet the reporting requirements, grant agreements or related documents should define the nature, format and frequency of reports required of the host government.

Nature of Audit requirements - The issue of audit must be discussed at the PAAD stage, and the type, frequency, and funding for audits must be specified in the grant agreements or related documents.

Regardless of the programming option selected, provision would be made for a periodic audit of the special account. For general sector support, the Supplemental Guidance is not clear regarding what type of audits should be made. Since local currency is to be used by specifically designated ministries and entities, we assume the scope of the audits would include a review of allocations and expenditures from the general fund to the individual agencies or ministries. The reason for this assumption is that in subsequent sections, the guidance requires periodic audits of the use of local currency by specific sector support and by recipients of extra budgetary support.

Why the Agreements Did Not Meet USAID Requirements

Grant agreements (263-K-624/625, 263-K-626, 263-K-627, and 263-0201.1) were used to program most of the $307 million of local currency for fiscal year 1993. These agreements (1) were not based upon a specific assessment of programming options, (2) did not include a requirement for the GOE to submit reports on the use of local currency or its program impact, and (3) did not require periodic audits. In short, these agreements did not provide the key controls over the use of local currency required under the 1991 USAID Supplemental Guidance, and did not meet the intent of the Congress that USAID take all appropriate steps to ensure that local currency is used for intended purposes.

As noted earlier, the GOE did not have a system to demonstrate the use of programmed local currency once it reached the GOE General Fund. Had an audit been conducted, it would have disclosed that there was no audit trail of transactions to show how the local currency was used.

Agreements Not Based on Specific Assessment - The agreements did not meet the requirements of Sections 2.2 and 2.5 of the Supplemental Guidance. Instead of a specific analysis based on the results of the General Assessment, the grant agreements were generally based on PAADs which merely noted that programming of local currency was limited to the four options (those required under Section 575 (a) of the 1991 Foreign Appropriations Act). No rationale (i.e., specific assessment) was provided to show why the mission had decided to use the local currency primarily for general sector support. For example, PAAD 263-K-626 dated August 20, 1992 authorized a cash transfer of $200 million, which generated much of the local currency programmed by the Mission for fiscal years 1993 and 1994.

Another example was Grant Agreement 263-0201.1, Eighth Amendment, dated February 18, 1992. The agreement is based upon a PAAD prepared on/before 1986 which would not fall under the 1991 Supplemental Guidance. The February 1992 amendment does. This amendment increased the Private Sector Commodity Import Program from about $810 million to $984 million but did not contain any rationale for the way local currency was programmed. Coupled with agreement 263-K-626 discussed above, the amendment and the agreement generated most of the local currency programmed by USAID/Egypt for fiscal year 1993.

To ensure that the required rationale was not contained elsewhere, we reviewed the Memorandum of Understanding (MOU) amendments dated September 30, 1992 (which programmed $307 million for fiscal year 1993) and December 20, 1993 (which programmed $160 million for fiscal year 1994). We found that these amendments allocated local currency for support to specific ministries, USAID projects, and USAID administrative costs. The 1992 amendment programmed $252 million as "Budget Support" to ministries, and the 1993 amendment programmed $127 million as "General Budget Support" to ministries also. Neither amendments to the MOU included a rationale to justify why the local currency had been programmed as it was.

Mission Claims It Intended to Provide General Budget Support - During the exit conference, the Mission claimed that, contrary to what the audit had found, its intent in 1992 was to provide the GOE with general budget support-not general sector support. Further, the Mission indicated that it had allocated local currency to specific ministries in the amendment to the Memorandum of Understanding to gain influence in dealing with the ministries. Apparently, the Mission's objective was to influence the ministries in other aspects of the USAID program in Egypt by showing the ministries that local currency was made available to them.

The evidence found during this audit does not support the Mission's claim and, in fact, indicates the contrary. We found that:

1. As discussed above, the PAAD justifying most of the $252 million programmed for fiscal year 1993 clearly indicates that the currency will be used in support of ministries. PAAD 263-K-626 ($200 million Cash Transfer) specifically states that local currency is to be used, among other things, as budget support for particular government sectors.

2. There is no rationale on file justifying a decision to provide the GOE with general budget support, i.e., either deficit or debt reduction. Considering the magnitude of the funds involved, we believe such a rationale, as required under PD-18, should justify why economic conditions or overriding U.S. foreign policy considerations in Egypt warrant or require such programming of local currency.

3. No Assistant Administrator approval for providing general budget support was obtained as required under Policy Determination 18. Again, considering the magnitude of the funds involved, we believe such approval should have been obtained based on a full justification of why USAID/Egypt wanted to provide deficit/debt reduction to the GOE.

We believe that a contributing factor to the lack of a system of control for local currency in pertinent grants and related documents was the fact that this was the first time the Mission implemented the guidance. Therefore, it may not have been fully aware of the importance of these controls in ensuring good financial and programming accountability.

Conclusion

The grant agreements and related documents were not based on specific assessments that: (1) justified why the local currency was programmed, (2) established the GOE's capability for managing local currency under the chosen programming options, or (3) established measures of impact. Furthermore, these documents did not clearly establish how USAID/Egypt was to ensure that the local currency was monitored, accounted for and audited. This lack of planning regarding control was compounded by the fact that the GOE does not have a system to identify the allocation and expenditure of local currency once it is deposited in the general fund.

As a result, USAID/Egypt could not ensure that $252 million of the local currency programmed for fiscal year 1993 would be used for intended purposes. Thus, the local currency program in Egypt, in our opinion, fell far short of providing the type of controls necessary to properly manage the program and to assess its impact. This lack of control makes the local currency program especially vulnerable to fraud and diversion - the very risks which the Congress and USAID through the Supplemental Guidance and Policy Determination 18 were seeking to avoid.

Did USAID/Egypt ensure that local currency generations were deposited and quickly disbursed as required by USAID policy and supplemental guidance?

USAID/Egypt ensured that local currency generations were deposited and quickly disbursed as required by USAID policy and supplemental guidance.

We found that USAID/Egypt: (1) agreed with the Government to ensure that the local currency was deposited at the highest legal exchange rate, (2) ensured separate special accounts were established, (3) issued a program implementation letter outlining the requirements for reporting on the status of the special accounts, and (4) verified reports on the status of the special accounts at least once each year.

In addition, USAID/Egypt prepared a study which justified its decision not to place the local currency in interest-bearing accounts. A June 1991 study by USAID/Egypt's Chief Economist concluded that neither the Government of Egypt nor the overall national economy would benefit from the payment of interest. Finally, our tests showed that the local currency was disbursed as quickly as was consistent with sound programming practices and prevailing economic conditions in the recipient country.

We conclude that USAID/Egypt complied with USAID's guidance to oversee deposits of local currency into special accounts and to ensure timely disbursements were made from the accounts.

Did USAID/Egypt ensure that local currencies generated were programmed and used for the intended purposes as required by USAID policy and supplemental guidance?

USAID/Egypt did not ensure that local currency was programmed and used for the intended purposes as required by USAID policy and supplemental guidance.

As explained in the preceding sections, USAID/Egypt's general assessment did not determine if the host country had the capability to ensure that local currency was used for intended purposes. Furthermore, the Mission's grant agreements were not based upon a specific assessment of appropriate programming alternatives available to the Mission based upon the general assessment. In fact, the assessment was completed after the agreements had already been signed.

We are making no recommendations under this audit objective, as we are addressing the problem areas under Recommendations No. 1, 2, and 3.

Did USAID/Egypt ensure that the impact of the local currency programs will be evaluated in accordance with USAID policy and supplemental guidance?

USAID/Egypt did not ensure that the impact of the local currency program will be evaluated in accordance with USAID policy and supplemental guidance.

As explained in the preceding sections, USAID/Egypt's general assessment did not determine if the host country had the capability to ensure that local currency was used for intended purposes. Furthermore, the Mission's grant agreements were not based upon a specific assessment of appropriate programming alternatives available to the Mission based upon the general assessment. In fact, the audit determined that USAID/Egypt could not verify that $252 of the $307 million in local currency was used for the intended purpose.

We are making no recommendations under this audit objective, as we are addressing the problem areas under Recommendations No. 1, 2, and 3.

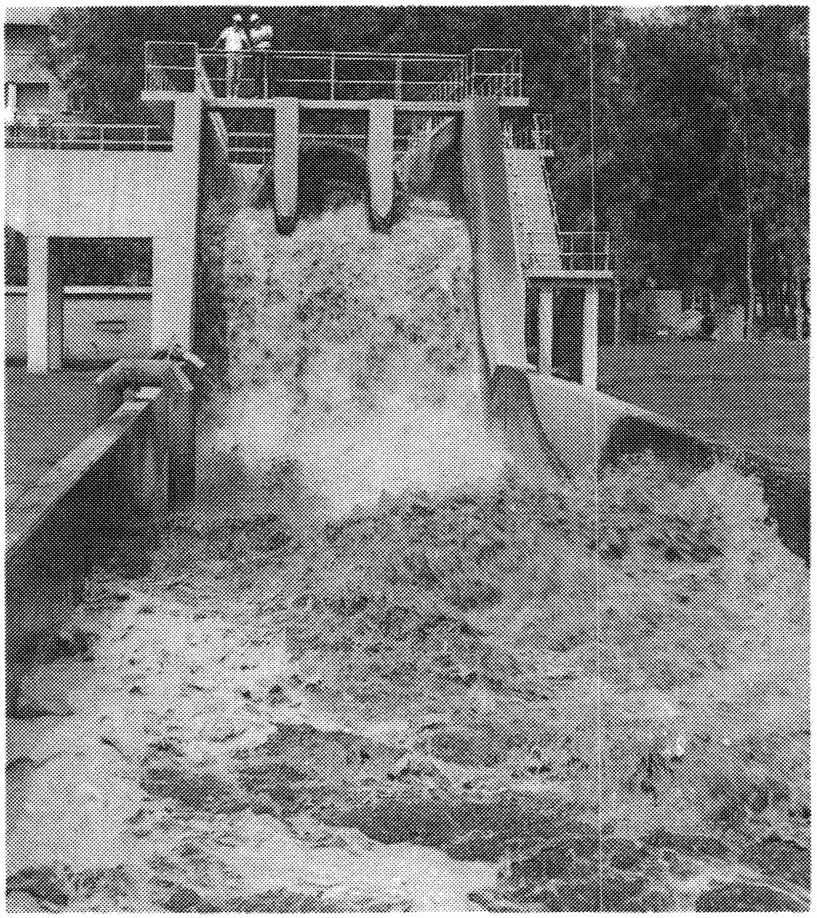
Cairo Sewerage II

Project No. 263-0173

received the equivalent

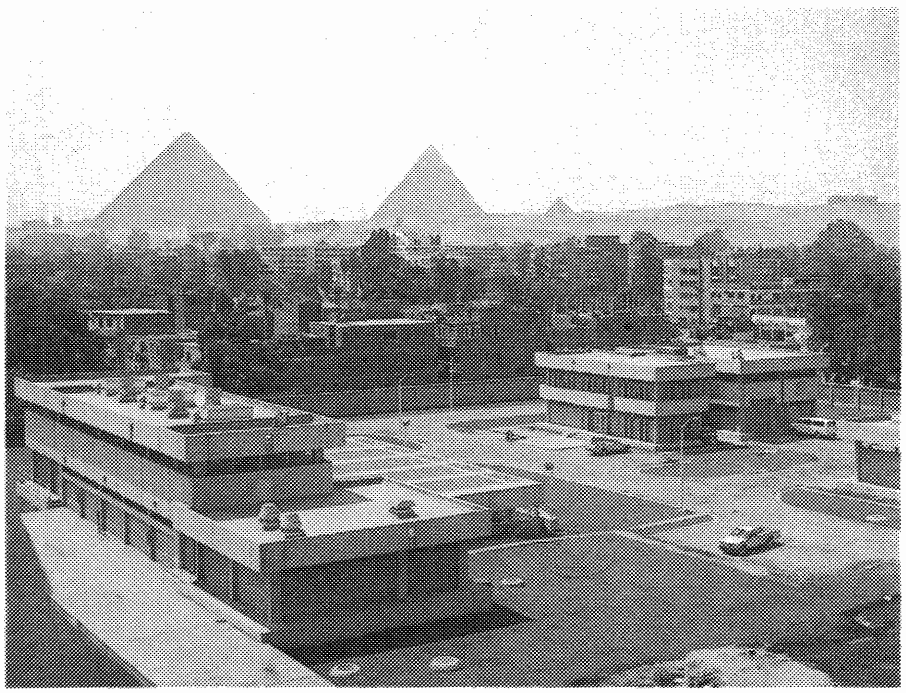
of $24 million

in local currency.



Zenin Wastewater Treatment Plant Near Cairo

BEST AVAILABLE COPY



Pyramids Pump Station Near Cairo

MANAGEMENT COMMENTS AND OUR EVALUATION

We provided USAID/Egypt with copies of the draft audit report on February 10, 1994. USAID/Egypt responded with written comments on March 22, 1994. The comments are included in their entirety in Appendix II of this report. We took the comments into consideration in preparing this final report. The Mission's response and our evaluation (in italics) are summarized below:

General Management Comments

In its comments, USAID/Egypt conceded that program documents did not clearly identify the approach used by the Mission to account for and program local currency. The Mission, however, stated this could not be construed as evidence that it was lax in its accountability for these resources. Rather, the Mission stated it was confident it had complied with the intent and the spirit of the 1991 Agency guidance on the programming of local currency, and it disagreed with the majority of the findings, conclusions, and all the recommendations reached in the draft audit report. Furthermore, the Mission rejected any implication that the accountability for the use of local currency resources has been compromised by the method the Mission has selected to program these resources.

The Mission referred to the nature of the Government of Egypt's budgeting process; the Mission's multiple political and development objectives; and the need to minimize the impact of monitoring local currency resources on a staff already stretched in monitoring an annual budget $815 million. Based on these considerations, the Mission stated it had programmed local currency on a "hybrid approach", i.e., a combination of General Budget Support and General Sector Support. To support its view, the Mission referred to decisions reached in 1987-1989 with regards to the programming of local currency.

We recognize the complexity of the USAID development assistance program in Egypt and the constraints attendant to the program. But we also recognize that the magnitude of the local currency resources program in Egypt, which for fiscal year 1993 alone was over $250 million, warrants fully meeting the intent of the U.S. Congress that USAID increase its responsibility for programming and accountability - including taking all appropriate steps to ensure that local currency is used for intended purpose. To meet this intent, USAID issued the 1991 Policy Determination (PD-18) and Supplemental Guidance limiting the use of local currency to four *programming options. Effective July 1, 1991, the Supplemental Guidance required USAID missions to adopt rigorous procedures to justify the use and accountability of local currency. The missions were required to (1) conduct a thorough assessment of host country capability to account for local currency, (2) undertake a specific analysis of which programming option(s) to select based on the results of the assessment, and (3) establish management controls to ensure accountability and evaluation of program impact on development assistance.*

As noted in this audit report, USAID/Egypt did not comply with these procedures. The Mission claims that assessments of GOE ministries, and other decisions reached in 1987-1989, constitute a continuing process that meets the intent of the guidance. This claim is not persuasive. Activities which took place several years before the Supplemental Guidance was issued might provide a starting point for later decisions, but they cannot replace actions which were required by the Mission under the new guidance. This is because - in response to repeated criticisms by the IG, the GAO and key Congressional Committees for the way in which host-country owned local currency was managed - internal correspondence within USAID, shows that USAID/W clearly intended that the guidance would change the way USAID was handling local currency. As a practical consideration, as noted in an Action Memorandum for the Administrator from the AA/PPC dated August 1, 1990, the guidance was also designed because "it reduces the potential for misunderstanding and criticism from Congress, auditors, and the public concerning the management and impact of the local currency programs...".

In addition to not complying with the guidance, we conclude that USAID/Egypt actions in programming local currency have increased, rather than reduced, past misunderstandings about the use of and accounting for local currency. Thus, it is still unclear as to what programming approach the Mission has used to program $252 million for fiscal year 1993.

In a December 12, 1988 memorandum to RIG/A/C, the Director, USAID/Egypt, in our opinion was clear and unequivocal when he stated that the Mission intended to use local currency to provide support to GOE ministries and (1) would ensure that there was documentation demonstrating that the local currency was indeed transferred to the Ministries' accounts, and (2) would generally satisfy itself on the quality of the overall program activities and the technical and administrative capabilities of the implementing entity or entities to carry out the program. Furthermore, periodic reports on budgetary allocations would be required over the period of the agreement to enable the Mission to assess compliance with agreed priorities. The Director added "This is the procedure we are and will be following". Mission records subsequent to this memorandum (PAADs and MOUs) show "Budget Support" to ministries and thus are in line with the Mission's policy, as explained in the above memorandum, of providing Sector Support to the GOE.

So, in September 30, 1993, the auditor reported that the Mission's records showed it had programmed local currency to support GOE ministries. But the auditors informed the Mission that it had not complied with the programming and accountability requirements set forth by the Supplemental guidance for this type of programming. In responding to these findings, Mission officials indicated that, records notwithstanding, the intent of the Mission had not been to provide *budget support to ministries but instead had been to provide "General Budget Support" to reduce the GOE budget deficit.*

Further audit work disclosed that Mission records did not support the Mission contention regarding General Budget Support, because no justification was available to support the Mission's intent, and an Assistant Administrator approval required by PD-18 had not been obtained. When the results of this additional audit work was disclosed to the Mission in our draft audit report in February 1994, the Mission response was that, notwithstanding these previous findings, the Mission had used a "hybrid approach" combining elements of both General Budget Support and General Sector Support, and that this approach complied with the Supplemental Guidance.

Contrary to the Mission's assertion that a "hybrid approach" complies with Section 6.2 of the Supplemental Guidance, we found that there is no provision in the Supplemental Guidance or PD-18 for combining programming approaches. This makes sense since each programming approach has its own unique accountability and programming requirement.

*Considering the magnitude of the resources involved (about $252 million for fiscal year 1993 and $127 million for fiscal year 1994), we believe a more rigorous approach, as required by the USAID 1991 Supplemental Guidance, should have been used to program local currency, including a **current** and **full** analysis of all programming options within the context of what is in the best interest of the U.S Government and the GOE **in 1994**.*

Finally, the Mission in its comments indicates that General Budget Support is the only option available to program local currency. We disagree. By conducting a General Assessment, as required by the Supplemental Guidance, the Mission could properly determine which options are available. And there are other options. For example, in a May 1989 memorandum addressing Local Currency, the IG suggested methodology to develop measurement indicators if USAID believed it was important to strengthen GOE ministries. The IG also suggested that the Mission may want to program local currency to "buy-in" into appealing GOE developmental programs, because this would be more consistent with USAID's statutory mission than paying GOE salaries and recurring costs.

Therefore, we stand by the recommendations made in this report. They will remain unresolved until agreement can be reached on their resolution with USAID/Egypt.

MISSION COMMENTS TO RECOMMENDATIONS AND OUR EVALUATION

Recommendation Number 1: We recommend that USAID/Egypt conduct an assessment of the GOE Accountability Environment - as required by USAID Policy and Supplemental Guidance - to be used for fiscal year 1994 programming, and as a basis for specific

assessments of local currency programming options in the future Program Assistance Approval Documents (PAADs).

The Mission found this recommendation unnecessary. It stated the recommendation overlooked the Mission's 14 years experience in programming local currency, and ignored the fact that the Mission had engaged in an ongoing assessment process which addresses the key points the auditors have identified in their report.

The Mission comments are not responsive to the intent of the recommendation. The audit report supports the fact that Mission's assessments have not met the requirements of the Supplemental Guidance. This is especially salient with regard to the fact that the assessments have never evaluated the adequacy of the GOE's system of budget allocations and expenditures from the GOE General Fund to GOE ministries. Instead, the assessments have always been limited to the ministries' ability to account for funds. The audit report recognizes that information about ministries is a proper part of the assessment, but it is quite short of the scope necessary to comply with the Supplemental Guidance requirement that "a decision in favor of budget support programming in a host country would be based upon evidence in the General Assessment of a rational budgetary allocation and expenditure system, adequate to report both budget allocations and expenditures from the General Fund, with built-in controls to prevent fraud or diversion of funds".

Recommendation No. 1 can be resolved and closed by conducting an assessment which meets this requirement. Like a non-Federal Audit, such an assessment can be conducted by non-federal auditors, and paid for by the GOE.

Recommendation Number 2: We recommend that USAID/Egypt prepare specific assessments of local currency programming alternatives available to the Mission in accordance with Section 2.2 and 2.5 of USAID 1991 Supplemental Guidance.

The Mission disagreed with this recommendation because it stated it had already performed assessments that meet the requirements of the 1991 operational guidance.

As discussed in our overall response to the Mission's comments, we conclude that the Mission has not complied with the intent or the spirit of the USAID 1991 Policy and Supplemental Guidance. In light of the magnitude of local currency resources in Egypt, we believe it is incumbent upon this Mission to provide a full rationale of programming decisions. As the audit report states, it is too late to remedy the lack of a specific assessment for $252 million programmed for fiscal year 1993, but it is not too late to conduct such an assessment for the $127 million programmed for fiscal year 1994, and for future years' programming.

Recommendation No. 2 can be closed by conducting a specific assessment which meets the requirements set forth in USAID 1991 Supplemental Guidance.

Recommendation Number 3: We recommend that USAID/Egypt amend existing agreements used to generate local currency to reflect the results of the specific assessments and also include provisions requiring audits and measurement of the impact of the local currency program.

The Mission disagreed with the recommendation but stated it would ensure that program documents clearly identify the hybrid approach. The Mission also indicated it did not believe any meaningful evidence of impact can be provided on the General Sector Support element of the programming hybrid, given the nature of the GOE budgetary system.

The auditor cannot address the Mission response until the Mission has implemented Recommendations Nos. 1 and 2
, and the results of a general and specific assessments are known. Therefore resolving and closing this recommendation will be contingent upon action taken by the Mission, based on the results of the Specific Assessment as described under Recommendation No. 2.

OTHER MISSION COMMENTS AND OUR EVALUATION

Below is our evaluation of other Mission comments, which although important, do not directly impact on the overall conclusion reached in our response above.

Mission's Comments:

"... the Mission employed a hybrid approach to the programming of local currency resources combining elements of the general budget support and general sector support approaches as defined in the guidance. This hybrid approach complies with paragraph 6.2 of the Operational Guidance which states...".

Auditor's Comments:

The Mission cannot combine elements from both types of programming because each type has its own unique accountability requirements. The Mission could have jointly programmed local currency for both purposes, but separately. An amount could have been programmed for general budget support and another amount for general sector support, each with its own accountability requirements. The Mission's statement that this "hybrid approach" complies with section 6.2 of the Operational Guidance is incorrect. Section 6.2 introduces Budget Support before further defining the different types of programming under this category, without any reference that those types could be combined. The Mission's conclusion that their hybrid approach complies with this paragraph is unfounded.

Mission's Comments:

"We further note here that the Inspector General (IG) formally communicated his disagreement with the Mission's decision to the AA/ANE in his May 1989 memo closing audit recommendations issued under Report No. 6-263-87-09. Thus, the IG is already on record with its opposition to a budget support approach in programming local currency".

Auditor's Comments:

The May 1989 IG memorandum to the AA/ANE did not express, either implicitly or explicitly, any disagreement or opposition to the Mission's decision to use the budget support approach to selected GOE entities. On the contrary, the IG stated that he did not question using the sector support option for local currency management. What concerned him was that (1) funds from the Special Account could not be tracked to the sectors ("developmental ministries") supposedly benefitting from the releases from the Special Account and (2) the absence of any performance indicators showing what level of services or operations USAID support to these sectors were intended to achieve.

One of the IG's suggestions was that if USAID believed it important to strengthen the operations of say, the Ministry of Health, then it should select certain performance indicators, based on recent documented experience and projected resource flows, and provide Special Account support to guarantee that those services are increased. The IG also suggested that certain "buy-ins" into appealing GOE development programs would be more congruent with USAID statutory mission than paying GOE salaries and recurrent costs.

Mission's Comments:

"The 1991 clarifications of General Sector Support and General Budget Support also reaffirmed the Mission's earlier conclusions that a pure form of General Sector Support was not possible given the nature of the GOE budgetary and accountability system". The Mission response also included a series of long arguments on the Mission's intent to guarantee that a minimum level of resources reached GOE ministries.

Auditor's Comments:

We do agree with the Mission that this type of support was not possible because the GOE's budgetary system precludes the ability to track specific resources from the Ministry of Finance to specific end-user Ministries. As suggested by the IG May 1989 Memorandum, if USAID wanted to strengthen a particular ministry, it could have developed specific indicators to demonstrate, based on recent experience that certain results were being achieved, or at least maintained. Also the Mission could have used a buy-in approach.

A properly conducted General Assessment would have demonstrated to the Mission what was truly feasible. It would also have shown, as suggested by the IG, that there was a way to guarantee a minimum level of resources reached the ministries. While this approach would not have guaranteed the Mission that Special Account local currency allocations reached specific ministries, it would have guaranteed that the GOE had made funds available to these ministries to achieve their program indicators. This approach was, in our opinion, consistent with the Supplemental Guidance, which recognizes that local currency may be commingled in the General Fund and therefore not directly traceable.

Mission's Comments:

"The naming of specific agencies in the MOU or in other Mission documentation was not intended to shift to the programming mode of General Sector Support, per se. Rather it was to guarantee that a minimum level of resources would continue to flow to the affected ministries in a time of overall budget stringency. A simple review of the annual budgets far exceeded what was provided to them from the Special Account, via the General Revenue Account".

Auditor's Comments:

Since USAID/Egypt cannot track Special Account local currency funds from the General Revenue Account to individual ministries, then the Mission has no guarantee that resources would continue to flow to the affected ministries. The reason for this is because Ministry of Finance controls the budgets of all ministries regardless of the source of funds. As shown below, the amount of local currency provided through USAID program represents a small percentage of revenues available to GOE ministries. Thus, once the funds are commingled, Special Account local currency cannot be identified.

Ministry	*Budget (Babs 1-2)*	*Special A/C*	*Percentage*
Agriculture	*LE 538.6 million*	*LE 35 m.*	*6.5*
Irrigation	*LE 325.7 million*	*LE 25 m.*	*7.7*
Education	*LE 4,753.8 million*	*LE 200 m.*	*4.2*
Health	*LE 902.1 million*	*LE 60 m.*	*6.7*

Mission's Comments:

"What we can say with certainty is that the Ministry of Finance (MOF) has an expectation that a specific overall level of resources will be provided and that this expectation is figured into the calculation of the GOE budget in any given year. Its ability to count on these resources allows it to meet important development objectives in a non-inflationary manner (i.e., without printing money) while meeting expected deficit reduction targets".

Auditor's Comments:

We agree with the Mission that the MOF relies on Special Account resources as a source of funds. However, this funding is not on a ministry-by-ministry level, but instead is for the national budget as a whole, so naming the ministries in the MOU is meaningless, according to MOF officials. Again, with regard to a ministry being able to meet important development objectives, as stated earlier, indicators can be established to assess that these objectives are being achieved or maintained.

Mission's Comments:

"Although we are describing our approach to the programming of local currency as a "hybrid" of General Budget Support, incorporating some aspects of General Sector Support, the Mission does not believe that this approach requires a level of monitoring or accountability beyond that which is required for General Budget Support".

Auditor's Comments:

We do not agree with the Mission's comments because the statement is not consistent with the Supplemental Guidance. As noted earlier the guidance does not provide for combining programming. But if we were to assume that it did, then the Mission statement still would not be correct. The requirements for accountability of General Budget Support are limited to ensuring that funds reach the General Account. The accountability requirements for General Sector include monitoring that funds reach the entity to be supported (in this case GOE ministries). Both require some measurement of the program impact of the local currency.

Mission's Comments:

"Furthermore, after the Mission concluded that the MOF was able to meet the new accountability standards called for by the 1991 guidance, ... ".

Auditor's Comments:

The Mission comments are not consistent with available evidence. As noted earlier, none of the General Assessments on file included an assessment of MOF ability to meet accountability standards. Therefore the Mission does not have a basis to assert whether MOF met accountability standards. Had such an assessment been made, it would show that MOF does not now meet the accountability standards for General Sector Support. Also, without an assessment, the Mission does not know if MOF meets the standards for General Budget Support, as required under Section 6.2 of the Supplemental Guidance for the allocation and expenditure of fund, and the prevention of fraud.

Mission's Comments:

"Based on the AA/ANE approval of the Mission's Cash Transfer Program, ... the Mission determined that the PAAD approval, in conjunction with the USAID/Egypt Director's Delegation of Authority No. 653, dated January 22, 1985 (DOA 653), enabled the USAID/Egypt Director to move forward and program the local currency as general budget support without obtaining a separate AA/ANE approval on this programming issue".

Auditor's Comments:

The AA/ANE approval was an ad hoc Delegation of Authority (DOA) to permit the Mission Director to approve the Sector Policy Reform Program, notwithstanding the absence of an AID/W-approved Project Assistance Initial Proposal (PAIP). In other words, if the PAIP was present, then there would have been no need for the DOA, or the AA/ANE approval. In addition, as shown on page 2 of this report, the Cash Transfer grant accounts for 40 percent only of the local currency generated, while the other 60 percent resulted from Commodity Import grants. These CIP grants were not covered by the AA/ANE approval. Furthermore, the Delegation of Authority (DOA 653) cited in the Mission's response has a ceiling of $20 million which the Mission Director cannot exceed without specific AA approval. The local currency programmed for FY93 was about $252 million. As stated earlier, considering the magnitude of these resources, an AA approval, as required by PD-18 should have been obtained for General Budget Support programming.

Mission's Comments:

"The Mission's assessment of GOE capabilities is a continuing process rather than a single event or document that is prepared solely at a particular point in time", and "The auditor's characterization of the assessment conducted by the CPA firm as the Mission's "1992 General Assessment" (while ignoring the complete body of analysis that has been undertaken since 1987) is therefore misleading and does not account for all the information the Mission has at hand in making decisions about the programming of local currency".

Auditor's Comment:

We agree with USAID/Egypt that assessing the host country's capabilities is a continuous process, in the sense that information developed in prior years must be considered in any new assessment. The 1991 Supplemental Guidance required a ***"General Assessment... expanded to include all nonproject assistance and local currency programming. The General Assessment will form the basis for the required specific assessments required in every project and program design document".*** *Correctly, the Mission in 1992 issued a scope of work for a: "GENERAL ASSESSMENT OF MANAGING HOST COUNTRY-OWNED LOCAL CURRENCY", which stated: "Recently, AID/W has issued supplemental guidance (STATE 204855) on programming and* *managing Host Country-owned Local Currency. The new guidance requires a general assessment of the accountability environment in the host country (both project and program) be performed at least once every five years. The general assessment will form the basis for the required specific assessments in every project and program design document. Since the Mission's last general assessment of GOE Ministries was in 1984, USAID/Cairo wishes to update the general assessment in accordance with the new AID/W guidance".*

On October 27, 1992, the CPA issued its report titled: "GENERAL ASSESSMENT OF MANAGING HOST COUNTRY-OWNED LOCAL CURRENCY", which stated that: "AID Washington Guidance (state 204855) requires USAID Mission to make a general assessment of the accountability environment in the host country at least once every five years. The general assessment forms the basis for the required specific assessments ... ".

In our opinion, the Mission's statement of work was correct. But the assessment did not include a fundamental step to determine how local currency could be programmed. It did not meet Section 6.2 of the Supplemental Guidance requirements to assess the adequacy of the host country budgetary allocation and expenditure system. To do so it would have had to assess the GOE Ministry of Finance operations. It did not. Instead, the assessment was limited to the same scope as the 1984 assessment: looking at the GOE ministries' abilities to account for funds.

Mission's Comments:

"... USAID in effect reviewed and assessed all of the programming options stated in the 1991 guidance and determined in 1991, that the only feasible option was for the Mission to continue providing general budget support, albeit a hybrid thereof".

Auditor's Comments:

We do not agree that the Mission reviewed and assessed all the programming options as required by the 1991 Supplemental Guidance, especially with the comment that it determined in 1991 that the only feasible option was to continue to provide General Budget Support.

As stated in the audit report, and in our earlier response to the Mission's comments, there is no evidence that the Mission reviewed and assessed all programming options in the 1991 guidance. The Mission did not conduct a complete General Assessment, did not prepare a Specific Assessment justifying why it selected particular options, and did not implement most of the controls required by the guidance.

The Mission's actions in programming and implementing the local currency program for fiscal year 1993 are inconsistent with the Mission's comments. The Mission claims that in 1991 it determined that General Budget Support was the only feasible option, yet the 1992 amendment of the Memorandum of Understanding between USAID and the GOE still shows budget support to ministries (General Sector Support) and does not mention General Budget Support, let alone *a hybrid thereof. Further, throughout the year, the Mission kept asking the GOE to provide reports on ministries' allocations and expenditures of local currency. These reports are required to monitor General Sector Support, but are not required to monitor General Budget Support.*

During the audit, Mission personnel provided us copies of these reports as evidence that the mission had met the monitoring requirement for **General Sector Support**. *Our review of the reports, and visits to the GOE Ministry of Finance, showed that they were meaningless because there is no way to trace funds from the General Fund to the ministries. This information was shared with Mission personnel during the audit and at the exit conference in October 1993. During the exit conference, Mission officials stated that they were not required to monitor allocation and expenditures of local currency from the General Fund to the Ministries, because their intention had been to program local currency as General Budget Support, not General Sector Support.*

Mission's Comments:

"This assessment confirmed that GOE Law 127 was being followed by the ministries that received host-country counterpart funds from the GOE's general revenue fund, and, that the GOE's budgeting and financial administration and management systems provide adequate internal management and accounting control over GOE assets. Based on the above, we concluded, with a reasonable degree of confidence, as required by the guidance that (1) the GOE's budgetary allocation process stems from established priorities; (2) is rational; and, (3) provides reasonable assurance that funds once disbursed from the Special Account will be used for its intended purpose".

Auditor's Comments:

We disagree with the Mission's conclusion. The assessment covered the adequacy of the ministries accounting for counterpart funds (project funds). What the assessment did not cover was the allocation and expenditure of local currency by the GOE Ministry of Finance from the General Fund to the Ministries. Also what the assessment did not cover was the fact that, regardless of whether the funds could be traced, the GOE had no budgetary system to identify the application of funds to development purposes. Without this coverage, it follows that the only assurance the Mission could have was that the ministries had an acceptable system to account for funds. This information is well known to the Mission, since it underlies the entire bilateral program in Egypt. In fact, much of the financial audit program in Egypt consist of audit of GOE ministries.

As stated in the audit report, the Mission has no assurance that the $252 million programmed for fiscal year 1993 was used for intended purposes. The Mission admits this in its statement on page 5 of its comments to the draft audit report, when it criticizes the nature of the GOE budgetary and accountability system because it precludes tracking specific resources from the MOF's General Revenue Fund to specific end-user ministries. This statement by the Mission *cannot be reconciled with the Mission's conclusion that it has reasonable assurance that funds once disbursed from the Special Account will be used for intended purposes.*

Mission's Comments:

"This audit was conducted in a sporadic fashion over a long period of time leading to some confusion within the Mission as to what was being audited".

Auditor's Comments:

We do agree that the audit was done in longer time than expected, but that was mainly due to the Mission being unable to define what type of programming option were they following, and whether they were able to meet its accountability requirements or not. As mentioned earlier, early in the audit the Mission claimed they were using General Sector Support, then at the Exit Conference they changed to General Budget Support, and finally to respond to the draft audit report they introduced the concept of a "hybrid approach" combining the two types.

With regards to "what was being audited", the objectives of the audit, as well as its scope, never changed.

Mission's Comments:

"Because of these findings the Mission saw no need to discuss the assessment process at the audit exit conference which was held on October 18, 1993".

Auditor's Comments:

Our initial conclusion that "USAID/Egypt assessed the accountability environment ..." is still valid because the assessment was actually conducted as required by the guidance. At that point it was just a matter of yes or no answer. We did not, however, test the quality of the assessment because our main negative finding related to programming over 80 percent of the available local currency (Objective Four) under an option that is not appropriate due to the GOE budgetary system. When USAID/Egypt, at the Exit Conference, indicated that regardless of what the record showed, their intent had been to provide General Budget Support, we had to test this new significant information against the guidance. This warranted a closer review of the General Assessment, and obtaining additional documents to determine if the Mission's statement was correct.

Mission's Comments:

"During this period, the Mission was contacted only three times by the auditors on issues which gave no indication that such a drastic reversal was being contemplated. We believe this led to erroneous conclusions by the auditors on the questions of the assessment process and the GOE accountability environment".

Auditor's Comments:

We disagree with the Mission's comments. After the Exit Conference on October 18, 1993, and during a meeting in November 1993, RIG/A/Cairo informed USAID/Egypt's officials, including the Mission Director, that the Local Currency discussion paper was being redrafted because of the Mission's comments that it intended General Budget Support and not General Sector Support. On November 23 and 24, 1993, our auditor met with other officials to inquire whether the GOE had the capability to report on allocations and expenditures; and to obtain the GOE law which disallows using a specific revenue for a specific purpose. In December 1993, the auditors contacted the Mission to obtain the 1984 study on the GOE internal control system, and the "Scope of Work" given to the firm who would conduct the assessment. This contact was followed by a memorandum between our office and the Mission to explain the reasons for redrafting the report. On December 30, 1993, our auditor interviewed the Deputy Controller to determine whether USAID/Egypt obtained an AA approval for General Budget Support, and whether PAADs included specific assessments of programming options, as required by the guidance.

Finally, on February 3 and 10, 1994, copies of our draft audit report were provided to the Mission with a suggestion that Mission officials meet with RIG/A/C before submitting its final comments. The Mission did not ask for such a meeting. Instead, it submitted its comments in final on March 22, 1994.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Egypt's Management of Host Country-Owned Local Currency in accordance with generally accepted government auditing standards. We conducted the audit from May 12, 1993 to October 18, 1993, and covered the local currency generated from Commodity Imports Grant Nos. 263-K-624/625, and 263-K-627, Cash Transfer for Sector Policy Reform Agreement No. 263-K-626, and the eighth amendment to the Private Sector Commodity Import Program No. 263-0201.1. All the agreements and amendments are for non-project assistance signed after July 1, 1991, the effective date of Policy Determination No. 18 and State cable 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency."

The audit covered the systems and procedures relating to (1) assessing the accountability environment in the host country, (2) designing the grant agreements and amendments, (3) depositing and quickly disbursing local currency, (4) programming and using local currency for intended purposes, and (5) evaluating the impact of the local currency program.

According to USAID/Egypt's records, about $477.5 million was obligated, and $352.6 million disbursed as of June 30, 1993, from non-project assistance agreements and amendments signed after July 1, 1991. The audit covered the local currency equivalent of about $244 million (about LE 816 million) deposited into, and about $250 million (about LE 838 million) withdrawn from the Special Account as of June 30, 1993.

Methodology

To accomplish our objectives as to whether USAID/Egypt followed new Agency guidance outlined in Policy Determination No. 18, and State cable 204855, we (1) obtained and reviewed USAID/Egypt's assessment of the host country's accounting environment; (2) tested the design of non-project assistance agreements and amendments; (3) verified host country's reports and bank statements on deposits to, and disbursements from the Special Account; in addition to obtaining documentary and testimonial evidence from the offices of USAID/Egypt and the Government of Egypt's Ministry of Finance.

USAID UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO EGYPT

MAR 22 1994

RECEIVED 22 MAR 94

TO : Philippe L. Darcy, RIG/A/C

FROM : Henry H. Bassford, Mission Director

SUBJECT : Audit of USAID/Egypt's Management of Host Country-Owned Local Currency.

I. INTRODUCTION.

The Mission is confident that it has complied with the intent and spirit of the 1991 Agency guidance on the programming of local currency, and it disagrees with the majority of the findings and conclusions of this audit, as well as all of its recommendations. Furthermore, the Mission rejects any implication that the accountability for the use of local currency resources has been compromised by the method the Mission has selected to program these resources. In this regard, since the beginning of local currency programming, the Mission has instituted procedures to ensure a reasonable and cost effective level of accountability as called for by the Federal Manager's Financial Integrity Act. These include a series of assessments (see Annex 1) which have been conducted by the Mission since 1987, to examine alternative means of local currency programming, the Egyptian budgetary process, and the GOE's capabilities of monitoring and accounting for local currency resources.

In 1988, subsequent to the issuance of the 1987 supplemental guidance, the Mission began programming local currency (with the exception of local currency funds programmed through the Operating Expense and Program Trust Fund Accounts) under the general rubric of "budget support[1]." The 1991 Agency guidance explicitly permitted Missions to jointly program with host country governments local currency to help fund a Government's deficit or reduce its debt. It also, expanded the term budget support to include "General Budget Support", "General Sector Support" and "Specific Sector Support", each with its defined

[1] Budget support is identified as "program support" in the 1987 Supplemental Guidance.

level of accountability. However, given the nature of the Government of Egypt's budgeting process, the Mission's multiple political and development objectives, and the need to minimize the impact of monitoring local currency resources on a staff already thinly stretched in monitoring an annual earmarked level of $815 million, the Mission employed a hybrid approach to the programming of local currency resources combining elements of the general budget support and general sector support approaches as defined in the guidance. This hybrid approach complies with paragraph 6.2 of the Operational Guidance which states:

> "Within the category of budget support programming, there are more specific ways of programming the local currency with their own unique accountability issues. Regardless of which type of programming is chosen, A.I.D., in addition to receiving reports, should retain rights adequate to ensure that A.I.D. with timely access can take an independent look at supporting documentation to verify that the agreement on uses of local currency has not been violated."

While we concede that Mission program documents did not clearly identify the hybrid approach and used the terms "general budget support" and "general sector support" in a manner which appeared inconsistent, and that certain Mission personnel with whom the auditors spoke may have used the two terms indiscriminately, this cannot be construed as evidence that the Mission was lax in its accountability for these resources. Nevertheless, the Mission will undertake to clarify this approach in all subsequent documentation.

II. BACKGROUND.

The Mission's current approach to the programming and monitoring of local currency resources is grounded in the historical relationship between the two governments. Most GOE-owned local currency has been generated through Commodity Import, Sector Assistance and/or Cash Transfer programs since 1980. (416(b) and P.L. 480 generated local currencies are not discussed herein.) These GOE-owned local currencies are deposited into a series of local currency special accounts, generally referred to under a single term, the "Special Account." These funds are on deposit at the Central Bank of Egypt, in the name of the Ministry of Finance (MOF), which manages the Special Account. They are programmed annually by AID and the Ministry of International Cooperation (MIC), through a Memorandum of Understanding (MOU).

Since 1980, the policies and guidance underlying local currency programming have changed several times. Mission management incorporated these changes into succeeding local currency disbursement mechanisms to ensure that the program met the test of evolving political and development objectives, accountability requirements and overall management imperatives. For example, in 1987, following a new statement of policy, the Mission evaluated the various local currency programming options and determined which were the most feasible for Egypt[2]. Based on this guidance, the Mission examined several options for the programming of local currency including: (1) investing in developmentally sound projects; and, (2) supporting particular sectors of the government's budget.

In 1988, the Mission rejected option # 1 above, specific project support, deciding instead to program resources as budget or sector support, with the exception of a few residual activities for which commitments to the GOE had already been made. USAID/Egypt selected Budget Support programming at this time, to support Egypt's new economic reform program. A specific component of this program was budget deficit reduction, as called for in an IMF-sponsored stabilization program and a World Bank Structural Adjustment program. USAID also supported this policy emphasis with its Cash Transfer Program. In addition, this option was the least management intensive for the Mission, which had repeatedly identified staffing as a major internal control weakness, and was facing additional staff reductions. The Mission also assessed the GOE budgetary system, including the procedures for allocating funds and monitoring programs, and found this process to be acceptable[3].

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[2] "A Report On The Special Account With Options For Future Actions," dated 11/17/87. This document reviews:
- (i) The legislative history that calls for the creation of Special Accounts;
- (ii) Mission and Agency policies and objectives in allocating Special Account resources through 1987; and,
- (iii) Recommends a course of action given the 1987 Supplemental Guidance.

[3] (1) "Study of Accounting and Internal Control Systems of Egypt Agents," by E.H. Gustman, CPA, issued November 13, 1984;
(2) "Utilization of Special account Funds in Support of USAID Projects," dated June 2, 1988, by Daniel

The first MOU to reflect this decision was signed in August 1988, whereby the Mission agreed to transfer the majority of the funds in the Special Account to the GOE as budget support. The Mission's rationale was documented in Mission files[4]. After questions were raised by the Regional Inspector General for Audit, Cairo, in a series of memos in late 1988, the Mission's decision was endorsed by the DAA/ANE[5]. It should be noted that at the time the DAA/ANE endorsed the Mission's 1988 decision to provide budget support, he was aware of the magnitude of the funds being programmed in this manner, based on information provided by the Mission in Cairo 6152.

We further note here that the Inspector General (IG) formally communicated his disagreement with the Mission's decision to the AA/ANE in his May 1989 memo closing audit recommendations issued under Report No. 6-263-87-09. Thus, the IG is already on record with its opposition to a budget support approach in programming local currency.

Leaty, a Mission employee;
(3) "The 1988/89 Government of Egypt Budget," dated July 26, 1988, by William F. Fox, Professor of Economics, University of Tennessee, and,
(4) Other internal Mission documents.

[4] See following:
(1) See Footnote # 2.
(2) Cairo 6152, from the Director to AA/ANE, C. Adelman, DAA/ANE W. Fuller, DAA/PPC G. Laudato, and ANE/EE R. Brown.
(3) The rationale was also communicated to the auditors in the following memoranda titled, "USAID's Rationale for Special Account Support of the GOE's Budget:
(i) Brown/Kalhammer, of October 26, 1988;
(ii) Kalhammer/Brown, of November 1, 1988; and
(iii) Brown/Kalhammer, of November 20, 1988.

[5] Memorandum dated April 24/1989, from William P. Fuller, DAA/ANE to George A. Laudato, DAA/PPC, titled, "Local currency Issues in Egypt."

III. THE CURRENT "HYBRID" APPROACH.

The 1991 guidance, recast the 1987 guidance and established new accountability criteria. The Mission was required to review the local currency programming options[6] which were: (1) Specific Sector Support (ie., investing in developmentally sound projects a la the 1987 guidance); (2) General Sector Support; and (3) General Budget Support. (The latter two were lumped together as "program support" in the 1987 guidance). The 1991 clarifications of General Sector Support and General Budget Support also reaffirmed the Mission's earlier conclusions that a pure form of General Sector Support was not possible given the nature of the GOE budgetary and accountability system. In short, the nature of this process precludes the ability to track specific resources from the Ministry of Finance's General Revenue Account (through which Special Account resources flow) to specific end-user Ministries. This was outlined in an internal Mission memorandum dated January 11, 1989 titled "U.S. Budgetary Support to GOE for Fiscal Year 1988/89. Current Status and Utilization". This memorandum stated:

> "Based on the brief description provided above on the GOE budgetary system as provided in GOE Law No. 127/1981 and as discussed with MOF officials during the referenced meeting, the L.E. 350 million budgetary support to the GOE fiscal year 1988/1989 is not traceable beyond the stage of funds deposit into the State current revenue account."

This point was recognized by the Inspector General himself in his memorandum to the AA/NE in April 1989, regarding the closure of three recommendations issued under the 1987 Audit Report # 6-263-87-09. The IG stated:

> "What concerns me with USAID/Egypt's course of action is the auditors' finding that funds from the Special Account cannot be tracked to the sectors ("developmental ministries") supposedly benefitted by releases from the Special Account, ..."

The IG's conclusion supports our own contention that it is not

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[6] As local currency held in trust by the Mission is basically excluded from both the 1987 and 1991 Guidance, they are not discussed here.

feasible to describe the Mission's approach as one of pure General Sector Support.

The General Budget Support option remains the preferred mode of local currency programming given the GOE's current economic reform programs negotiated with the IMF and World bank following the Gulf War. And USAID's staffing levels have been reduced from 128 to 98 persons, with further reductions expected in the future.

While it is not possible to track specific resource flows from the General Revenue Account because of the nature of the GOE budgetary system, the Mission determined that there was, nevertheless, political and psychological value to naming the development ministries eligible to receive budget support from the Special Account. First of all, under an economic reform regime which calls for reduced budget deficits, virtually all GOE agency budgets can be expected to suffer. It was in USAID's interest, as well as in the interests of the affected agencies themselves, for the Mission to send a political signal to the Ministry of Finance (the agency which determines budget resource flows) that development agencies of the government should not be excessively penalized by a deficit reduction compared to other agencies such as the ministries of Defence and Interior. The naming of specific agencies in the MOU or in other Mission documentation was not intended to shift to the programming mode of General Sector Support, per se. Rather it was to guarantee that a <u>minimum</u> level of resources would continue to flow to the affected ministries in a time of overall budget stringency. A simple review of the annual budgets of those eligible agencies would indicate that their actual budgets far exceeded what was provided to them from the Special Account, via the General Revenue Account.

Although one may question whether these resources were "additive" to the affected agency budgets, implying thereby that a greater monitoring role is necessary to track the specific transfer of these resources, we believe this issue is largely irrelevant since it is impossible to track these resources. Further, we cannot know what those agencies would have received in their annual budgets in the absence of Special Account resources provided under the MOU. What we can say with certainty is that the Ministry of Finance (MOF) has an expectation that a specific overall level of resources will be provided and that this expectation is figured into the calculation of the GOE budget in any given year. Its ability to count on these resources allows it to meet important development objectives in a non-inflationary manner (ie.,without printing money) while meeting expected deficit reduction targets.

Although we are describing our approach to the programming of local currency as a "hybrid" of General Budget Support, incorporating some aspects of General Sector Support, the Mission does not believe that this approach requires a level of monitoring or accountability beyond that which is required for General Budget Support. Once again, the actual amounts transferred from the General Revenue Account to the ministries represent only a portion of their total budgets. Our experience with the GOE since 1978 (in addition to frequent assessments of institutional capacity) has given us the confidence we need to conclude that the Government has satisfactory systems in place to program both U.S. dollar and local currency resources. This is addressed in more detail in the next section of this response.

Furthermore, after the Mission concluded that the MOF was able to meet the new accountability standards called for by the 1991 guidance, the intention to program local currencies generated through general budget support was articulated in the Mission's request to the AA/NE to re-delegate the FY 93 Cash Transfer Program PAAD authorization to the Mission[7].

Cairo 12474 described the FY 93 Cash Transfer Program and explained that local currency generated would be used to provide general budget support. Based on the AA/ANE approval of the Mission's Cash Transfer Program[8], the Mission moved forward to implement it. Although the auditors have indicated that AA/ANE approval was required for the Mission to program local currency as general budget support, the Mission determined that the PAAD approval, in conjunction with the USAID/Egypt Director's Delegation of Authority No. 653, dated January 22, 1985 (DOA 653), enabled the USAID/Egypt Director to move forward and program the local currency as general budget support without obtaining a separate AA/ANE approval on this programming issue.

IV. USAID/EGYPT'S ASSESSMENT PROCESS

We disagree with the conclusion of the draft audit report which

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[7] Cairo 12474, dated July 14, 1992.

[8] Action Memorandum signed by the AA/NE, dated August 14, 1992.

states that "USAID/Egypt's General Assessment did not provide crucial information", or that "USAID/Egypt's 1992 assessment did not reach conclusions regarding the various local currency programming options as required by the guidance." The Mission's assessment of GOE capabilities is a continuing process rather than a single event or document that is prepared solely at a particular point in time. For example in 1990, the Mission's Economic Support Directorate prepared a report on the GOE budget process which incorporated many studies conducted by the Mission since 1987. This report explained the GOE budgetary system, including the operations of the GOE's General Revenue Account. From 1990-1991, the Mission analyzed the new guidance[9], and once again reviewed what it already knew about the GOE budgetary process, based on the lengthy evaluative process which began in 1987.

USAID's ongoing "assessment process" was internal (the guidance calls this "informal"). The Mission's review was augmented by an independent review conducted by a CPA[10] to provide the Mission with the additional assurances it needed as to the overall GOE accountability environment.

During our ongoing assessment process, which considered the work done from 1987 to 1992, USAID in effect reviewed and assessed all of the programming options stated in the 1991 guidance and determined in 1991, that the only feasible option was for the Mission to continue providing general budget support, albeit a hybrid thereof.

The auditor's characterization of the assessment conducted by the CPA firm as the Mission's "1992 General Assessment" (while ignoring the complete body of analysis that has been undertaken since 1987) is therefore misleading and does not

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[9] (1) Note to Director from the Associate Director for Financial Management, dated December 10, 1990, providing detailed history and information regarding the Agency's local currency programming requirements; and

(2) "USAID Special Account Local currency Resources; Law and Policy," dated December 12, 1991, by Ted Carter, the Mission's Legal Advisor.

[10] Report titled, "General Assessment of Managing Host Country-Owned Local Currency," issued by Shawki & Co., on October 27, 1992.

account for all the information the Mission has at hand in making decisions about the programming of local currency.

Specific assessment findings relating to sections of the 1991 guidance are as follows:

A. Management of the Special Account.

The management of the Special Account is covered by Section 5.0 of the guidance and it basically deals with the process of deposit and withdrawal from the Special Account. With respect to deposits into the Special Account following their generation by under the CIP and Cash Transfer programs, the Mission determined that the GOE had developed and implemented internal control procedures which ensure that these funds are properly accounted for. The Regional Inspector General for Audit also audited this function and found the systems to be adequate.

There usually are less than ten withdrawals from the Special Account each year. All funds withdrawn from this account, with the exception of the funds provided to AID in trust, are deposited into the General Revenue Fund of the GOE, under the rubric of General Budget Support. USAID is notified of all disbursements from the Special Account and provided copies of bank statements. Routine Special Account reconciliations are performed by USAID.

Based on the above, the Mission assessed the MOF's ability to meet the requirements of Section 5.0 of the 1991 guidance, as satisfactory.

As we were not contemplating the use of Special Account resources to support local currency projects (other than funds held in trust by USAID/Egypt), there was no need or requirement (see Para 5.1.A of the Operational Guidance) to assess the MOF's ability to arrange and/or perform financial assessments or audits of recipient organizations.

B. Accountability Guidelines.

These are stated in Section 6.0 of the 1991 guidance.
The guidance calls for standards of accountability when the budget support programming option is used as measured by evidence of a "rational budgetary allocation and expenditure system, adequate to report both budget allocations and expenditures from the general fund, with built in controls to prevent fraud or

diversion of funds." The bases for Egypt's budgetary allocation and expenditure systems are its Budget Law, under which the Government aims to achieve specific targets within its general economic and social plan and Law No. 127 enacted in 1981, titled, "Government Accounting and Implementation Procedures." All GOE entities that receive funds from the GOE's general revenue fund are required to adhere to this law.

Once again, from 1987 to 1992 the Mission assessed the GOE's overall budget allocation process including assessments of the financial and contracting capabilities of 13 GOE implementing agencies which received budgetary allocations from the General Revenue Account Fund for host country contributions to AID financed projects. These assessments, conducted by local CPA firms including Price Waterhouse, concluded repeatedly that these agencies followed the rules and regulations contained in Law No. 127 of 1981; and, that Law 127-based procedures and internal control systems provided adequate control over millions of L.E. funds provided through the GOE's budget process. The Mission reasonably concluded that the same budgetary systems which govern the allocation of host country project contributions (which are nothing more than budgetary allocations under another name) are operative in the use of budgetary allocations from the General Revenue Account for other purposes.

Finally, the Mission contracted with still another local CPA firm to provide further assurances. The Shawki & Co report issued on October 27, 1992, corroborated the findings of earlier assessments. This assessment confirmed that GOE Law 127 was being followed by the ministries that received host-country counterpart funds from the GOE's general revenue fund, and, that the GOE's budgeting and financial administration and management systems provide adequate internal management and accounting control over GOE assets.

Based on the above, we concluded, with a reasonable degree of confidence, as required by the guidance that (1) the GOE's budgetary allocation process stems from established priorities ; (2) is rational; and, (3) provides reasonable assurance that funds once disbursed from the Special Account will be used for its intended purpose.

V. <u>RESPONSE TO AUDIT RECOMMENDATIONS.</u>

Based on the foregoing, the Mission's response to the specific recommendations in the audit follows.

Recommendation #1: We recommend that USAID/Egypt, conduct an assessment of the GOE accountability environment - as required by USAID policy and supplemental guidance - to be used for fiscal year 1994 programming, and as the basis for specific assessments of local currency programming options in the future Program Assistance Approval Documents (PAADs).

We disagree with this recommendation, finding it unnecessary. Quite apart from ignoring the Mission's experience in programming and monitoring U.S. dollar resources in Egypt (with the same GOE agencies responsible for local currency) for the past 14 years, the audit also ignores the fact that the Mission has been engaged in an ongoing comprehensive assessment process that addresses the key points the auditor's have identified in their report. An additional assessment will serve no purpose other than to occupy scarce staff time and financial resources on a redundant exercise.

Recommendation #2: We recommend that USAID/Egypt prepare specific assessments of local currency programming alternatives available to the Mission in accordance with Section 2.2 and 2.5 of USAID 1991 Supplemental Guidance.

We do not agree with this recommendation. As we have stated in our response to Recommendation # 1, the Mission has already performed assessments that meet the requirements of the 1991 operational guidance.

Recommendation #3: We recommend that USAID/Egypt amend existing agreements used to generate local currency to reflect the results of the specific assessment and also include provisions requiring audits and measurement of the impact of local currency programs.

We disagree with this recommendation. As stated in our response to Recommendation #1, we have performed assessments that identified and evaluated the various programming options. We shall however, ensure that the Mission's program documents clearly identify the Mission's hybrid approach to the programming of local currency resources.

This recommendation also addresses the issue of impact measurement. The Mission believes that "impact" has little meaning at the level of General Budget Support, other than to provide evidence that such support has been provided. This is done on a routine basis. The Mission does not believe that any meaningful evidence of impact can be provided on the General

Sector Support element of the programming hybrid given the nature of the GOE budgetary process, as described above, other than to insure that affected ministry budgets do not fall below the total amounts provided to the Ministry of Finance on an annual basis. However, we suggest that it would be appropriate to look at the impact on the budget deficit of our U.S. dollar-funded Sector Policy Reform Program which supports specific deficit reduction measures as a complement to our efforts with local currency.

VI. ASPECTS OF THE AUDIT.

This audit was conducted in a sporadic fashion over a long period of time leading to some confusion within the Mission as to what was being audited. Indeed, a Discussion Paper issued by the RIG on September 30, 1993, which followed closely upon the heels of the actual audit field-work, presented conclusions which belie the findings of the current draft audit report, to wit:

> "USAID/Egypt assessed the accountability environment for the Government of Egypt as required by A.I.D. policy and supplemental guidance." And,

> "We conclude that USAID/Egypt complied with A.I.D.'s guidance to assess the Government of Egypt's accountability environment and to use that assessment in the authorization of programs that result in local currency."

Because of these findings the Mission saw no need to discuss the assessment process at the audit exit conference which was held on October 18, 1993. Subsequently, the RIG/A/C revised its entire audit reversing its earlier conclusion about the GOE accountability environment. We find the long period between the exit conference and the issuance of the draft final audit to be unusual, particularly since the reversal of its findings was not based on meaningful exchanges in the interim. During this period, the Mission was contacted only three times by the auditors on issues which gave no indication that such a drastic reversal was being contemplated. We believe this led to erroneous conclusions by the auditors on the questions of the assessment process and the GOE accountability environment.

Annex 1

11/17/87
"A Report On The Special Account With Options For Future Actions," dated 11/17/87. This document reviews the legislative history that called for the creation of Special Accounts, reviews Mission and Agency policies and objectives in allocating Special Accounts resources through 1987, and reviews new options given the issuance of the 1987 Supplemental Guidance and recommends a course of action for the Mission to take.

04/19/88
"Economic Impacts of Special Account Uses," a memorandum to the Director by the Mission economist, dated April 19, 1988.

06/02/88
"Utilization of Special Account Funds in Support of USAID Projects," dated June 2, 1988, by Daniel Leaty, of the Mission's Program Office.

07/26/88
"The 1988/89 Government Of Egypt Budget," William F. Fox, Professor of Economics, University of Tennessee, Knoxwille, dated July 26, 1988.

10/04/88
"The Egyptian Government Budget and the Special Account," by the Mission's Economist dated 10/4/88.

10/14/88
Vivikka Molldrem memo to the files dated 10/14/88, regarding USAID/Cairo's Use of the Special Account for Budgetary Support.

10/26/88
"USAID's Rationale for Special Account Support of the GOE's Budget," a memorandum dated October 26, 1988, from the Mission Director to the Regional Inspector General for Audit, Cairo.

11/01/88
"USAID's Rationale for Special Account Support of the GOE's Budget," a memorandum dated November 1, 1988, from the Regional Inspector General for Audit, Cairo to the Mission Director.

11/20/88
"Your Memo of November 1 concerning the Mission's Rationale for Special Account Support for the GOE's Budget," a memorandum dated November 20, 1988, from the Mission Director to the Regional Inspector General for Audit, Cairo.

<u>01/11/89</u>
"U.S. Budgetary Support to GOE for Fiscal Year 1988/1989. Current Status and Utilization," a memorandum to the Associate Director for Financial Management, dated January 11, 1989, by Mohamed A. Mounir, Mission Financial Analyst.

<u>03/07/89</u>
"LE. 350 Million Budgetary Support to GOE for Fiscal Year 1988/1989," a memorandum to the Associate Director for Financial Management, dated March 7, 1989, by Matta G. Matta, a Mission Financial Analyst.

<u>03/15/89</u>
"Programming of Host Country-Owned Local Currency - RIG/A/C Follow-Up on Open Recommendations - Special Account Controls in Egypt," Cairo 6152 dated March 15, 1989, from the Mission Director to AA/ANE C. Adelman, DAA/ANE W. Fuller, DAA/PPC G. Laudato and ANE/EE R Brown.

<u>04/24/89</u>
"Local Currency Issues in Egypt," dated April 24, 1989, a memo from William P. Fuller, DAA/ANE to George A. Laudato, DAA/PPC.

<u>05/15/89</u>
"Unresolved Recommendations - Audit of USAID/Egypt Controls over the Special Account (Report No. 6-263-87-09, June 25, 1987)," a memorandum for AA/ANE, Carol Adelman, by the Inspector General, Herbert L. Beckington.

<u>08/15/89</u>
"Progress on Special Account Allocations and General Funding," a memorandum to the Associate Director for Program Development and Support, dated August 15, 1989, by David DuLavey, a Mission Program officer.

<u>11/09/89</u>
"Programming and Monitoring Local Currency," a memorandum, dated November 9, 1989, by Brian Miller, the Associate Director for Legal Affairs.

<u>06/19/90</u>
"The GOE Budget," dated June 19, 1990, by Sahar Mishriki, a Mission Economist.

1991 - 1992

Assessments of 13 GOE implementing Agencies conducted by various Local CPA firms, including Price Waterhouse and Co. These implementing agencies provide millions of Egyptian pounds programmed and appropriated through the GOE budget process and accounted for under GOE Law 27 of 1981. These assessments have concluded that:

(1) Law 27 encompass sound internal and administrative control procedures; and

(2) That this Law was followed by these implementing agencies in accounting for these GOE resources that flow through the MOF's general revenue fund.

12/10/90

A "Note to the Director," dated December 10, 1990, by the Associate Director for Financial Management, which provides a historical record and information on key new developments in the area of local currency programming and accountability.

12/12/91

"USAID Special Account Local Currency Resources; Law and Policy," a memorandum to the Director, dated December 12, 1991, by Ted Carter, the Associate Director for Legal Affairs.

APPENDIX III

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