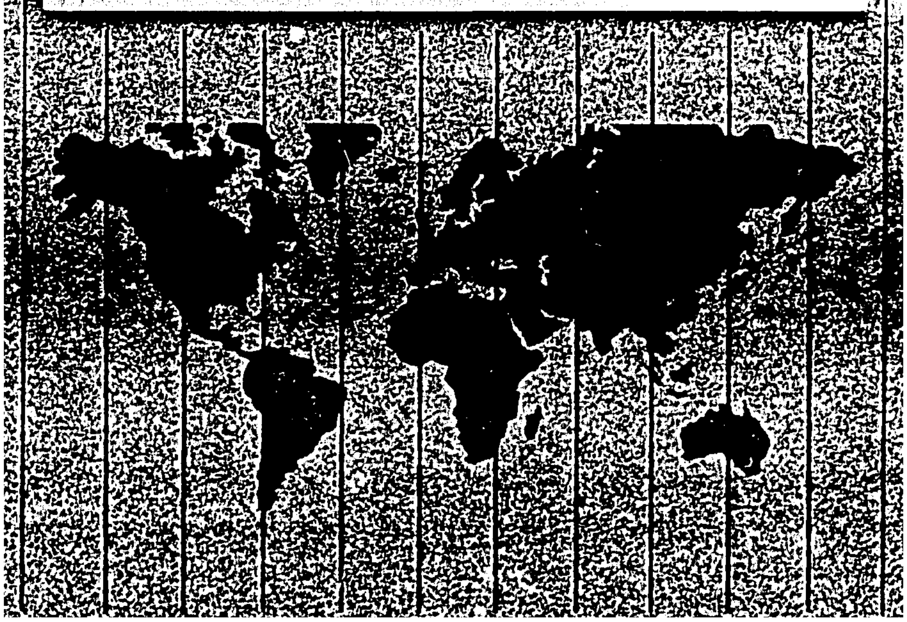
UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE INSPECTOR GENERAL

AN AUDIT OF THE SUEZ CEMENT COMPANY PROJECT NO.263-0012

Audit Report No.6-263-82-2

November 29, 1981



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The project is a $185 million undertaking to design and contract a cement plant for the Suez Cement Company capable of producing 1 million tons of cement per year. AID granted up to $100 million to cover foreign exchange costs. The balance of funding was provided by GOE public sector companies and private investors.

Initial estimates of project costs were too low, and four years after the initial agreement, AID provided an addition $10 million grant to complete the project and borrowings had to be restructured to maintain the company's viability. Also, USAID monitoring of agents' commissions, fixed fees, use of equipment, and SCC accounting for GOE reloans needs to be improved.

The report includes 12 recommendations.

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EXECUTIVE SUMMARY

Introduction

On July 31, 1976, AID granted the GOE up to $90 million (Grant No.263-0012) for the design and construction of a cement plant. On September 28, 1980, the grant was amended, increasing the total to $100 million. Estimated total cost of the project at September 28, 1980 was about $185 million including local currency costs.

The Suez Cement Company (SCC), a joint stock company, is the owner of the project financed cement plant. The Company's shares are owned by both public sector banks and companies (79 percent) and private investors (21 percent). Project financing in addition to the AID grant is generated by sales of shares and public sector borrowings.

The largest single dollar procurement is the cement production line equipment from the Fuller Company, Bethlehem, Pennsylvania. This procurement will total about $70 million. Supplementary equipment for the quarries, workshop and laboratory has been procured from various equipment suppliers in the United States. H.K. Ferguson International (HKFI) of Cleveland, Ohio, is the consulting engineering firm. The civil work is being done under contract by Egyptian construction companies.

Audit Purpose and Scope

This is the initial audit of the project. Our objectives were to evaluate the efficiency, economy, and effectiveness with which financial, program and management responsibilities were carried out. We visited the plant site, reviewed USAID, Suez Cement Company and contractor documentation and discussed our findings with AID, GOE and contractor officials.

Project Planning

Project costs, especially local currency costs, were substantially understated in project planning documents. AID subsequently provided an additional $10 million for the project and the original terms of the GOE's subgrant and subloan to the SCC had to be liberalized to maintain SCC's viability. Project paper estimates of cement plant costs were

LE 22.9 million* plus $78.7 million. The project paper was revised in April 1980 and estimated costs of LE57.4 million and $89.4 million. This significant increase in cement plant cost increased the SCC's debt: equity ratio to a point where SCC debt had to be rescheduled, interest rates had to be reduced, and additional AID grant funds had to be provided to maintain SCC viability. The $64.9 million GOE reloan of grant funds was extended from 15 to 22 years with a 10 year grace period. Interest was waived during the grace period providing relief equivalent to $100 million. Funds from the additional $10 million AID grant were subgranted to finance additional equipment and consultant's contract costs.

The private stockholders (21 percent of the capital stock) shared in the benefits of the debt restructuring and subgranting of AID funds to SCC. We believe that action is needed to assure that private stockholders do not unduly benefit from the AID funds provided to the SCC through GOE subgrants and reloans. (Page 6)

Agents' Commissions

The equipment supplier's contract required that all local costs were to be paid in Egyptian currency. The supplier certified to AID, however, that $71,429 of the approximately $657,000 in commissions paid to Egyptian firms was paid in dollars. (Page 10)

Within Egypt Transportation Costs

AID grant funds were used to pay about $400,000 of within Egypt transportation costs, although the AID grant funds were to be used to finance foreign exchange costs. Practically all of the AID-financed equipment was purchased on a cost-insurance-freight (CIF) basis with ocean bills of lading to Port Suez, which is near the plant site. However, AID approved an arrangement whereby shipments were offloaded in Alexandria or Port Said and trucked to the project site. About $400,000 paid as

* LE is the symbol for Egyptian Pounds. The exchange rate at September 30, 1981 was about LE.84 : $1.00.

foreign exchange costs under ocean bills of lading was in reality paid for local trucking costs. (Page 11)

Consultant's Fixed Fee

The consultant's fixed fee was increased by $185,000, based on an extension of the term of the contract and the number of person-months of service to be provided. At the same time the scope of the contract was amended to eliminate a requirement to train personnel. In effect scope of services decreased and the fee increased. The dollar budget of the original contract was $6.376 million, including a $650,000 fixed fee. The contract was amended to provide for a 15 month extension and a budget increase to $7.923 million which included a fixed fee of $835,000. The increase in fixed fee was directly related to the additional time required to carry out the original contract. Scope of work did not increase. (Page 12)

Consultant's Equipment

SCC has diverted for its own use 8 vehicles and 17 air-conditioners which were procured for use by the consultant. Also, the SCC plans to procure a $65,000 computer through the consulting contract although the consultant does not need this piece of equipment. (Page 15)

Other Matters

Construction of the cement plant was about 2 years behind schedule. As a result, warranties on $11 million of quarry equipment, shipped to Egypt and paid for, may expire before the equipment is assembled and used. (Page 18) Also, payments to quarry equipment suppliers included payment for services to supervise equipment assembly and train personnel. These services had not yet been provided because of cement plant construction delays. (Page 19)

Of the three parties to the project, (SCC, GOE, AID), the SCC maintains the only detailed expenditure records. We found that SCC records understated its loan liability by the equivalent of about $6 million. (Page 17)

Recommendations

The report contains 12 recommendations.

INTRODUCTION

Background

Project Description - On July 31, 1976, AID granted the GOE $90.0 million (Grant No. 263-0012) to cover the dollar costs of a project for the design and erection of a Portland cement plant capable of producing one million tons of cement per year. The plant site is near the city of Suez. On September 28, 1980, $10 million was added to the grant raising it to $100 million. Estimated total project cost at September 28, 1980 was $103.4 million, plus LE 57.4 million.*

The project is being implemented by the Suez Cement Company (SCC) which will own and operate the plant when it is completed. The SCC is a joint stock company formed in 1977. Ownership of the SCC stock is as follows:

	Percent
The four existing GOE owned cement companies	34
Public sector banks and insurance companies	45
Private stockholders	21
Total	100

Although the majority of the stock is owned by four existing cement companies and by banks and insurance companies, all of which are government-owned, determination of dividends will be made under the advantageous terms of the Egyptian law governing private sector companies.

Project Justification - The project was justified on the basis of a projected demand for cement of eight million tons in 1981, increasing to ten million tons in 1984. In 1976, annual production capacity in Egypt was 3.8 million tons, all from Government-owned plants. The planned expansion of the cement industry included increasing the production capacity of the existing companies to 5.8 million tons per year and building several new plants with a combined annual capacity of 4.2 million tons. This total production capacity of 10 million tons was planned to be achieved by 1984.

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* At the time of our audit the official rate of exchange was LE.70: $1.00. Prior to issuance of this report the official rate was changed to about LE.84:$1.00.

On June 2, 1976, the GOE through its Ministry of Economy and Economic Cooperation, requested AID financial assistance in building a new cement plant proposed for the Suez area.

Project Implementation - The project was being implemented by firms under contract to the SCC. H.K. Ferguson International (HKFI) provided consulting engineering services. The Fuller Company contracted to provide detailed plant engineering, supply cement production line equipment and provide training in plant operation and maintenance. Most specialized consulting services for the construction and erection of the facilities were subcontracted by HKFI to U.S. and Egyptian engineering firms. The civil construction was contracted to Egyptian construction companies. The status of the initial $90 million grant was:

L/Comm No.	Purpose	Amount
1201	Finance the H.K. Ferguson consulting contract	$ 6,400,000
1202	Finance the Fuller Company contract	65,242,954
1203*	Commodities from Abbott Power Corp.	187,359
1204*	Commodities from Wm. S. Lane, Inc.	167,642
1205*	Commodities from Gen. Cable Corp.	85,192
1206*	Commodities from Peerless Pump	14,168
1207	Quarry equipment	10,900,000
1208	Workshop equipment	1,809,345
1209	Laboratory equipment	502,500
1210	Finance the electric transmission line	4,578,480
		$ 89,887,640

* Direct L/Comms paid out of AID/W. Others are bank L/Comms.

The $10 million increase in the AID grant in September 1980 provided for additional consulting engineering services, equipment escalation costs and additional funds for the electric transmission line.

Construction of the plant was about two years behind schedule because the Egyptian prime contractor was unable to maintain the construction schedule for the civil works.

The Quattamia Cement Plant - In addition to the Suez Cement plant, the SCC was undertaking to build a second cement plant to be located along the Quattamia Road. The Quattamia plant was planned for an annual capacity of about 1.4 million tons at an estimated cost equivalent to $267 million. AID has committed $95.0 million to the project under Loan No. 263-K-051. The SCC has increased its authorized capital stock from LE 16.0 million (4.0 million shares) to LE 56.0 million (14.0 million shares) to provide additional capital for the Quattamia plant.

This report, discusses the capitalization of the SCC only as it pertains to the Suez Cement plant. To show the total capitalization of the company, we have included a schedule of the estimated costs and sources of funds for each of the two plants (See Exhibit B).

Audit Purpose and Scope

This was our initial audit of the Suez Cement Company Project, AID Grant No. 263-0012. Our objectives were to evaluate the efficiency, economy and effectiveness with which financial, management, and program responsibilities were carried out. Specifically, to determine if (a) the GOE and Suez Cement Company were fulfilling their obligations as required in the Grant Agreement and various subagreements; (b) there was compliance with the various laws, regulations, policies, covenants; (c) the project was meeting the objectives stated in the Project Paper and Agreement with the GOE; and (d) the USAID's monitoring of project activities was adequate.

Although there were problems in the implementation of the project and the estimated completed date had been extended by two years, we excluded this area from our in-depth review because during our initial survey, we concluded that the USAID is well aware of the implementation problems. Information provided by the consulting engineering firm's monthly progress reports, USAID officials' frequent contacts with the SCC and consulting firm, and periodic site visits have kept USAID management well informed regarding implementation problems.

We audited the project during the period December 1980-March 1981 and we covered project activities from inception through March 1981.

Management Comments

During the course of the audit, we provided records of audit finding (RAF) to the USAID on our major audit findings. We submitted a draft audit report to the USAID on May 5, 1981, and on May 27, 1981, we held an exit conference with the USAID Director, Deputy Director, Controller, and alternate project officer. A representative of AID/W's Bureau for Near East also attended. On June 8, 1981, we received the USAID's response to our draft audit report.

The USAID's written responses to our records of audit findings and to the draft report were considered in the preparation of this report.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Project Financial Planning

The project costs, especially the local currency costs, were substantially understated in the project planning documents. AID subsequently provided an additional $10 million for the project and the original terms of the GOE's subgrant and subloan to the SCC were liberalized to maintain the viability of the company.

Local cost estimates

A February 1976 Feasibility Study Report and a June 1976 AID Project Paper were the basis for the decision to implement the project.

As shown by the following schedule, there is a wide disparity in the local currency cost estimates contained in the planning documents when compared with later cost estimates; although all of these estimates were based on a project of the same size and scope.

					Estimated Costs	
					LE	$
					(000 Omitted)	
A.	Feasibility Study Report	-	February	1976	16,000	72,500
B.	AID Project Paper	-	June	1976	22,893	78,700
C.	Consultant's Report	-	October	1977	52,769	103,599
D.	SCC Report	-	November	1977	27,100	87,901
E.	Revised Project Paper	-	April	1980	57,378	87,072
F.	Consultant's Report		November	1980	71,668	89,410

Following is a brief discussion of the cost estimates, Exhibit A presents the estimates in comparative form with some additional details.

<u>The Feasibility Study Report</u> was prepared by the Arab Swiss Engineering Company (ASEC). According to this report, SCC would obtain the LE16.0 million needed for local costs from the sale of capital stock. Foreign currency would be a loan from the GOE out of the proceeds of an AID grant, repayable in local currency. The report used the official rate of LE0.40 = $1.00, so the $72.5 million foreign currency requirement equated to LE29.0 million.

According to the USAID, the original local cost estimates were arrived at by taking accepted capital cost per metric ton factors, subtracting known foreign exchange costs and then converting the remainder from foreign exchange to Egyptian Pounds at the official rate rather than the more realistic market rate. Thus the local construction costs were underestimated by a ratio of 70 to 39.

At the time ASEC carried out the feasibility study, the four existing cement companies, which were subsequently among the founders of the SCC, owned controlling interest in ASEC. Also, SCC subsequently became a stockholder in ASEC, purchasing 10.2 percent of its capital shares. During project implementation, ASEC was awarded a subcontract by SCC's consulting engineering firm.

<u>The Project Paper</u> estimated local currency requirements at about LE22.9 million. This LE6.9 million increase over the amount in the Feasibility Study Report was primarily for; LE4.1 million for loan interest during the construction period, LE0.8 million for the Egyptian Pound cost for SCC's U.S. consultant and LE1.7 million for working capital.

The Project Paper showed that the local currency would be obtained from the sale of stock and from bank loans. The dollars would come from the $90.0 million AID grant of which about $65 million would be reloaned by the GOE to the SCC. Both the AID grant agreement with the GOE and the AID project agreement with the SCC contained a special covenant which was in conflict with the Project Paper financial plan. The covenant prohibited the SCC from incurring any long-term debt in excess of 200 percent of its net worth. The financial plan in the Project Paper, however, showed that long-term borrowing equivalent to LE 37.6 million was needed to complete the project. This amounted to 235 percent of the SCC's LE16.0 million proposed net worth (37.6 - 16.0).

The Consultant's Report of October 1977 was prepared by SCC's engineering consultant, H.K. Ferguson International (HKFI). (The estimate dollar costs of $103.6 million were high because $11.0 million for the civil construction was included. These civil construction costs did not materialize.) The consultant's local currency cost estimate was about two and one-half times the estimate in the Project Paper and more than three times the estimate in the Feasibility Study Report although HKFI's Report was prepared only about a year and a half after the other reports. SCC reviewed the Consultant's Report and made material downward adjustments to the HKFI estimate.

The SCC Report of November 1977 was presented to the USAID by SCC on November 17, 1977, with a request for additional assistance, i.e.;

- a $10 million grant to cover additional dollar costs of the project;

- a reduction in the rate of interest on the GOE reloan of $64.9 million from 10 percent to 6 percent; and,

- setting an exchange rate for the repayment of the $64.9 million reloan at LE0.39 = $1.00.

The Revised Project Paper of April 1980 recommended authorization of an additional $10.0 million grant. The estimate of increased dollar costs was attributed to an approximate two-year delay in project implementation and higher than expected inflation. Local currency costs increased from LE22.9 million in the original Project Paper to LE57.4 million in the Revised Project Paper. The reasons for this LE34.5 million increase in local currency costs to the SCC were not discussed in the Revised Project Paper. Nor, was there any mention of this increase in the Action Memorandum for the Administrator dated May 22, 1980, requesting the $10.0 million add-on to the Grant.

The Consultant's Report of November 1980 prepared by HKFI, was the most current estimate of the costs to the SCC at the time we completed our audit work. This report attributed cost increases of $3.272 million and LE18.817 million to a 10-month delay in completion of the project; from November 1981 to August 1982.

In response to our Record of Audit Finding, the USAID states that:

> "The original local cost estimates in the Project Paper were LE27.887 million minus LE4.994 million for power and water for the plant, leaving a net of LE22.893, as reported in RAF #3. We agree that these estimates have proven to be low.
>
> "Prior to the authorization of the Suez Cement Plant on June 30, 1976, USAID did contract with Dames and Moore to prepare (confirm) the mining plan for limestone and clay deposits for the Suez Cement Plant. The final report for this effort was delivered by Dames and Moore on June 12, 1976 in accordance with their Contract No. AID/otr-C-1304, Work Order No. 3 dated February 27, 1976.
>
> "On the other hand, we can find no indication in the files that the LE civil construction and erection costs of the project estimated by Arab-Swiss Engineering Co. were reconfirmed by any AID-financed consultant. In researching this with SCC we found that the original local cost estimates were arrived at by taking accepted capital cost per metric ton factors, substracting the known FX cost and then converting the remainder from FX to LE at the official rate. Thus, the local construction costs were underestimated by a ratio of 70 to 39."

We concluded that (a) the Feasibility Study was prepared by a firm which would benefit from the project and (b) because of this firm's interest in the project, the USAID review should have been more thorough. The underestimate in the Feasibility Study of the local currency construction costs by a ratio of 70:39, for example, should have surfaced. The underestimate of the project costs was a primary reason for subsequent financial problems with the project.

Suez Cement Company Capital Structure

The feasibility study report estimated that the project would cost the equivalent of LE45.0 million and that sales of LE16.0 million of capital stock would justify long-term borrowing of the balance of LE29.0 million. Four million capital shares were subsequently offered at LE4 each for a total of LE16.0 million. The projected debt to equity ratio (LE29.0 million to LE16.0 million) of about 1.8 to 1.0 was high but reasonable, considering that the GOE would be the lender. The original estimates, however, proved to be unreasonably low. The November 1981 consultants' report estimate was LE71.7 million, plus $89.410 million. Therefore, the SCC, which was capitalized as a business costing the equivalent of LE45.0 million, must capitalize a business costing the equivalent of LE134.3 million.

Terms of the initial agreements have been softened. The following schedule shows the distribution of the AID grant:

Subgrant to Electrical Authority	$5.8	
Subgrant to Public Cement Companies (To purchase stock in SCC. Equivalent to LE5.4 million in capital stock)	7.7	
Total Subgrants to Govt-Owned Companies		$ 13.5
Subgrant to SCC (Windfall to SCC due to $13.8 million subgranted for public cement companies capital stock in SCC but only $7.7 million utilized for stock purchase)	$6.1	
Subgrant to SCC (For consulting services. Not being capitalized by SCC)	10.0	
Subgrant to SCC (For equivalent cost escalation)	5.5	
Reloan to SCC (Repayable in LE, 10% annual interest. Amended terms provide for repayment in 22 years with 10-year grace period. Interest is waived during grace period.)	64.9	
Total Subgrants & Reloan to SCC		86.5
Total Amount of AID Grant		$100.0

The 64.9 million GOE reloan was amended, effective November 18, 1980, to (1) extend the repayment period from 15 to 22 years; (2) provide for a grace period of 10 years for the repayment of principal; and, (3) waive the interest for the 10-year grace period. The relief from the interest payable will, as a result, exceed the equivalent of $100 million. Although a major portion of the SCC stock is owned by GOE entities, nearly 21 percent is owned by private investors. Therefore, 21 percent of the money granted to the SCC and 21 percent of the benefits to the SCC from the softening of loan terms is a benefit to the private shareholders of the company. The following schedule shows the purchased equity and the ownership of the company:

Stockholders	Capital Stock Purchased			
	No. of Shares	Percent of Total	Cost in LE	Dollar Equiv.
			(in millions)	
Cement Companies	1,350,000	33.75%	5.4	7.7
Other Public Companies	1,825,000	45.625	7.3	10.4
Private Investors	825,000	20.625	3.3	4.7
Totals	4,000,000	100 %	16.0	22.8

The $21.6 million of AID funds subgranted to the SCC results is a $4.5 million benefit (20.625% x $21.6 million) to the private shareholders. Also, the interest forgiveness provision alone of the $64.9 million loan results in more than a $100 million reduction in required interest payments over the 10-year grace period. If the Company remains solvent, more than $20 million of these savings will accrue to the private shareholders.

The USAID in response to our Record of Audit Finding on this matter stated that AID has been directed by Congress to provide assistance for the development of private enterprise.

In our draft audit report, we recommended that the USAID take immediate action to ensure that the provision of AID funds to the project did not result in a windfall to the SCC private shareholders. The USAID replied:

> "The Mission dealt with this issue in our reply to the RAF. The word "Windfall", of course, is charged and does not adequately reflect the serious and substantive nature of the issue raised in your report. We urge that the Recommendation be rephrased to address the "private sector", issue more generally.

We believe that there are actions that can be taken to assure that private stockholders do not unduly benefit, while at the same time protecting their interests. One example would be to treat the GOE subgrants of the AID $10 million amendment as public sector capital contributions requiring issuance of proportionally additional shares to the public sector companies.

Recommendation No. 1

USAID should ensure that the provision of AID funds to the project does not result in undue benefits to the SCC private shareholders.

The Fuller Company Contract

Agents' Commissions paid in dollars - The Fuller Company paid the equivalent of $657,143 in commissions to the Company's sales agents in connection with the contract. Of this amount $71,429 was paid in dollars. The contract required that all local costs were to be paid in local currency.

The Fuller Company reported on Form AID-1440-3, Contractor's Certificate and Agreement with the Agency for International Development, that it had paid commissions equivalent to $657,143 to two agents ($150,000 and $507,143) in connection with its contract with the SCC. These payments were made in both U.S. dollars and Egyptian pounds, as follows:

	Commissions Paid	$ Equivalent ($1 - LE 0.70)
Agent A	$ 71,429	$ 71,429
	LE 55,000	78,571
Agent B	LE355,000	507,143
Total & Equivalent		$657,143

The agents were Egyptian firms with offices in Cairo, Egypt, and the services for which the agents were paid commissions were performed in Egypt. The contract included LE413,710 for the Fuller Company's agents' fees and other in-Egypt expense.

In accordance with AID host-country rules in effect at the time the contract was executed, the contract required that all local costs were to be paid in Egyptian Pounds, and that whenever necessary, for the performance of the Contract, the contractor was to convert US dollars into Egyptian Pounds through the AID Mission Controller or as otherwise directed by AID.

Recommendation No. 2

USAID should take action to recover the amount of the agents' commissions paid in dollars.

Within-Egypt transportation costs were paid from the AID grant funds

Practically, all of the equipment was purchased on a cost-insurance-freight basis (CIF), Port Suez, which is near the project site. The equipment was, however, offloaded at either the Port of Alexandria or Port Said and transported overland to the project site. We estimate that over $400,000 of the AID grant was used to pay for inland transportation.

About $55.5 million (exclusive of escalation costs) of cement plant equipment was procured under the SCC contract with the Fuller Company. Most of the equipment was contracted CIF Port Suez, the ocean bills of lading showed Suez as the port of discharge, and the freight was prepaid to the Port Suez. However, SCC records show that the equipment was offloaded at Port Said and trucked to the project site.

In March 1978, the Fuller Company requested confirmation that AID would approve ocean bills of lading calling for discharge at Port Said with final destination shown as Port Suez with the understanding that transportation between Port Said and Port Suez would be via inland motor carriage or waterways and the carrier issuing the ocean bill of lading would be responsible for carriage to Port Suez. The SCC and AID approved the Fuller Company request. AID also advised Fuller that it had no objection to Fuller submitting the ocean bills of lading showing CIF Port Suez in support of the invoices for payment.

The equipment was transported by truck from Port Said directly to the project site. We estimated that the ocean shipping companies paid about $394,000 for inland freight. In addition to the Fuller Contract, other equipment was purchased CIF Port Suez, but offloaded at either Alexandria or Port Said and trucked to the project site. Considering all of the equipment purchased, we estimated that over $400,000 was paid by the ocean shipping companies for inland freight.

According to the terms of the Grant Agreement, grant funds are to be used to finance the foreign exchange costs of the goods and services required to carry out the project. The costs to transport the equipment from either Alexandria or Port Said to the project site were not foreign exchange costs, and therefore not eligible for financing under the grant. The amount expended for these inland transportation costs should, therefore, be recovered.

Recommendation No. 3

USAID should either (a) recover the amount of AID funds spent on within-Egypt transportation or (b) obtain the appropriate waiver to authorize this expenditure of AID funds.

H.K. Ferguson International Contract

The Suez Cement Company (SCC) selected the H.K. Ferguson International Company (HKFI) of Cleveland, Ohio, as its consulting engineering firm for the project and entered into a contract with the firm on December 16, 1976. HKFI, however, could not begin to provide services under the contract at that time because conditions precedent to disbursement had not yet been met and project money was not yet available. Project funds became available in May 1977, and the SCC/HKFI contract came into force on May 2, 1977.*

The contract is a host country cost reimbursement plus fixed fee agreement. HKFI services included the planning, site design and engineering and procurement of a complete one million ton per annual cement plant; all related engineering services; assistance with the personnel and financial management of the company; and, the training of personnel. The contract included six subcontractors; two Egyptian firms and four U.S. firms. The original term of the contract was to August 1, 1980, the planned project completion date. However, the project fell behind schedule and the contract term was extended to November 1981 and will need to be

* To avoid delay in project implementation, the USAID provided $135,329 and LE16,537 to finance an AID Direct Contract, No. 263-77-002, with H.K. Ferguson International (HKFI). The AID Direct Contract was dated December 17, 1976, and its term was November 29, 1976 through May 30, 1977. The dollar funding came from Project 263-0013, Technical and Feasibility Studies and the local currency from Project 263-0005, Local Cost Project Support.

re-extended. (More recent estimates of completion of the plant were August 1982.) The dollar amount of the original contract was $6,376,700. The amount was increased to $7,923,040 to cover the extension and will need to be increased again. At the time of our review, there were five expatriate employees working under the contract in Egypt. Four, the Chief of Party, an engineer, a procurement specialist and an administrative officer, were assigned to the SCC main office in Cairo. The fifth member, another engineer, was assigned to the plant site.

<u>HKFI's fixed fee was increased upon extension of the contract term although the scope of contract services was actually reduced</u> - HKFI's fixed fee was increased $185,000 based on an extension to the term of the contract. Normally, an increase in a contractor's fixed fee is justified by a corresponding increase in the scope of services to be provided by the contractor. In this case, however, the scope of HKFI's contractual services actually decreased; the contract was amended to reduce the scope of services by eliminating the requirement to train plant personnel. Nearly $700,000 had been budgeted for this service in the original contract.

The dollar budget of the original contract was $6,376,000, including a $650,000 fixed fee. A 15 month extension to the contract negotiated by the SCC resulted in a tentative budget of $7,971,311 which included a $883,270 fixed fee. On January 8, 1980, the SCC submitted this tentative budget to the USAID with a request that the USAID negotiate the revised costs, especially the fixed fee, with HKFI. The USAID approved a fixed fee of $835,000. The contract amendment, with a $7,923,041 budget (including about $2.0 million for subcontracts) was signed by representatives of the SCC and HKFI on January 14, 1980. USAID did not formally approve the amendment until after September 28, 1980, when $10 million in additional grant funds became available.

The Chief of Party of the HKFI contract team told us that the increase in fixed fee was based solely on the increase in expatriate man-months resulting from the contract extension. He said that the amount of the fee was determined as follows:

> Original fee of $650,000 divided by 429, the original expatriate man-months = $1,515 fixed fee per man-month.
>
> $1,515 times the revised man-months of 550 = $833,250 rounded to $835,000.

The Chief of Party told us that he had requested a revised fixed fee of $883,270 which contained an inflation factor but that the USAID would not agree to an amount higher than the original fixed fee per man-month.

Cost plus percentage of cost contracts (where the fee varies directly with the costs) are prohibited by AID regulations. Although this contract is not a cost plus percent of cost type contract, it is similar in that the fee is increased in direct proportion to the increase of an element of cost, the direct man-months. Consulting engineering firms, by the very nature of their supervisory duties and responsibilities, can have a positive or negative effect on the time needed to complete a project. If the fixed fee is to be proportionally increased for every extension to the term of the contract, the financial incentive to a consulting firm to strive for the timely completion of the project is effectively diluted.

At the time of our review, the estimated completion date of the project was August 1982. The HKFI contract had been extended only to November 1981; therefore, it will need to be re-extended. The Chief of Party indicated that he expected the fixed fee to be increased for the re-extension as it was for the contract extension.

In our draft audit report, we recommended that the USAID provide procedural guidance to operating personnel on contracting principles in regard to fixed fees. We also recommended that the USAID advise the SCC, prior to SCC's next contract negotiation with HKFI, that extension of the term of the contract is not sufficient basis for increasing the fixed fee. The USAID replied:

> "The Mission has established, within the past year, a Contracts Office which provides procedural guidance to Project Officers. This office also participates in negotiation of contract fees and will do so in connection with SCC's next Contract negotiation with HKFI. The Mission requests these Recommendations be withdrawn."

A Contract Services Division has been established within the USAID's Legal Office and a contracting specialist is on-board; but, according to the functional statement (Mission Order 17-8, dated August 26, 1980), the Contract Services Division assists in the negotiation, drafting and approval of host country contracts for the USAID's Offices of Agriculture and Human Resources only. There is no requirement for the Contract Services Division to assist or advise the Offices of Development Resources and Program Support (DRPS) or Industry and Trade (IT) with host country contracts for the projects they administer. We believe that the USAID/Egypt Contract Services Division should have advisory responsibility for all host country contracts.

Recommendation No. 4

USAID should assign the Contract Services Division the responsibility to assist in the review and approval of all USAID-financed host country contracts.

The SCC has taken for its own use the equipment procured under the contract for HKFI use - The SCC utilizes some of this equipment strictly for its own purposes. This matter has been a long-standing dispute between HKFI and the SCC. It had been reported to the USAID as early as October 1978.

The contract budget included $226,000 for equipment. The contract provided that the equipment would be titled to the SCC but that the equipment would be under the custody and control of HKFI until no longer needed to perform the services under the contract. At the time of our review, $95,000 had been expended for vehicles, air-conditioners, office equipment, and communications equipment.

When the equipment was received, the SCC took physical control of the equipment and used it for the Company's needs in preference to the needs of HKFI. For example, vehicles were assigned to the SCC motor-pool and operated only by SCC drivers. One vehicle was reserved for the exclusive use of the Company's Legal Officer. Two vehicles which were at the plantsite were inoperable at the time of our review. Five other vehicles were for use of the SCC and HKFI. HKFI employees told us that much of the time the five vehicles were not available to them when needed. They said that the lack of dependable transportation hampered their effectiveness.

Also, 20 air-conditioners were purchased for use in HKFI offices and living quarters. The SCC, however, took most of them for their own use. At the time of our review, three of the air-conditioners were installed in the HKFI offices. The other 17 were installed in SCC offices. HKFI employees told us that the HKFI purchased, at its own expense, additional air-conditioners for the living quarters.

SCC control and use of HKFI vehicles and air-conditioning units was reported to the USAID by RIG/II/Cairo in October 1978. The USAID reviewed the RIG/II/C report and advised RIG/II/C that this was an administrative matter that they would handle. However, the situation as reported to the USAID in 1978 had not changed at the time of our review.

Recommendation No. 5

USAID arrange for HKFI control and use of the equipment purchased under the HKFI contract for HKFI use.

Mini-Computer - The HKFI contract budget included $65,000 for a mini-computer. HKFI does not need this equipment for performance under the contract. In fact, the mini-computer had not been ordered although it was included in the original contract budget. An SCC official told us that the mini-computer would be procured and used for SCC operations.

The equipment budgeted under the HKFI contract was intended for HKFI needs. The purchase of a mini-computer under the HKFI contract is inappropriate because HKFI does not need it and there has been no justification of the SCC's need for this equipment.

In our draft audit report, we recommended to the USAID that the contract be amended to eliminate the purchase of a mini-computer. The USAID replied:

> "The Mission approved the contract which authorizes the purchase of this equipment. Such purchases are often included in technical services contracts when the use of the equipment, as in this instance, is related to the objectives of the technical services. We will address the issue more fully in the final report."

Recommendation No. 6

USAID review the matter of the mini-computer and either (a) provide justification for the granting of AID funds to the SCC to purchase this piece of equipment; or, (b) arrange to delete the mini-computer from the SCC/HKFI contract.

Other Matters

Warranties

About $11 million worth of equipment was procured for quarry operations. Procurement was scheduled so that the quarries would be operational by the planned completion of the main plant; i.e., August 1980. Most of the equipment arrived on schedule, but there has been a two-year delay in completing the main plant. In a letter dated August 24, 1980, HKFI informed SCC that supplier warranties would begin expiring during the latter part of 1980, long before the equipment could be put to use. HKFI recommended that SCC and HKFI contact the supplier and propose that warranties be extended. At the time of our review, HKFI and SCC were actively working on getting the warranty period extended.

The equipment involved included:

> Two electric power shovels. The CIF price of these two pieces of equipment, plus spare parts, delivered to Port Suez was $3.5 million. The supplier posted a 5 percent performance bond which was to remain in effect until the end of the warranty period. The warranty was against defective materials and workmanship for a period of 12 months after start-up, or 3,000 hours of operation, or 15 months after CIF delivery, whichever occurred first. SCC records showed that the power shovels were received by August 1979, so the 15 month warranty period ended in 1980. The shovels, however, will not be put into use until shortly before the cement plant is operational; now scheduled for August 1982. When we visited the plant site in December 1980, the power shovels were still unassembled.
>
> Other items procured for the quarries included cranes, dozers, drills, off-road trucks, hydraulic loaders and compressors. The warranty terms were similar to the warranty for the electric power shovels, although warranty periods were generally limited to 12 months rather than to 15 months after delivery.

We believe that the USAID should assist the SCC/HKFI in extending supplier warranties against defective materials and workmanship.

> Recommendation No. 7
>
> USAID should provide assistance in getting equipment warranty periods extended to protect the SCC against defective materials and workmanship.

Final Payments - Some of the purchase agreements for quarry equipment required the sellers to provide supervision for erection and assembly and to train SCC personnel in the operation and maintenance of the equipment. However, final payments were made to these suppliers upon the shipment of the equipment.

A $3.48 million purchase agreement for two electric power shovels, for example, required the supplier to provide a competent services engineer, for up to 90 days, to supervise the assembly of the shovels and to train SCC personnel in the operation and maintenance of the equipment. The cost of these services, about $20,000, was included in the price of the shovels. However, final payment was made to the supplier upon shipment. The shovels were received at the plant site by August 1979. At the time of our visit to the plant site in December 1980, the shovels were still unassembled. The shovels were not needed at the time they were received, and will not be needed until about August 1982. The purchase agreement provided that the supplier be paid 100 percent of the purchase price upon shipment; i.e., before he had provided all the services specified in the agreement.

Handbook rules in effect at the time the purchase agreements were entered into required that equipment and materials contracts should contain provisions for the final payment to be withheld until all services specified in the contract had been completed (Handbook 11, Chapter 3, Section D, 33).

In our draft audit report, we recommended that the USAID establish controls to ensure that host country contracts require that final payment be withheld until all services specified in the agreement have been received. The USAID replied:

> "The Mission believes that Mission Order No. 5-4 establishes controls through the enforcement of contract review procedures. We request, therefore, that the recommendation be withdrawn."

The Mission Order cited was amended in January 1981. It provided for the redelegation to the various USAID offices of the Mission Director's authority to negotiate, execute and implement projects. The Mission Order specifies which offices are responsible for clearances and approvals. Accordingly, we are withdrawing the recommendation.

We believe, however, that SCC should establish accounting control over purchase agreements involving payments made prior to receipt of services. The purchase order for the electric shovels, for example, contained the following provision:

"Service Engineer - Price includes competent service engineer to supervise erection/assembly of the shovels and to train Owner's personnel in the operation and maintenance of the equipment. Ninety (90) days are included for the two (2) shovels. If the erection and on-site training is accomplished in less than (90) days, a credit of $200 per day will apply but not exceeding a credit for 30 days. Any period in excess of ninety (90) days will be charged at $240.00 per day."

By making final payment at time of shipment, the SCC paid for services not yet received and is entitled to a refund if less than 90 days' services are utilized.

Recommendation No. 8

USAID arrange for accounting control by SCC over incidental services paid for but not yet received. This should include, as a minimum, the determination of the amounts paid for said services.

Letters of Commitment have been issued in amounts in excess of funds authorized - The total amount of the Letters of Commitment issued for project costs (other than costs for consulting services) exceeds the dollar amount authorized for this category of project assistance by about $210,000.

Of the original $90.0 million grant to the GOE, $85.4 million has been subgranted and reloaned to the SCC. The AID Grant Agreement provided a subgrant of $6.7 million for the dollar costs of consulting services. The Grant Agreement also provided a subgrant of $13.8 million and a reloan of $64.9 million for other project costs. The GOE/SCC subgrant and reloan agreements were effected on July 31, 1976. We found that the dollar amount of the Letters of Commitment issued for costs other than consulting costs exceeded the dollar amount subgranted and reloaned to the SCC for that purpose. The Letters of Commitment total $78,909,460, whereas the amount subgranted and reloaned for this purpose totaled $78,700,000:

	Subgrant to EEA for Equipment	Subgrant to SCC for Consultant	Subgrant/loan to SCC for Equip./other	Total
Subgrants	$ 4,600,000	$ 6,700,000	$ 13,300,000	$ 25,100,000
Subloan			64,900,000	64,900,000
Total	$ 4,600,000	$ 6,700,000	$ 78,700,000	$ 90,000,000
L/Comms	$ 4,578,480	$ 6,400,000	$ 78,909,460	$ 89,887,940
Funds available	$ 21,520	$ 300,000	($ 209,460)	$ 112,060

Recommendation No. 9

USAID should assure that the funds committed under Letters of Commitment do not exceed funds available under the Grant.

The borrower rather than the lender keeps the loan records - Of the three primary parties to the project, (the SCC, the GOE and the USAID), the SCC maintains the only detailed expenditure records. We found that the SCC records understated the amount of its loan from the GOE by about LE4.2 million ($6.0 million).

AID provided assistance for the project through a grant of funds to the GOE. Of the initial $90.0 million AID grant, the GOE passed $85.4 to the SCC, $20.5 million as a grant and $64.9 million as a loan. AID issued Letters of Commitment directly for the account of the SCC; the GOE was not on distribution for funding or disbursement documentation, and did not maintain records over the expenditure of the AID funds. Both the USAID and the SCC kept records on disbursements. The USAID records, however, were in summary form based on monthly Advices of Charge received from AID/W. The USAID records did not show whether the AID expenditures were chargeable to the GOE/SCC grant or to the GOE/SCC loan. The SCC records on the other hand, were detailed and supported by the suppliers' invoices, shipping documents, and bank disbursement information. The SCC records showed the date expenditures were made and whether charged against the grant or the loan. Therefore, records of the status of the GOE loan and grant to the SCC, were only available at the SCC.

We found two instances in which expenditures of the AID funds were charged against the GOE/SCC grant when the expenditures should have been charged against the GOE/SCC loan. As a result, SCC records understated the loan by about LE4.2 million:

- The cost of equipment procured under L/Coms 1203, 1204, 1205 and 1206 was recorded as a grant of AID funds. These L/Coms involved procurement of $455,780, equivalent to LE 319,046.

- Payments to the Fuller Company in the amount of $5.5 million during the period from July 2, 1980, through August 27, 1980, were recorded as a grant. These payments were for cost escalation on equipment and should have been charged to the loan.

We also found that $9.4 million of procurement took place before the official rate of exchange was changed in January 1979 from LE.39 : $1.00 to LE.70 to $1.00. The $9.4 million was charged against the GOE reloan at the old rate of $1.00 = LE0.39 but the new rate of $1.00 = LE0.70 was used to record the value of the equipment procured. In other words, the assets were recorded at LE6.6 million ($9.4 million x 0.70) while the offsetting liability was recorded at LE3.7 million ($9.4 million x 0.39). The difference, LE2.9 million, was recorded in the owner's equity accounts as a capital surplus.

For good internal control, we believe that the GOE should establish records to independently record the GOE loan to SCC. Accordingly, we recommend that:

Recommendation No. 10

USAID arrange for establishment of loan records within the GOE that provide independent verification of SCC's loans from the GOE.

Recommendation No. 11

USAID provide the GOE with the necessary documents to maintain an accounting of GOE loans to SCC.

Recommendation No. 12

USAID (a) reconcile the GOE/SCC loan disbursements and (b) arrange for adjustments to the SCC records to accurately reflect the status of the loan.

SUEZ CEMENT COMPANY (SCC)
COMPARISON OF VARIOUS COST ESTIMATES
(000 OMITTED)

	Columns A: Est.Costs per Feasibility Study-Feb. 1976		Columns B: Est.Costs per Project Paper June 1976		Columns C: Est.Costs per Consultant Report Oct.1977		Columns D: Est.Costs per SCC Report-Nov. 1977		Columns E: Est.Cost per Revised Project Paper-April 1980		Columns F: Est.Costs Per Consultant Report-Nov.1980	
	LE	$	LE	$	LE	$	LE	$	LE	$	LE	$
SCC Assets – Includes land, equipment civil work and related costs.	13480	72135	13402	78700	38042	103599 1/	21803	87901	36261	86572	46161	89410
Consulting Services – Costs of SCC's U.S. consultant, H.K.Ferguson Int.,and subcontractors.	not shown		845	(6700) 3/	2362	(7583) 3/	2006	(7376) 3/	3339	(10415) 3/	2729	9161) 3/
Power And Water – Costs to bring electricity and water to the plant site. Although these are project costs, they are not to be born by the SCC.	not shown		(4994) 2/	(4600) 2/	not shown		not shown		not shown	(5900) 2/	not shown	
Other Costs – Includes pre-operating costs which will be capitalized.	1084	165	1403	-0-	2365	-0-	3291	-0-	7778	500	2778	-0-
Interest – Interest on loans during construction period.	not shown		4129	-0-	10000	-0-	not shown		10000	-0-	10000	-0-
Working Capital – First & second estimates contained line item for working capital	1436	200	3114	-0-	not shown		not shown		not shown		not shown	
Miscellaneous	not shown		not shown		not shown		not shown		not shown		10000	-0-
Costs to SCC	1600	72500	22893	78700	52769	103599	27100	87901	57378	87072	71668	89410

1/ Includes $11.0 million for non-Egyptian construction materials, equipment, and management services. These anticipated foreign exchange construction costs did not materialize.

2/ Non-add. Costs will be born by the A.R.E.

3/ Non-add. Dollar costs of consulting services are granted to the SCC.

EXHIBIT B

SUEZ CEMENT COMPANY
SUEZ AND QUATTAMIA CEMENT PLANTS
ESTIMATED COST AND THE SOURCE OF FUNDS

		Suez	Quattamia	Total
	(In $ millions. All conversions @ LE 0.70 = $ 1.00)			
ESTIMATED COSTS		$170.5	$267.3	$437.8
SOURCE OF FUNDS				
SALE OF CAPITAL STOCK				
To Public Sector Co.	(AID Funds)	$ 7.7	$ 23.1	$ 30.8
To Public Sector Co.		10.4	22.6	33.0
To Private Shareholders		4.7	11.4	16.1
TOTAL CAPITAL STOCK		$ 22.8	$ 57.1	$ 79.9
OTHER SOURCES				
Premium on Stock		-0-	0.2	0.2
Other Payments & Revenues		2.0	1.8	3.8
GRANT	(AID Funds)	5.5	8.4	13.9
GRANT (currency valuation)	(AID Funds)	6.1	-0-	6.1
GRANT for consulting service	(AID Funds)	10.0	5.0	15.0
TOTAL OTHER		$ 23.6	$ 15.4	$ 39.0
LONG-TERM DEBT				
Bank Loans		45.7	65.7	111.4
Bank Overdraft		5.7	-0-	5.7
Capital Interest - Bank Loans		7.1	22.1	29.2
Suppliers' Credits		-0-	20.0	20.0
Dollar Loan - IFC		-0-	30.0 1/	30.0
Dollar Loan	(AID Funds)	64.9 2/	58.5 3/	123.4
TOTAL LONG-TERM DEBT		$123.4	$196.3	$319.7
TOTAL		$169.8	$268.8	$438.6
TOTAL AID FUNDS		$ 94.2	$ 95.0	$189.2

1/ Loan from the International Finance Corporation
Terms: 1% per annum commitment charge on principal amount of the loan: 12 1/2% interest per annum on principal disbursed and outstanding; financial repayment in 16 equal semi-annual installments beginning on 1/15/85.

2/ Loan from A.R.E. from Proceeds of AID Grant No.263-0012
Terms: Repayment within 22 years with first installment due 10 years after date of first disbursement under the loan; 10% interest which shall begin to accrue from the date of first repayment of principal under the loan.

3/ Loan from A.R.E. from Proceeds of AID Loan No.263-K-051
Terms: Repayment within 15 years with first installment deferred for five years after first disbursement. 10% interest accruing from dates of disbursements under the loan.

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Recommendation No. 1 — 10

USAID should ensure that the provision of AID funds to the project does not result in undue benefits to the SCC private shareholders.

Recommendation No. 2 — 11

USAID should take action to recover the amount of the agents' commissions paid in dollars.

Recommendation No. 3 — 12

USAID should either (a) recover the amount of AID funds spent on within-Egypt transportation or (b) obtain the appropriate waiver to authorize this expenditure of AID funds.

Recommendation No. 4 — 14

USAID should assign the Contract Services Division the responsibility to assist in the review and approval of all USAID-financed host country contracts.

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Recommendation No. 5	15

USAID arrange for HKFI control and use of the equipment purchased under the HKFI contract for HKFI use.

Recommendation No. 6	16

USAID review the matter of the mini-computer and either (a) provide justification for the granting of AID funds to the SCC to purchase this piece of equipment; or, (b) arrange to delete the mini-computer from the SCC/HKFI contract.

Recommendation No. 7	17

USAID should provide assistance in getting equipment warranty periods extended to protect the SCC against defective materials and workmanship.

Recommendation No. 8	19

USAID arrange for accounting control by SCC over incidental services paid for but not yet received. This should include, as a minimum, the determination of the amounts paid for said services.

Recommendation No. 9	20

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APPENDIX II

LIST OF REPORT RECIPIENTS

USAID/EGYPT

Director	5
Regional Inspector General for Investigations & Inspections (RIG/II/C)	1

AID/WASHINGTON

AID Deputy Administrator	1
Assistant Administrator/Bureau for Near East (AA/NE)	5
Office of Egypt/Israel Affairs--Egypt Desk (NE/EI)	1
Bureau for Near East (Audit Liaison Office)	1
Bureau for Program and Management Services (AA/SER/SA)	6
Bureau for Program and Policy Coordination/Office of Evaluation (PPC/E)	1
Legislative and Public Affairs Office of IDCA	1
Office of Development Information and Utilization (DS/DIU)	4
Office of the General Counsel (GC)	1
Office of Financial Management (FM/ASD)	1
Office of Legislative Affairs (LEG)	1
Office of the Inspector General (IG)	1
Office of Policy, Plans and Programs (IG/PPP)	1
Office of Investigations nd Inspections (IG/II/W)	1
Executive Management Staff (IG/EMS)	12

REGIONAL INSPECTORS GENERAL FOR AUDIT

RIG/A/Karachi	1
RIG/A/Karachi--New Delhi	1
RIG/A/Manila	1
RIG/A/Nairobi	1
RIG/A/La Paz Residency	1
RIG/A/Panama	1
RIG/A/Washington	1
RIG/A/WA	1