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AUDIT OF
USAID/EGYPT CONTROLS OVER THE
ARRIVAL AND DISPOSITION OF
COMMODITY IMPORT PROGRAM SHIPMENTS
Audit Report No. 6-263-88-5
August 31, 1988

memorandum

DATE: August 31, 1988 *W.C. Spat*
REPLY TO
ATTN OF: William C. Spat, RIG/A/Cairo (A)
SUBJECT: Audit Of USAID/Egypt Controls Over The Arrival
And Disposition Of Commodity Import Program Shipments
TO: Mr. Marshall D. Brown, Director USAID/Egypt

The Office of the Regional Inspector General for Audit, Cairo has completed its audit of USAID/Egypt Controls Over The Arrival And Disposition Of Commodity Import Program Shipments. Ten copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains eight recommendations. Recommendation Nos. 4, 5, 6, 7, and 8 are considered resolved but will remain open until compliance is assured. Recommendation Nos. 1, 2, and 3 are unresolved. Also, Recommendation No. 2 was slightly modified after discussions with A.I.D./Washington officials in the Office of Information Resources Management and the Office of Financial Management.

Please advise this office within 30 days of any additional actions taken to implement Recommendation Nos. 4, 5, 6, 7, and 8 and further information you want us to consider on Recommendation Nos. 1, 2, and 3.

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

EXECUTIVE SUMMARY

Since the Commodity Import Program (CIP) was established in Egypt in 1975, more than \$3.4 billion in A.I.D. grant and loan funds have been disbursed for a wide range of commodities. A.I.D. Regulations require the borrower/grantee (the Government of Egypt) to maintain records adequate to document the arrival and disposition of A.I.D.-financed commodities. The borrower/grantee may rely on its overall system to provide evidence to determine that commodities were received in the quantity and condition for which payment was made, assure prompt customs clearance, record importers' claims for losses, shortages, or damages to A.I.D.-financed commodities, and to assure the availability of data for end-use verification. If the system cannot provide these assurances, Missions can maintain their own systems until the borrower/grantee systems become adequate. USAID/Egypt determined that the Government of Egypt did not have the capability to maintain such a system and since 1976 the Mission has assumed responsibility for operating the arrival accounting system.

The objectives of this financial and compliance audit were to determine whether USAID/Egypt procedures provided reasonable assurance that A.I.D.-financed commodities were actually received in Egypt, commodities were properly used, and lost or damaged shipments were recovered.

The audit showed that USAID/Egypt lacked the capability to effectively determine if Commodity Import Program shipments to Egypt had arrived in the quantity and condition for which payment was made, and whether commodities received were properly used by importers. In an effort to address these long standing problems, in September 1987, USAID/Egypt initiated a series of actions directed to improving accountability over CIP transactions and to collecting missing shipment documents necessary to verify commodity arrivals. Notwithstanding the improvements made, the Mission still could not effectively link commodity disbursements with shipment arrivals in Egypt. In addition, Mission end-use checks to verify the use of commodities were uneven and unsystematic and information was lacking on follow-up, feedback and corrective actions taken on reported commodity utilization problems. Finally, USAID/Egypt had not effectively monitored and/or taken corrective actions on reported lost or damaged commodity shipments. The audit results are amplified in the following paragraphs.

The Mission had not verified the arrival in Egypt of more than \$263 million in A.I.D.-financed commodities as of April 30, 1988. This condition existed because USAID/Egypt

lacked the information necessary to link CIP disbursements and actual arrivals. A.I.D. Regulation 1 and A.I.D. Handbook 15 required the recipient country to maintain an adequate commodity arrival accounting and disposition system. USAID/Egypt assumed responsibility for managing arrival accounting functions in 1976, because the Government of Egypt had not developed an appropriate system. The Mission system, however, never operated effectively. Systems deficiencies in A.I.D./Washington and the Mission precluded complete and timely commodity disbursement information, thus making effective shipment arrival verification impossible. As a result, the Mission lacked assurance that commodity shipments actually arrived and were received by the importers in the quantity and condition for which payment was made. We recommended that USAID/Egypt account for all unverified CIP arrivals to Egypt, coordinate with A.I.D./Washington regarding the development of an effective linkage between CIP disbursements and arrivals, and reexamine the Government of Egypt's capability to operate its own arrival accounting system. The Mission commented that extensive changes had been made to improve the arrival accounting system, and the problems had been sufficiently addressed; the Mission also commented that the Government of Egypt still was incapable of operating an appropriate arrival accounting system.

End-use checks to verify utilization of commodity arrivals were uneven and unsystematic. Also, routine follow-up, and corrective action on reported commodity utilization problems were lacking. Mission Order 15-3 required systematic monitoring of commodity arrivals in order to assure proper utilization and adherence to A.I.D. regulations. The Office of Financial Management, however, could not provide the staff resources to properly plan for and monitor commodity utilization. Also, the Office of Commodity Management and Trade did not take systematic action on disclosed end-use problems because other staff activities took precedence. Consequently, USAID/Egypt was not assured that A.I.D.-financed commodities shipped into Egypt were properly and effectively used. We recommended that USAID/Egypt develop plans for systematic and comprehensive end-use coverage of commodity arrivals, and continued follow-up and reporting on disclosed problems. The USAID/Egypt Office of Financial Management agreed to the desirability of a formal annual plan, and said efforts were underway to increase end use coverage through outside contract. The Office of Commodity Management and Trade commented that a follow-up system for responding to end use-checks had already been established.

USAID/Egypt had not effectively monitored and/or taken actions on an estimated \$3.4 million in reported lost or damaged commodity shipments dating back to 1980. A.I.D. Regulation 15 and Mission Order 15-3 required the Mission to monitor and follow up on lost or damaged shipments to ensure compliance with A.I.D. requirements and appropriate use of loss proceeds. Higher staff priorities in the action office, the Office of Commodity Management and Trade, precluded systematic follow-up needed to resolve the reported commodity loss and damage problems. As a result, in March 1988, the Mission "deleted" from its records an estimated \$2.7 million in accumulated commodity losses and damages reported prior to March 1985. A.I.D. interests have not been fully protected regarding the recovery of the commodity losses, and assurance that refunds were used in accordance with A.I.D. regulations. We recommended that USAID/Egypt resolve all outstanding losses and damages and establish improved procedures for follow-up and resolution of reported commodity losses and damages. The Mission commented that the new arrival accounting system had been implemented by the Office of Commodity Management and Trade to prevent any future accumulation of reported losses and damages.

USAID/Egypt comments on the draft report are excerpted at the end of each finding section and presented in their entirety as Appendix 2. Office of Inspector General comments are also contained at the end of each finding section and its overall response to Mission comments is presented as Appendix 3.

Office of the Inspector General

AUDIT OF
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COMMODITY IMPORT PROGRAM SHIPMENTS

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PART I - INTRODUCTION

A. Background

Since the Commodity Import Program (CIP) was established in Egypt in 1975, more than \$3.4 billion in A.I.D. grant and loan funds have been disbursed for a wide range of A.I.D.-financed commodities. These commodities included, among others, agricultural products, raw materials, machinery, medical supplies, transportation equipment, and spare parts. In recent years, the program level has been at an average of about \$200 million annually, with Fiscal Year 1988 funding established at \$100 million.

A.I.D. Regulation 1, Section 201.41 and A.I.D. Handbook 15 require the borrower/grantee (the Government of Egypt) to maintain records adequate to document the arrival and disposition of all A.I.D.-financed commodities. The borrower/grantee may rely on its overall system to: (1) provide evidence to determine whether commodities were received in the quantity and condition for which payment was made; (2) assure prompt customs clearance; (3) record importers' claims for losses, shortages, or damage to A.I.D.-financed commodities; and (4) assure the availability of data for end-use verification.

If the system cannot provide these assurances, USAID/Egypt can maintain its own system until the borrower/grantee system becomes adequate. Since inception of the CIP in Egypt in 1975, the Government of Egypt has been judged to lack the capability to maintain such a system. USAID/Egypt, therefore, assumed responsibility for operating an arrival accounting system.

The USAID/Egypt CIP arrival accounting and disposition functions have been the subjects of numerous Office of Inspector General (OIG) and General Accounting Office (GAO) audits. In sum, the audits have concluded that USAID/Egypt's Arrival Accounting System lacked timely and complete information to accurately determine that commodities paid for by A.I.D./Washington were actually received and utilized in Egypt as intended. Also, problems were reported in

monitoring and following up on lost and damaged shipments, and in performing end-use checks on commodity arrivals. Audit report recommendations for corrective actions have been closed on the basis of completed or promised actions on the part of USAID/Egypt. (See Appendix 1 for a summary of selected past audit findings).

Two USAID/Egypt offices share program management responsibilities. The Office of Commodity Management and Trade (CMT) has principal responsibility for the CIP and is the focus for coordinating annual commodity agreements with the Government of Egypt's Ministry of International Cooperation. CMT operates a computerized CIP Arrival Accounting System, which generally depends on shipping documents mailed by suppliers to verify commodity shipments and arrivals. A CMT office at the port in Alexandria provides the system with arrival details such as date received, amount, quantity, customs clearance, and losses or damages. The Office of Financial Management makes end-use checks on commodities received, and formally notifies CMT of actions needed to resolve problems or discrepancies uncovered in the arrival accounting, port monitoring, and end-use checking.

B. Audit Objectives And Scope

The audit was made to determine whether Commodity Import Program shipments to private and public sector importers in Egypt had arrived in the quantity and condition for which payments were made. The specific objectives of this financial and compliance audit were to determine whether USAID/Egypt procedures provided reasonable assurance that: (1) A.I.D.-financed commodities were actually received in Egypt; (2) commodities were properly used; and (3) lost or damaged shipments were recovered.

The audit was made at the USAID/Egypt Office of Commodity Management and Trade, the Office of Financial Management, the CMT Alexandria Port Office, and judgmentally selected CIP importer locations in the Cairo-Alexandria area.

The basic approach was to review past audit reports, examine follow-up actions, and judgmentally select certain transactions in order to evaluate the adequacy of procedures governing shipments and arrivals. The arrival accounting system was tested by reviewing shipping documents and arrival records obtained from 28 of 207 CMT-approved Letters

of Commitment covering the period from April 1986 through December 1987. These transactions totaled about \$18.3 million.

Cargo shipments and arrivals and resolution of losses and commodity dispositions were verified on a selected basis through written contact with U.S. suppliers and visits to in-country importers. The audit relied extensively on past audit findings and recommendations by the Office of Inspector General and the General Accounting Office because of their current relevance. Four of the past audits of the Office of Inspector General and the GAO are excerpted in Appendix 1.

The audit was made during the period from November 1987 through April 1988. The review of compliance and internal control was limited to the findings in this report.

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PART II - RESULTS OF AUDIT

The audit showed that USAID/Egypt lacked the capability to effectively determine if Commodity Import Program shipments to Egypt had arrived in the quantity and condition for which payment was made, and whether commodities received were properly used by importers. In September 1987, USAID/Egypt initiated a series of actions to improve the accountability of CIP transactions and to collect missing shipment documents necessary to verify commodity arrivals. Notwithstanding the improvements made, the Mission still lacked the information necessary to effectively link commodity disbursements with shipment arrivals in Egypt.

End-use checks to verify the use of CIP commodities were uneven and unsystematic. Also, information on follow-up, feedback and corrective actions on reported commodity utilization problems was lacking. Finally, USAID/Egypt had not effectively monitored and/or taken corrective actions on reported lost or damaged commodity shipments.

The report contains eight recommendations. We recommended that USAID/Egypt: initiate immediate remedial efforts to account for unverified shipment arrivals; coordinate with A.I.D./Washington's Office of Financial Management in order to develop data base modifications for effective linkage of all CIP disbursements and arrivals; reexamine the Government of Egypt's capabilities for operating its own arrival accounting system, develop plans for systematic and comprehensive end-use coverage of commodity arrivals and follow-up of disclosed problems; and establish improved procedures for follow-up and resolution of reported commodity losses and damages. USAID/Egypt initiated several corrective actions in response to the report, but generally disagreed with the need for the actions recommended.

A. Findings And Recommendations

1. The USAID/Egypt Commodity Arrival Accounting System Needs Improvement

USAID/Egypt had not verified the arrival in Egypt of more than \$263 million in A.I.D.-financed commodities as of April 30, 1988. This condition existed because USAID/Egypt lacked the information necessary to link Commodity Import Program disbursements and actual arrivals. A.I.D. Regulation 1 and A.I.D. Handbook 15 required the recipient country to maintain an adequate commodity arrival accounting and disposition system, but USAID/Egypt assumed responsibility for managing arrival accounting functions in 1976 because the Government of Egypt had not developed an appropriate system. The Mission system, however, never operated effectively. Systems deficiencies in A.I.D./Washington and the Mission precluded complete and timely commodity disbursement information thus making effective arrival verification impossible. As a result, the Mission lacked assurance that commodity shipments actually arrived and were received by the importer in the quantity and condition for which payment was made.

Recommendation No. 1

We recommend that USAID/Egypt account for all unverified Commodity Import Program commodity arrivals in Egypt.

Recommendation No. 2

We recommend that USAID/Egypt, in coordination with A.I.D./Washington's Office of Financial Management, identify and develop data base modifications to allow effective reconciliation of Commodity Import Program disbursements with commodity receipt data recorded in the arrival accounting system.

Recommendation No. 3

We recommend that USAID/Egypt reexamine the Government of Egypt's capability to operate an arrival accounting system that conforms to A.I.D. Handbook 15 and A.I.D. Regulation No. 1 requirements.

Discussion

A fundamental principle of any commodity management control system is that purchases can be verified as having arrived in the quantities specified and in appropriate condition. Yet, despite 12 years of system deficiencies reports and

agreements by the Mission and A.I.D./Washington to correct the problems, the commodity control system in Egypt still lacks the basic capability to match payments for purchases made with commodities received. The underlying reason for this condition is that information on the amounts disbursed by A.I.D./Washington to U.S. suppliers of goods to Egypt is not provided in a way that can be used by the Mission to verify arrivals. Therefore, the Mission lacks the assurance that shipments actually arrived in Egypt and were received by the importers.

A.I.D. Regulation 1, Section 201.41 and A.I.D. Handbook 15, Chapter 10 require the recipient country of A.I.D.-financed commodities to maintain a system of records that document the arrival and disposition of A.I.D.-financed commodities. This system must identify the parties to the transaction, provide evidence to show whether commodities are received in the quantity and condition for which payment is made, and record adjustments from importers (i.e. commodity losses, shortages and damages). In the event that the recipient country cannot fulfill its arrival accounting requirements, the Mission is to establish and maintain its own system, until the recipient's system becomes adequate.

The Commodity Import Program was established in Egypt in 1975. Since then the Mission has considered that the Government of Egypt was incapable of maintaining acceptable commodity records despite the fact that in 1986/87, Egypt imported about \$8.5 billion in commodities for its own account. As far as the audit was able to determine, this assumption has not been seriously examined by the Mission since at least 1979 nor is it documented by any detailed analysis. About six people in the Mission in Cairo and Alexandria spend most of their time on some aspect of the system.

The USAID/Egypt Arrival Accounting System, established in 1976, is a computerized system managed by the Office of Commodity Management and Trade (CMT). CMT generally relies on shipping documents (e.g. bill of lading, invoices and packing lists) sent by suppliers from the United States. In order to match A.I.D.-financed commodity shipments and arrivals, shipping document information is recorded into the system, and sent to the CMT staff in Alexandria. The CMT Alexandria staff reviews port arrival records and provides feedback with respect to arrival details on the quantity, date and value of goods off-loaded, cleared through customs, and received by importers. Thus, verification of arrivals

generally depends on CMT's receiving shipping documents. Arrival verification is unlikely if shipping documents are not received.

Prior systems problems

A.I.D. Handbook 19, Attachment Q and Mission Order 15-3, dated June 1, 1988, state that the Mission commodity arrival and disposition system should permit A.I.D.-financed shipments to be traced from the agreement stage through borrower/grantee authorization, shipment, in-country arrival, and acceptance by the importers.

The USAID/Egypt system, however, has been continually plagued by problems that have hindered complete and timely tracking of commodity shipments, arrivals and disposition. In 1987-88, CMT initiated several system controls that improved shipment accountability. Nevertheless, essentially the same systems problems in linking disbursements with arrivals that have existed for the past 12 years remained. A summary of some of the past audits of the USAID/Egypt commodity arrival accounting system shows a history of reported verification problems, and failed corrective actions (See Appendix 1 for a listing of selected audit findings).

- In 1980, two A.I.D. Office of Inspector General (formerly Area Auditor General/Egypt) audits reported that the system in effect for 5 years showed little improvement in obtaining timely and accurate information on commodity arrivals necessary for effective arrival accounting. The audits concluded that the AID/Washington accounting and information system was not functioning properly and not addressing USAID/Egypt's needs. The auditors recommended that: (a) USAID/Egypt modify its planned computer programs to include actual disbursements made by A.I.D./Washington; and (b) A.I.D./Washington computer programs be modified to include Letter of Credit information and any other information required by "Missions" in their integration of computer systems. Although deficiencies were recognized by management and corrective action promised, the corrections never took place.

- In 1983, a draft Office of Inspector General report, addressed essentially the same arrival accounting system deficiencies and recommendations contained in the 1980 reports. The 1983 report again recommended that

A.I.D./Washington include disbursement data by individual Letters of Credit for each Letter of Commitment, and that USAID/Egypt (and other Missions) modify their arrival accounting systems based on actual disbursements. USAID/Egypt officials accepted the legitimacy of the report recommendation, but suggested that the auditors were striving for perfection in a system that was only intended to monitor the GOE import system. The final report was never issued and corrective actions were never initiated.

- In 1987, a General Accounting Office (GAO) review team reported that the USAID/Egypt arrival system was inadequate for determining the status of supplier shipments and importer receipts. GAO concluded that shipping documents were frequently not received and/or were untimely. Thus, substantial commodity shipment arrivals were not accounted for, and a potential for diversion was created. At the time this audit was completed, the GAO draft was still in process.

In September 1987, reflective of the inherent systems problems of verifying commodity receipts, the USAID/Egypt CIP-Arrival Accounting/End Use Report showed that the value of shipping documents received by the Mission was \$175 million less than reported by A.I.D./Washington commodity grant disbursements. Also, more than \$403 million in shipping documents recorded by USAID/Egypt were unverified as shipments received in Egypt. The situation was exacerbated because A.I.D./Washington had not sent monthly transaction disbursement reports (W-214's) 1/ to the Mission for several months. The delays meant that the Mission could not effectively validate accounting records and establish the financial status of its grant agreements.

Notwithstanding the admitted system weaknesses, USAID/Egypt's vulnerability assessment for 1987 failed to disclose the fact that it was unable to match disbursements and arrivals. The Mission, therefore, did not develop a strategy for dealing with its problems within the framework of the assessment process.

1/ A.I.D. Non-Project Assistance Transaction Detail Reports of Loan and Grant Activities.

Accounting system improvements

CMT management officials acknowledged during the audit that they were aware of the arrival accounting problems, but said that the need to improve the systems controls over CIP transactions, (agreement, allocation, award, no objection letters, etc.) took precedence over the need to verify arrivals.

In September 1987, however, CMT initiated a comprehensive effort to locate over \$100 million in missing shipping documents for active grants ^{1/}, and to confirm the actual issuance of more than \$45 million in Direct Letters of Commitment and Letters of Credit. At about the same time, CMT also initiated a series of controls intended to improve the accountability over Letter of Credit and Direct Letter of Commitment issuances and shipments. Several monthly exception reports were developed to check outstanding balances, and missing shipment amounts. These efforts substantially reduced the amount of missing shipment documents. However, CMT reports showed that as of April 30, 1988, more than \$263 million in commodity shipments still had not been verified as having arrived. CMT management officials explained that suppliers either had not submitted shipment documents as required, or documents were sent to wrong locations, were erroneously posted, or were lost. No firm explanation for the large gap was given.

The audit sampled 28 approved Letters of Commitment totaling \$18.3 million initiated between April 1986 and December 1987, and involving 26 shipments in an effort to determine the reason for missing shipment information. CMT files showed that shipment documents were not received for 8 of the 26 expected shipments. Suppliers for 7 of the 8 commodity shipments replied to us, however, that the required shipping documents had, in fact, been sent to the Mission. In the 7 cases, the supplier sent us copies of mailed documents or certifications as evidence. The other supplier said that the transaction had been cancelled over a year ago, and that the Mission had been notified.

^{1/} CMT did not gather shipment information and verify arrival for expired grants. This exercise, therefore, covered only grants from Grant No. 263-K-604 which was approved in 1982.

The majority of the remaining 18 shipments tested were verified as arrived from 3 to 10 months after actual arrival in port. CMT did not stamp the date shipping documents were received in Egypt; therefore, the reasons for the lengthy delays in verifying arrivals could not be readily determined. Nevertheless, the tests established that: (a) the CMT system did not assure that all commodity shipments paid by A.I.D./Washington actually were received in the quantity and condition for which payment was made; and (b) verifications were being accomplished long after the goods arrived in country.

The systems controls initiated by CMT in September 1987 should improve verification of shipments. The primary control problem in arrival verification, however, needs to be addressed by A.I.D./Washington. As reported in 1980, the A.I.D./Washington accounting and information system needs to be modified to address USAID/Egypt's problems and address all "Missions" required informational needs. In short, a system must be designed that identifies disbursements in a way that USAID/Egypt and other Missions can readily identify the related arrival of the commodities for which payment was made. Implementation of such a system would address a major Agency internal control weakness. Over the longer term, USAID/Egypt should decide on the question of whether to continue to operate the arrival accounting system. Transferring some or all of the arrival accounting responsibilities to the Government of Egypt could conserve Mission resources and contribute to the Mission's goal of institution building within the host government.

Management Comments

The Office of Commodity Management commented extensively on the changes it had made to improve arrival accounting information. The comments apparently were intended to convince readers that all of the long standing problems mentioned in the report have now been resolved. CMT considered the report's recommendations to be unnecessary. With respect to the Government of Egypt's ability to operate an appropriate arrival accounting system, CMT said it had already determined the Government was incapable of operating such a system.

Office Of Inspector General Comments

The changes instituted by the Mission during the audit period improved accountability over A.I.D.-financed commodities. However, a commodity system that operates with

a disbursing office in one location (Washington) and a receiving office in another location (Egypt) must provide for eventual reconciliation of the data in order to ensure that commodities paid for were received. The Mission's improved procedures fail to deal effectively with the fundamental problem addressed in the report, mainly because the problem is outside the Mission's control. The paying office must present payment data in a format that can be related to specific commodity arrivals, which it presently does not provide. USAID/Egypt must identify its information needs and work jointly with the A.I.D./Washington Office of Financial Management to establish the best system.

Concerning the Government of Egypt's operating an arrival accounting system, A.I.D. Payment Verification Policy 15 states that all Missions with existing or planned CIP's should evaluate host country arrival accounting systems as part of their overall evaluations of host country activities. The evaluations should be included in the Program Assistance Approval Documents requesting CIP authorizations. Asserting that the Government of Egypt is incapable of operating an acceptable system without analyzing the reasons is not responsive to Payment Verification Policy 15, and does not allow the Mission a basis for ever moving away from using its own resources for this purpose. A.I.D. Handbook 15 indicates it is appropriate for Missions to establish their own systems until the host governments' systems become adequate. This language shows that at some point the host government is expected to operate its own system.

After considering the Mission's comments we continued to believe Recommendation Nos. 1, 2, and 3 were actionable. Accordingly, these recommendations will remain open until satisfactorily addressed by the Mission.

2. Systematic End-Use Checks And Follow-up Actions Are Needed To Assure Proper Commodity Utilization

End-use checks to verify utilization of commodity arrivals were uneven and unsystematic. Also, routine follow-up, and corrective action on reported commodity utilization problems was lacking. Mission Order 15-3 required systematic monitoring of commodity arrivals in order to assure proper utilization and adherence to A.I.D. regulations. The Office of Financial Management, however, did not provide the staff resources to properly plan for and monitor commodity utilization. The Office of Commodity Trade and Management did not take systematic action on identified end-use problems because other staff activities took precedence. Efforts were undertaken during the audit to expand end-use coverage through outside contracts and to establish better reporting. Nevertheless, at the conclusion of the audit USAID/Egypt was not assuring that A.I.D.-financed commodities shipped into Egypt were properly and effectively used.

Recommendation No. 4

We recommend that USAID/Egypt develop and revise, as necessary, yearly end-use plans that provide for comprehensive coverage of imported commodities, including those commodities with particularly high vulnerability for misuse or of concern to Mission management. The plans should be jointly developed and agreed upon by the Mission's Office of Financial Management and Office of Commodity Management and Trade, and include benchmarks for measuring performance.

Recommendation No. 5

We recommend that the Office of Financial Management continue negotiation efforts with the Government of Egypt to expand end-use audit coverage through outside contract services.

Recommendation No. 6

We recommend that the Office of Commodity Management continue newly initiated follow-up efforts on reported end-use audit problems, and provide timely feedback to the Office of Financial Management regarding corrective actions needed and/or taken.

Discussion

End-use checks are essential to ensuring the integrity of the program and to keeping the Mission informed of the use of A.I.D.-funded equipment and commodities. USAID/Egypt Mission Order 15-3, mandated the Office of Financial Management to conduct independent end-use checks of CIP commodities reported as having arrived in Egypt. End-use results with discrepancies and problems were to be written up and sent to CMT, which, in turn, was required to reply in writing on the corrective actions taken.

End-use checks, however, have not been systematic and have lacked the coverage to ensure proper commodity utilization and adherence to A.I.D. regulations. Also, there has been little or no feedback on actions taken by CMT to correct deficiencies disclosed in past end-use checks.

End-use checks

In 1980, the A.I.D. Office of Inspector General reported that end-use coverage was uneven, and heavily emphasized some commodities while neglecting others. Recommended actions included reassessing planned coverage and ensuring that adequate coverage of all types of imports was planned. The Mission agreed and emphasized various changes in end-use plans and selections. In subsequent years, however, the emphasis on end-use checks declined, and the number of reports subsided dramatically.

<u>Fiscal Year</u>	<u>Number of Reports Issued</u>
1982	23
1983	36
1984	20
1985	13
1986	12
1987	9

Similarly, the Office of Financial Management (FM) end-use plans became less detailed regarding the reasons for choosing selected importers and commodities, and the plans were not followed in such a way as to measure performance

progress or to identify audit shortfalls. For example, in 1983, end-use plans included specific criteria for audit coverage for the year and identified the importers and commodities to be reviewed. Also, there was an indication that CMT was involved, and FM Controller approval was received. Although actual compliance with the plans could not be readily determined, Fiscal Year 1983 was the most productive year in terms of the number of audits performed.

There was less emphasis in identifying end-use needs after 1983, and prepared plans essentially were not followed. For example, in Fiscal Year 1987, only a handwritten "draft" plan was prepared. The plan was not reviewed by FM management nor used by the auditors. The Fiscal Year 1988 plan was not formally reviewed by FM management, but included 24 targeted audits that, in reality, were not expected to be accomplished. According to FM accountants, the criteria for selecting importers or commodities for end-use review was informal and allowed flexibility in selection.

The primary reason for the lack of emphasis and decline of end-use checks was attributed to using FM accountants to collect and verify data for the FM "Counterpart Accounting System" for the CIP Special Account. This account is used for local currency deposits and disbursements stemming from CIP transactions. The FM accountants estimated that until recently 65 percent of staff time was charged to verifying Special Account transactions.

An additional problem has been the obvious lack of a systematic approach and plan by FM to assure that adequate end-use coverage was accomplished. For example, since 1983 the Mission disbursed about \$84 million for "tinplate". Even though 10 reported lost-and-damaged shipments of tinplate were outstanding in the December 1987 "CIP Loss Activity Report", no end-use checks had been made of tinplate. Conversely, all sulphur shipments for Fiscal Years 1983 through 1986, totaling \$37.5 million, were checked. These checks disclosed no problems with sulphur shipments.

Mission management has recognized the need for more end-use checks. A proposed amendment to the "Memorandum of Understanding regarding Special Account," requested GOE concurrence to use LE250,000 (about \$108,000) in outside contract services to ensure proper utilization of commodities. As of the date of the audit, the GOE had rejected this request and negotiations were continuing.

Follow-up actions

CMT is supposed to follow up and take action on deficiencies or problems disclosed by end-use audits. The CMT is also directed by the Mission Order to formally respond to FM on corrective actions taken. Until recently, however, there was little evidence that CMT formally followed up and/or took actions on end-use audit recommendations. From 1983 to 1987, at least 12 end-use checks recommended CMT follow-up action, but there were no available records showing actions taken to resolve the presented deficiencies.

CMT management acknowledged that until March 1988 no formal follow-up system existed, and there were no specific files regarding actions taken to resolve end-use recommendations. CMT management mentioned other priorities that took precedence over such a system. However, in March 1988 CMT responded to the problem by setting up an end-use report action file. This system should improve controls over the resolution of end-use recommendations. The next step is for CMT to communicate to FM, actions taken to resolve the reported deficiencies or problems.

In sum, end-use audits need to be planned more systematically and needed resources should be provided for comprehensive coverage of CIP commodity arrivals. Also, communication between the CMT and FM is needed regarding actions taken on reported deficiencies and problems.

Management Comments

The Office of Commodity Management and Trade said it had now set up a follow-up system for responding to end-use checks reports. The Office of Financial Management said it agreed with the desirability of a formal annual plan for end-use coverage and had drafted a Mission Order to this effect. It also said efforts were underway to increase end-use coverage through the use of outside contractors.

Office Of Inspector General Comments

The Office of Commodity Management and Trade established its follow-up system after the audit called attention to the problem in a briefing of the Office Director in February 1988. As stated in the text of the report, the CMT system for follow-up actions, if implemented fully, should improve controls over the resolution of end-use recommendations. The actions promised by the Office of Financial Management

regarding planning and coverage are responsive to the audit report recommendations. Recommendation Nos. 4, 5, and 6 are considered resolved. The recommendations will be held open until compliance is assured.

3. Improved Follow-up Actions Are Needed To Resolve Reported Commodity Losses And Damages

USAID/Egypt had not effectively monitored and/or taken action on an estimated \$3.4 million in reported lost or damaged commodity shipments dating back to 1980. A.I.D. Regulation 15 and Mission Order 15-3 required the Mission to monitor and follow up on lost or damaged shipments to ensure compliance with A.I.D. requirements and appropriate use of loss proceeds. Higher staff priorities in the action office, the Office of Commodity Management and Trade, precluded timely and systematic follow-up to resolve the reported commodity loss and damage problems. As a result, in March 1988, the Mission "deleted" from its records an estimated \$2.7 million in accumulated potential commodity losses and damages reported prior to March 1985. The lack of attention to this area meant that USAID/Egypt was not assured that A.I.D. interests had been protected regarding the recovery of commodity losses, and that refunds of claims were used in accordance with A.I.D. regulations.

Recommendation No. 7

We recommend that USAID/Egypt Office of Commodity Management and Trade resolve all outstanding listed commodity losses and damages, and inform the Mission's Office of Financial Management of the resolution of reported losses or other actions taken.

Recommendation No. 8

We recommend that USAID/Egypt implement A.I.D. Regulation 15, Mission Order 15-3, and the Office of Commodity Management and Trade directive for handling, reporting and clearing commodity losses and damages.

Discussion

A.I.D. Handbook 15, Chapter 8 requires the Mission to monitor country programs regarding marine insurance to ensure compliance with A.I.D. requirements and appropriate use of loss proceeds, and to keep informed of loss situations. Importers who receive loss payments from A.I.D.-financed insurance are required to use the proceeds to procure eligible commodities within a reasonable period, or to refund to A.I.D. an equivalent amount. A.I.D. does not exercise formal controls over the use of non-A.I.D.-financed

insurance proceeds for nonproject assistance losses, but Missions are supposed to be aware that the proceeds were used in a manner consistent with the agreement terms.

In Egypt, lost or damaged CIP commodities are generally identified by the CMT Alexandria port staff during their verification of shipment arrivals. The staff subsequently sends "incoming status reports" with information showing losses, damages, or short shipments through CMT to FM. In accordance with Mission Order 15-3, FM acts as a clearance office and formally notifies CMT of unresolved commodity losses through issuance of a quarterly "CIP Loss Activity Report". CMT is required to notify the importer, or utilizing agency, and to request a report on actions taken to resolve the problem. If sufficient response is not received, the Mission Director should be apprised, and a decision reached as to additional measures needed. In any case, FM is supposed to be promptly notified by CMT regarding actions taken to resolve the problems.

An Office of Inspector General Audit Report (formerly Area Audit General/Egypt) in 1980 concluded that although the Controller (FM) had been publishing a quarterly report of commodity losses, it had not been used by CIP management to initiate actions needed. Consequently, the quarterly reports continued to accumulate and show commodity losses that would never be collected. The audit report recommended, among other things, that CMT provide systematic feedback to FM on refunds collected, losses determined uncollectible, and any other actions taken that affected the status of losses indicated in the quarterly reports.

Eight years later, essentially the same situation existed. As of December 1987, an estimated \$3.4 million in reported lost or damaged commodity shipments had not been resolved. More than \$799,000 of reported losses and damages were shown in the "CIP Loss Activity Report" along with a "value unknown" loss estimated at about \$2.6 million for more than 90 importers that received commodities in damaged containers. These transactions went back as far as 1980.

CMT management acknowledged during the audit that little had been done in the past to resolve issues of lost or damaged cargoes. Basically, a letter was sent to the importer inquiring about actions taken on the loss or damage problem. If no response was received, a follow-up letter was sent. Due to higher CMT staff priorities, no further action was

taken. FM was not notified about the status of loss or damage proceedings and no systematic records were maintained by CMT.

The auditors visited four CIP importers selected at random from a quarterly loss report in order to test the existing systems and to determine the status of selected outstanding commodity losses. The inquiries showed that the Mission's interests were not always protected and that contrary to the FM reports of unresolved claims, three out of the four cases had been resolved.

- A shipment received in April 1987 showed losses of \$32,957 upon arrival. The importer's delivery terms were Cost-Insurance-Freight (CIF) 1/. The importer said he had not been contacted by CMT regarding the losses. The importer filed for and received \$36,096 from the insurance company for its claim. Although the funds were supposedly used to purchase additional raw materials, the importer could not verify that the materials were purchased from U.S. suppliers as required by A.I.D. regulations. In a sense the transaction had been resolved, although not necessarily satisfactorily, but was still considered an open item by USAID/Egypt.
- A shipment received in March 1987 reportedly had \$5,800 in damages and \$2,175 shown as "short-shipped." The delivery terms were CIF, but the importer did not make a claim for the losses or damages. The main reason was that the importer did not know how to submit the insurance claims. Although CMT Alexandria staff initially visited the importer regarding the losses, a company official said that no other follow-up was made and no advice was provided. Thus, the interests of the importer and the Mission were not protected while the shipping company and the U.S. exporter received full compensation.
- A shipment received by an importer in May 1984 incurred a reported \$37,000 in a short shipment and damaged goods of an "unknown" value. The delivery terms were CIF and the importer advised us that \$41,000 in losses and damages were reimbursed. The importer said, however,

1/ According to CMT management, insurance for CIF and "Cost and Insurance (C&I) is financed by A.I.D.

that the refund was not used to replace the lost commodities, as required. According to the importer, CMT never contacted the company. (This shipment was "deleted" from the quarterly loss listing because the loss was more than 3 years old.) The Mission's interests were not protected because the lost or damaged items were not replaced from U.S. sources.

- A shipment received in May 1987 had 61 damaged packages costing \$91,109. The delivery terms required the importer to bear all costs when the goods were shipped, and 57 packages were rejected by an inspection engineer in the U.S. before shipment. As of May 1988, some 48 of the 61 packages were replaced, while 13 packages had not yet been replaced. According to a later quarterly loss activity report, this problem had been resolved.

In March 1988, FM deleted nearly \$2.7 million in accumulated outstanding reported losses and damages listed prior to March 1985. One reason for the "deletion" was attributed to the nonresponsiveness of the majority of importers in regard to loss recoveries and claims collected. FM concluded that only about 37 percent of the shipments were A.I.D.-financed insurance and only \$202,326 of the total \$2,667,541 loss figure represented known actual losses. (In many cases, unknown losses involved damaged outside containers, but the actual commodity loss figure could not be established.) Regardless, if CMT had followed the Mission Order requirements in 1980 when the Inspector General identified the commodity loss and damage problem, and taken appropriate follow-up actions, such large and dated outstanding loss figures likely would not have accumulated. Instead of "deleting" old shipments, A.I.D. may have received assurance that the commodity losses had been recovered or otherwise taken appropriate action.

CMT agreed with the audit concerns and in mid-March 1988 issued CIP Operating Procedures Memo No. 9 on Damages and Losses. The procedures established uniform guidelines for handling, reporting and clearing losses and damages, and assigned responsibilities for the implementing of the procedures. These procedures, if implemented, should alleviate newly reported commodity losses and/or damages. However, the problem of outstanding listed losses or damages still remains.

Management Comments

The Office of Commodity Management and Trade said (in accordance with the new procedures) it intended to continue reporting to the Office of Financial Management on the resolution of loss/damage cases. CMT also said that the new Arrival Accounting system has been designed and implemented to prevent any future accumulation of reported outstanding losses and damages. CMT considered Recommendation Nos. 7 and 8 to be closed.

Office Of Inspector General Comments

The procedures for handling, reporting and clearing losses and damages, if implemented, should alleviate the problems with newly reported losses. The issue of old outstanding losses is considered resolved, but Recommendation Nos. 7 and 8 remain open until compliance is assured.

B. Compliance And Internal Control

Compliance

In the areas audited, compliance exceptions to A.I.D. regulations were as follows: (1) USAID/Egypt was not complying with verification policy requirements concerning whether the Government of Egypt had established a system of records that documented the arrival and disposition of A.I.D.-financed commodities; (2) USAID/Egypt had not performed systematic end-use checks and follow-up actions to assure proper commodity utilization; and (3) USAID/Egypt had not performed required follow-up actions to resolve reported commodity losses and damages.

Internal Control

The audit disclosed the following areas of weak internal controls:

(1) Due to systems weaknesses in providing disbursement information to the CIP Arrival Accounting System, USAID/Egypt lacked the capability to effectively verify whether CIP commodities were received in the quantity and condition for which payment was made.

(2) USAID/Egypt lacked procedures for systematic verification of commodity disposition and utilization, and follow-up on disclosed problems.

(3) USAID/Egypt procedures did not provide for effective monitoring on reported lost and damaged commodity shipments.

The review of compliance and internal control was limited to the finding areas discussed in the report.

AUDIT OF
USAID/EGYPT CONTROLS OVER THE
ARRIVAL AND DISPOSITION OF
COMMODITY IMPORT PROGRAM SHIPMENTS

PART III - APPENDICES

Selected Past Inspector General And GAO Findings
On The Arrival And Disposition Of
Commodity Shipments

(1) Office of Inspector General Audit Report on the Financial Procedures and Controls of the Commodity Import Programs of Egypt. Audit Report No. 6-263-81-1 dated November 30, 1980.

- A.I.D.'s accounting and information system for CIP's did not provide all the information needed by management for efficient program implementation, nor did it have adequate controls to prevent misuse. A.I.D./W reports of disbursement had not been timely and accurate for controlling local currencies generated under CIP assistance. Also, the system did not reach the Letter of Credit level; therefore, the needs of USAID/Egypt, as prime program manager, were not addressed.
- Quarterly reports continued to accumulate for commodity losses, but no effective actions had been taken by the responsible action officers, and those losses that were recoverable and collectable needed to be identified and pursued.

(2) Office of Inspector General Audit Report Covering the Internal Operating Procedures Used by Management in the Arrival Accounting and End-Use Functions of Commodity Import Programs in Egypt. Audit Report Number 6-263-81-5 dated December 30, 1980.

- Since the GOE had not yet achieved the capability to establish and maintain an adequate commodity arrival accounting system, USAID/Egypt assumed this responsibility for the past 5 years. However, since the 1976 Area Audit General (now Office of Inspector General) audit report, little improvement had been made in obtaining timely and accurate information on commodity arrivals necessary for effective arrival accounting procedures and controls.
- The combination of A.I.D./Washington disbursement information based on Letters of Commitment rather than Letters of Credit and the USAID/Egypt system that bypassed A.I.D./W disbursements, precluded full assurance by USAID/Egypt that commodities paid for by A.I.D. were received in country and processed into Egypt's economy.

APPENDIX 1

Page 2 of 2

-- While improvements from the 1976 review were significant, end-use coverage saturated some commodities while neglecting other commodities. In addition, plans and benchmarks were on a calendar year basis, but reports were identified by fiscal years.

(3) Office of Inspector General Draft Memorandum Report - Improvements Are Needed In The Accountability Over Commodities Imported Into Egypt - October 1983.

-- Payments made by A.I.D./Washington were neither included in the USAID/Egypt arrival accounting system database nor identified for follow-up action. Since these expenditures were outside the accounting control of the Mission, there was no way to ensure that all commodities paid for by A.I.D./Washington were received in Egypt.

-- The lack of adequate data on payments made by A.I.D./Washington impeded USAID/Egypt's ability to identify and follow up on commodities items to be received.

(4) GAO Exit Paper - Review of ESF Assistance to Egypt - June 1987

-- The arrival accounting system was inadequate for determining the status of supplier shipments and importer receipts. It was noted that (1) shipping documents were not generally supplied to the arrival accounting staff until 3 or 4 months after commodities were released, and (2) although suppliers were required to provide copies of shipping documents they were not frequently provided and millions of dollars in CIP arrivals were not accounted for, thus creating the potential for diversion of commodities.

-- The procedures for end-use monitoring, when conducted, provided reasonable assurance that commodities were used as intended. However, end-use monitoring has been severely restricted in 1987 because personnel were diverted to other activities.

memorandum

APPENDIX 2

Page 1 of 13

DATE: July 07, 1988

REPLY TO
ATTN OF: OD/CMT/IS, Robert B. Richardson

SUBJECT: Draft Audit Report

TO: RIG/I, Joseph Ferri

Thru FM/FA, James B. Brody

RIG/A Response by

Item Number *

Item # 1 1. This audit has been conducted at an important juncture in the activities of the Commodity Management & Trade (CMT) office. The thrust and scope of the audit are appropriate. We agree with many of the findings and accept some of the recommendations. Most of the fundings and recommendations however, have been overtaken by events. Certain major discrepancies contained in the report should be answered in order to clarify some of the issues being addressed. Smaller errors in fact should be addressed, more to correct the record than to change the overall direction of the report. One major conceptual failing in the report should be addressed as it is central to CMT's efforts to tighten controls over the Commodity Import Program (CIP).

2. (a) A brief background description of CMT's attempts to solve its arrival accounting problems will shed light on some of the statements made in the Report about the nature of the problems and will assist the reader to follow how solutions to the arrival accounting problems have been found.

(b) In January, 1986, CMT requested a comprehensive audit of the CIP that at that point had disbursed over \$3.0 billion since 1975. Although several minor audits had been performed in the past, there had never been a methodical, consistent approach to auditing what had become the largest single activity in the history of AID. The Regional Inspector General (RIG) Office agreed to begin the audit in June 1986. (This date later slipped somewhat to September 1986). However, in June, 1987 the RIG, in consultation with AIG/A from AID/W, decided after a false start lasting some three months, that the audit should be discontinued.

Item # 2

* NOTE: RIG's numbered Responses to Management's Comments are contained in Appendix 3.

Item # 3 The verbally stated reason for discontinuation was that the CIP was "too big and too complicated" to be audited by RIG. The written reason was that, since the exchange rates in Egypt were soon to be unified, the CIP would no longer be continued so that there was no point in concluding the audit.

Item # 4 (c) In May, 1987, the GAO in reviewing certain aspects of the AID program in Egypt was told about the aborted audit and that the CMT had been obliged to do its own assessment of its weaknesses and to commence corrective action on its own. The task was prioritized as follows:

- (1) Strengthen personnel, (2) Strengthen controls over financial management and (3) Strengthen controls over arrival accounting.

Item # 5 It was felt that at the time of the GAO visit, although CMT had the plan developed for strengthening control over arrival accounting, it had not begun to implement as yet because the first two tasks had only recently been completed. GAO prepared an exit report in June, 1987, highlighting the arrival accounting situation as discussed with CMT and it was at this point that the RIG interest began in CIP arrival accounting. The current audit therefore, was conducted at the same time as CMT was designing and installing the new arrival accounting system and, although the auditors were engaged in their activity during this period, certain developments have occurred such that much of the audit's findings have been overcome by events.

- Item # 6 (d) It should be pointed out that whereas the audit suggests that certain improvements were carried out as a result of "audit concerns", it would be more accurate to state that improvements were being set in place according to the CMT agenda for implementation as the result of a logical progression of the corrective work although some of the improvements did occur while the audit was being conducted. Furthermore, the assertions by the audit that CMT held problems of arrival accounting and loss/damage correction to be "low priorities", in fact, CMT considered these issues to be extremely important but not logically addressable until the two other priorities of personnel and financial matters had been corrected.
3. The first issue addressed by the audit deals with AID regulations covering the maintenance of records in Regulation I, Section 201.41. The first sentence of para 2 on page 1 of the report comes directly from Regulation I. The rest of this paragraph comes from the auditors and selected portions of HBK 15. Nevertheless, the report does say at the top of page two, that if the GOE cannot assure availability of data for end-use verification, then the USAID "can" (quotes added) maintain its own system until the GOE can do it on its own. This point is raised again on page 9 of the Report. As a sad matter of reality, USAID has been obliged to keep responsibility for arrival accounting (as the auditors point out) but this fact later improperly becomes a "compliance exception" on page 32 of the Report. Certainly, a periodic review should be conducted to assess the GOE's ability to keep its own arrival accounting records¹. However, two items raised by the Report itself on this matter appear to be germane but ironic: 1) Those officials in the GOE with whom we would presumably discuss the matter of GOE assuming responsibility for arrival accounting are the same officials who, according to page 23 of the Report, turned down the USAID request to contract for the end-use monitoring function because there are no firms in Egypt that can do the work even though several of the U.S. "Big 8" accounting firms are represented here. 2) In the absence of a thorough audit of how the GOE accounts for its own arrivals we feel it would be rather naive to suggest that the accounting is satisfactory as per page 10 of the Report.
- Item # 7

Item # 8 4. Although the stated purpose of the audit on page 3 of the Report is the examination of public and private sector arrivals, the Report has been limited to public sector importations. It would have been more appropriate for the Report to show that, in fact, private sector arrival accounting was examined and found to be entirely satisfactory. This is not to seek kudos for the private sector CIP but rather to note that many elements of concern that CMT had on the public sector side were consciously avoided when the private sector program was begun and certain elements now determined to have been useful on the private side are now being applied to the public side.

1/ See response to Recommendation 3 on the update of M.O. 15-3 dated June 1, 1988, which reasserts the Mission's finding that the GOE is not able to maintain adequate records.

5. The following are factual clarifications by page not bearing directly on the general outcome of audit but stated for the sake of accuracy:

- Item # 9 Page 4. The audit claims to have reviewed \$18.3 million of transactions approved between April, 1986 and December, 1987. The number of approved transactions during this period was \$349 million making this selectively-drawn audit sample somewhere on the order of 5 percent which may not be statistically significant for audit purposes. The Report repeats this issue on page 15.
- Item # 10 Page 5. The audit states, "followup, feedback and corrective actions on reporting commodity utilization problems have been lacking". This statement parallels the audit Statement on page 23 "... the CMT set up an End-Use Report Action file in March 1988 ..." Unfortunately the auditors failed to add that the Action File now requires informing FM of CMT action as required by the new Mission Order 15-3 dated June 1, 1988, several weeks before the draft audit appeared. Perhaps this inconsistency in the audit would be clarified by replacing "...have been lacking ..." with "... are no longer lacking."
- Item # 11 Page 5. The same applies for the following statement on "reported lost or damaged commodity shipments". The new system that was being installed as the audit was taking place has now effectively handled all four transactions selected by the auditors themselves on pages 28 and 29 thus making the statement above from page 5 no longer valid. See comments for pages 28, 29.
- Item # 12 Page 7. "Effective verification of CIP shipment arrivals is unlikely, due to the lack of complete and timely shipment information". This statement has long been overtaken by events. Since November, 1987, the Alexandria CMT Office has been obtaining all bills of lading from every ship carrying AID commodities directly from the shipping companies. This is a feature of the new CMT Arrival Accounting system to be discussed under section 6 of this memorandum.

- Item # 13 Pages 7, 9, 15, The audit hammers away at the existence of "... material internal control and systems weaknesses ..." by speaking at least 3 times of "\$263 million of missing arrival verifications as of April 30, 1988." Ironically, these figures come from the new CMT Arrival Accounting system and not from the auditors. The very fact that the auditors could find this data on the CMT system means that, in fact, there is a system, it works and it is effective. Because of constant followup work being done by the CMT staff, by the time this memorandum was completed, the value of unverified shipping arrivals had been reduced to \$84.8 million. Thus, the auditors have unwittingly used their own assertion to make CMT's case that the new accounting system is alive and working well. The auditors failed to point out that one of CMT's greatest problems - the lack of shipping documents - has been addressed by the new CMT Arrival Accounting system such that, from December 1987 to May 1988, the value of missing documents has fallen from \$104 million to \$19.6 million.
- Item # 14 Page 10. The audit claims that since "... 1975 the Mission has considered that the Government of Egypt was not capable of maintaining acceptable commodity records". In fact, the early Loan Agreements beginning in 1975 through 1976 (026, 027 and 029) included, as an attachment to Implementation Letter Number 1, specific guidance on how the GOE was to maintain arrival accounting records. These instructions, prepared for the Egypt CIP were then incorporated into AID's Handbooks for overall Agency use. It was not until late 1976, when it was clear that the GOE could not handle these reporting requirements, that the USAID took charge of arrival accounting (including port monitoring for the CIP).
- Item # 15 Pages 11, 18. The audit draft makes numerous references to M.O. 15-3. Clearly, however, the references in the audit are to the version of March 1979, per page 19 of the Report. The new version 15-3 was printed on June 1, 1988 and invalidates a number of the audit's assumptions on how the Mission handles arrival accounting/end-use monitoring well before the audit was completed.

- Item # 16 Pages 11, 12, 13. The audit refers to an AAG Report in 1980 and an IG Report in 1983 done on arrival accounting. But, in addition to revealing the paucity of audits done on what had become by 1983 a \$3.0 billion program, the audits themselves pointed more to problems in AID/W than in the Mission. More on this in Section 6 of this memo.^{2/}
- Item # 17 We were truly amused by the auditor's statement that we had not received the Monthly W-214 Reports^{3/} from AID/W "for several months" even though the drafter knew that we did not get reports from November, 1986, until March, 1988, a period of some 16 months.
- Item # 18 Page 14. The declaration quoted by the auditors from Vulnerability Assessment for 1987 is a pure fabrication and is found nowhere in the Assessment document itself.
- Item # 19 Page 15. The auditors received "... copies of mailed documents as evidence". We may be overly rigorous in CMT, but we would expect "evidence" of mailing to consist of a Return Receipt of a Registered Letter and not simply copies of what the supplier claims that he sent. In this case, we feel the auditors were a little too easily satisfied.
- NOTE: Although a RIG/Egypt auditor specifically visited AID/W, FM/PAFD, for the purpose of verifying CMT's problems with the W-214 Report, no report was ever made showing that the entire AID/W program accounting system covering several billion dollars on current account had by then been totally out of commission for over 6 months with no fixed prospects of being repaired!!!
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2/ The draft GAO Report was received and answered by CMT by June 7, almost two weeks before receipt of the initial draft.

3/ The old W-214 Report has been replaced with a new Status of Disbursement Authorization Report. We will refer to it as the new W-214 Report until a new code identifier is assigned to it.

- Item # 21 Pages 16, 17. The audit feels that AID/W should improve its reporting on arrival accounting, then states that the Mission should do it. Finally, we are told that the GOE should do it. However, the USAID couldn't get the W-214 Report from AID/W for 16 months. How should the GOE do better than that? This highlights the fuzziness of the analysis on what exactly the RIG wants to see done.
- Item # 22 Page 20. Again, as on page 5, the drafter either has a problem with the verb tense in "... has been little or no feedback on action taken by CMT to correct deficiencies ..." or the drafter forgot this statement when on page 23 he wrote that "the CMT set up an end-use report action file ..." which should have been followed by "in full accordance with M.O. 15-3". In any case, copies of all End=Use Reports have always sent to the RIG Office for review and follow-up.
- Item # 23 Page 25. "\$3.4 million in reported lost or damaged commodities shipments dating back to 1980" refers to .23 percent of disbursements since then, rendering statistically insignificant whatever this reference is intended to show.
- Item # 24 Pages 28, 29. On these pages are discussed the only four specific transactions in the Report. This seems like a small number when one considers that CMT runs about 200 to 300 transactions at any given time. In any case, of the four transactions as of March 31, 1988, two had been zeroed out and letters on the other two had been sent on May 25, 1988 according to procedures of the new system.
- Item # 25 Page 30. The nearly "2.7 million" deleted by FM represents less than .08 percent of total disbursements to 1985 thereby creating a "de minimus" argument.

6. Major Audit Flaw:

Item # 26 Although the above errors in fact can be corrected or deleted with little effect on the main thrust of the audit, one major flaw exists that should be clearly understood by the auditors and corrected in order to maintain the integrity in the audit.

In numerous places in the audit, the importance of AID/W is listed as the critical chokepoint for providing the link between disbursements and shipments. The audit never gives us any idea about what it is that AID/W is supposed to do or why. But, the suggestion made in the audit that AID/W be responsible for this element of the CIP, reveals a lack of understanding of the CIP process and of the newly-installed CIP arrival accounting system. This is truly unfortunate since the audit was being conducted as the final details of the system were being debated and implemented. And, instead of learning the system, the auditors spent their time pointing out shortcomings that now have been overtaken by events and are being cured by the new system. As set forth above, much energy seems to have been devoted in the audit to implying through careful uses of verb tenses that what was wrong in the past somehow continues into the present.

Item # 27* The linking of disbursements to shipping as proposed by the audit is an important but limited goal that is not sufficient for CMT to properly account for CIP funds because commodities and expenditures must be tied firmly back to the allocations.

Item # 28* Although bills of lading are collected as payment documents in AID/W, the actual verification of shipping comes from the CMT port monitoring function. That is to say, if payments in AID/W are made against faulty shipping documents, the necessary physical "evidence" of this will appear in Egypt.

Item # 29* The full measure of CMT's task is to tie arrivals all the way back to allocations and, ultimately, to the grants. This is done by verifying the amounts of disbursements as well as by counting the commodities that arrive. The linking of disbursements to shipping per the audit therefore, is only a half measure and insufficient to the full task.

Item # *30 CMT was obliged to do all of the corrective arrival accounting system work under conditions that included (A) the refusal by RIG to assist CMT with the kind of comprehensive audit that would have helped us to turn up these problems in 1986 and (B) the impossibility of obtaining a W-214 Report for the "several months" between November, 1986 and March, 1988. The mechanics of the new CMT system therefore were thrust upon us by elements beyond our control and are reflective of these two major factors. We simply did not feel that a solution to CIP accounting shortcomings should wait until AID/W had solved its program accounting problems.

Item # *31 In order to properly understand the full scope of the arrival accounting system, one must view the AID/W role as that of a paying office. That is, the Mission requests AID/W to open financial instruments on behalf of the Egyptian importers and to make payment to suppliers upon receipt of documents required by CMT instructions. The auditors have been led away from the scent by the fact that one of the documents required for payment is a bill of lading. In order to bring the auditors back on track, one should imagine the case in which all payments were made by USAID/FM. In such a case, the bills of lading would be presented to USAID as documents for payment but the arrival accounting system would still require CMT port monitoring no matter where the bills of lading come from. They now come directly from the shipping companies as the ships arrive in Egypt and from the suppliers and, to our knowledge, we have never received a falsified bill of lading and can think of no scenario in which we should, given the fact that we now monitor arrivals against fresh bills of lading. However, in the unlikely event that we ever turn up a falsified bill of lading, we will deal with the matter as necessary. Of course, the use of bank L/COMs largely precludes USAID/FM from being the paying office.

The new CIP arrival accounting system needs to satisfy two basic questions:

- (a) Did the importer receive the goods he bought and AID financed?
- (b) Have the allocated funds been properly used?

The audit unfortunately blurs these questions by concentrating on the linking of disbursements with shipping.

CMT maintains two sets of files for the sake of simplicity of cross verification and for the ease of work functions. These are:

- (a) Transaction files which follow each procurement from allocation of funds up to USAID's concurrence in a given transaction by the issuance of our Letter of No Objection (NOL) which includes all relevant information including importer's name/address; supplier's name/address; full commodity description/price/delivery terms and L/COM number.
- (b) Financial files which follow the funds from the grants through the allocation process to the issuance of L/COMs to disbursements by banks or AID/W.

The CMT Arrival Accounting Office now uses bills of lading and suppliers' invoices not only for conducting port monitoring exercises but also to serve as the documents that will close the transaction and financial files. The bills of lading received from the shipping companies are to be used after completion of port monitoring to close the transaction files and the bills of lading and invoices received from the suppliers will be used to close the financial files after verification with AID/W of disbursements through the new W-214 Report.

- Item # 33* The CMT computerized data system is called the "CIP AA System". It contains all information relative to financial and procurement activities under each grant. The heart of the new CMT Arrival Accounting System is the linking of arrivals of commodities and their values with the grant amount from which all allocations of funds were made. That is to say, the new system converts from a linear accounting system to a circular one through a process of "closing the loop between arrivals and allocations."
- Item # 34* The grant funds are allocated for use by the importer who then performs procurement and makes an award. CMT issues an NOL which authorizes the importer to purchase specific commodities using a specific amount of money from his specific grant allocation. At this point, the new CMT Arrival Accounting System takes over by subtracting commodity arrivals and values from the NOL amounts until the NOL is zeroed out. If the NOL amounts are not zeroed out, the CMT portfolio manager responsible for the transaction finds out why not and takes remedial action.
- Item # 35* All of the foregoing was explained to the auditors during the audits. We realize that it is somewhat complicated but it should have been absorbed. The audit draft however, does not reflect absorption of the concept or understanding of the system now going into place.

Hundreds of hours of CMT Staff time was taken by the auditors while we were trying to design and implement the new arrival accounting system and to locate the vast number of shipping and financial documents we discovered to be lost thanks to the new system. With only two, and at times three, members of the CMT Arrival Accounting staff available to install and implement the new system, we still patiently answered all questions and opened all files to the auditors. The resultant draft audit would tend to show that CMT time was not well used in this process and could better have been devoted to locating the missing documents and implementing the new system per our agenda.

7. Recommendations:

- Item # 36 1) One of the express purposes of the new CMT Arrival Accounting System is to locate and account for previously unverified CIP arrivals. This work has been in process since November, 1987 and will continue through completion. This recommendation is now considered closed.
- Item # 37 2) This recommendation fails to provide all but a half-measure solution to CIP Arrival Accounting problems. As elaborated in Section 6 of this memorandum, full tracking of CIP transactions including disbursements and shipments is now available in USAID/CMT. This recommendation has been overtaken by events and should be closed.
- Item # 38 3) The Mission has already decided this issue in Mission Order 15-3 which appeared June 1, 1988, several weeks prior to completion of the draft audit. It was determined by the Mission before issuance of M.O. 15-3, that the GOE is not able to satisfactorily account for arrivals of commodities financed under the CIP.
- 4) This is for USAID/FM to answer.
- Item # 39 5) This recommendation assumes that the GOE is more willing to expand staff than the USG. As such, the recommendation manifests a considerable amount of unfamiliarity with conditions in Egypt. USAID will however, continue to pursue the avenue of contracting for end-use monitoring services. We consider this recommendation now closed.
- Item # 40 6) Having set up its own system to follow-up on end-use problems, CMT is not likely to dismantle it. This recommendation is now closed.
- Item # 41 7. It is CMT's intention to continue to inform USAID/FM of the resolution of reported losses. This recommendation can now be closed.
- Item # 42 8) The new Arrival Accounting System has been designed and implemented by CMT to prevent any future accumulation of reported outstanding losses and damages. This recommendation can now be closed.

Office Of Inspector General Response
To USAID/Egypt Management Comments

1. The Regional Inspector General for Audit, Cairo (RIG) recognizes that CMT has taken certain steps to strengthen CIP controls. These steps were long overdue. The issues presented in the report, however, remain relevant and have not been overtaken by CMT's recent system improvements.
2. This statement is incorrect. Six audit reports were issued by this office between 1980 and 1981. In 1987, another report concerning a CIP-related project was issued. GAO audits relative to the program were made in 1984 and 1987.
3. There were several reasons for discontinuing of the 1987 audit: (a) CMT records of early grants were in total disarray; (b) the Mission Director was vocal about wanting to terminate the public sector CIP; (c) the unification of the exchange rate took away a major incentive to use the program; (d) and program levels were decreasing raising further uncertainties. A 43 page report was prepared that summarized the audit options.
4. Day to day management of the CIP is a fundamental responsibility of the Director, CMT. The Director need not wait for an audit to point out internal weaknesses. There was a long history of reported CIP shortcomings. CMT did not need further affirmation of its management problems as it was acutely aware of the fact that it could not account for hundreds of millions of dollars in purported arrivals. Also, CMT could not reconcile its financial records of earlier grants, and USAID/Egypt end-use checks and RIG reports were pointing out utilization problems.
5. This statement is incorrect. RIG interest dates back to 1976. Also, concerns over the Arrival Accounting system deficiencies were presented in our audit of the Controls Over The Special Account (Audit Report No. 6-263-87-9 dated June 25, 1987). This audit work was performed nine months before the GAO report in June 1987. Also, the GAO audit team consulted this office concerning deficiencies in the arrival accounting system during their audit.

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6. It was more than coincidental that the "improvements" were initiated during the course of the audit, and after briefings of CMT management. Regarding the issue of priorities, the reference to low priority was presented in the context of other office responsibilities.
7. A.I.D. regulations require a determination regarding the adequacy of the grantee's arrival accounting system. The point of the report is that there is no documented analysis of the Mission's determination. As suggested by the above comments, the Mission merely asserts that the GOE cannot operate a satisfactory system (See Office of Inspector General comments, pages 10 and 11).
8. The audit also covered private sector imports. The remaining segment of the paragraph is not relevant.
9. The sample was not intended to be statistically significant. The purpose of the sample was to test if the CIP Arrival Accounting system was adequately recording shipment arrivals into Egypt. There was no reason to increase the dollar value of the sample, since the report point was made with the sample selection, and the sample results were consistent with CMT and FM reports of unverified arrivals.
10. Until February 18, 1988, when RIG auditors briefed the Director, CMT concerning the lack of a system for follow-up on end-use problems, no formal follow-up was performed and FM received no feedback on resolution of problems. To say "...are no longer lacking" would be premature.
11. In the February 18, 1988, briefing, the Director, CMT agreed that follow-up efforts on commodity losses identified by CMT were minimal, and this area should be addressed. In the four transactions described there were no available records that indicated CMT management knew about the resolution of these cases until the audit disclosed them.

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12. Recent developments have allowed better monitoring by Alexandria CMT staff. Nevertheless, the staff has always relied on shipping documents (bills of lading, invoices and packing lists) to verify arrivals, and those documents sent by CMT Arrival Accounting staff are still lacking. CMT's records showed that as of July 17, 1988, there were over \$ 50 million in commodities that have not been verified. These figures include transactions that occurred after November 1987.

13. The FM-issued quarterly CIP Arrival Accounting/End-Use Reports, have for years reported large reported arrival deficits. Although CMT has reduced the unverified shipment arrivals, the bottom line is that currently at least \$150 million in disbursements (private and public) since Grant 263-K-604 have not been verified. The CMT reply repeatedly mentions the "new" accounting system. This system is essentially the same automated system that was developed in 1982. Due, in part, to RIG and GAO audit work, CMT has attempted to make a greater effort to find missing shipping documents (through several means), and to gradually reduce the unverified amounts. In the past, the arrival accounting system has slipped back into its original state of disorder after the pressure to perform arrival activities was reduced.

14. It is not material whether it has been since 1975 or 1976 that the GOE could not handle the system. The date used in the report was changed to 1976.

15. The new Mission Order generally restates the previous order. As such it does not invalidate anything in the report.

16. Contrary to CMT's statements that few audits were performed, six audits were completed by the Area Auditor General (AAG) between August 1980 and February 1981. GAO also issued a report in 1984 and "drafted" another in 1987. Finally, in 1986, the RIG issued a report on the audit of the Production Credit Project (a CIP type project). These audits provided indepth coverage of the CIP program and made appropriate recommendations for program improvement. The two AAG audits referred to in the report as issued in 1980 included other topics in addition to arrival accounting.

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17. Contrary to the CMT statement, a W-214 report was received for February 1987 (albeit handwritten and untimely). Also, the CMT Program Finance section received a W-214 in July 1987, but the report was inaccurate and unreconcilable. According to the CMT Program Finance Section Chief, since January 1988 AID/W disbursement information has been fairly accurate.
18. The statement appears on page 29 of the supporting papers to the Mission's 1987 internal control assessment.
19. We know of no requirement that shipping documents be mailed on a registered basis, nor would we see any need to question the veracity of exporters on whether they mailed the shipping documents.
20. This statement is probably incorrect. In any event, it is not relevant to this audit.
21. RIG wants USAID/Egypt to develop in coordination with the A.I.D./Washington Office of Financial Management disbursement information that will allow it to match disbursements made by A.I.D./W with actual arrivals in Egypt. (See Recommendation No. 2.)
22. There was no formalized system of feedback between CMT and FM on end-use reports until the audit results were disclosed to the Director, CMT. It remains to be seen whether the system will be effective.
23. In RIG's view \$3.4 million is a large amount that cannot be discounted as statistically insignificant.
24. Based on discussions with CMT and FM officials, RIG knew that CMT was not adequately following up on losses. The four case examples were only to get an idea of what the losses involved, and to see if CMT attempted to determine whether A.I.D.'s interests were being protected.
25. Nearly \$2.7 million is a significant amount of money in absolute terms. Moreover, RIG knows of no authority that USAID/Egypt has to arbitrarily waive possible rights in these cases.

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26. RIG disagrees with CMT that its actions have corrected the fundamental problem of not being able to match arrivals and disbursements which are basic internal control requirements of any payment system (See Office of Inspector General comments, pages 10 and 11).

27. The report does not advocate linking disbursements with shipments. The report says disbursements and arrivals in terms of quantities and condition.

28. If the bills of lading presented for payment are different from the bills of lading supporting the arrival of commodities, the system in Egypt will not catch the differences. The system has no way of specifically matching documents supporting payments with those supporting shipments and/or arrivals.

29. This is a fiscal task directed to determining the status of allocated amounts. The audit was not interested in whether a particular ministry spent all of its allocation. The audit was directed to knowing whether the goods we paid for arrived in Egypt in proper condition (and were used).

30. There were 6 reports issued by this office between 1980 and 1981. The problems were clearly identified and understood. CMT, despite all this information, failed to take substantive corrective action. The report point is that necessary information in addition to gross numbers (as presented in the W-214) was not provided to match with CIP shipment arrivals in Egypt and disbursements made by A.I.D./W. Despite CMT's efforts the problem still remains.

31. This section contains procedural information that is not pertinent to the audit. CMT must provide the verification of arrivals. That is the primary point of this report. Depending on the point in time when examined, the undocumented arrivals ranged from \$150 million to \$400 million. This situation is unacceptable and must be corrected.

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32. To our knowledge, bills of lading "abstracts" were only provided to notify USAID/Egypt project officers of expected or recent arrivals. They were not used to close "transaction files."

33. Without necessary information from A.I.D./W that can link disbursements to CIP shipment arrivals into Egypt, the system lacks the capability to systematically verify that commodities paid for by AID were received and disposed of in the condition for which payment was made.

34. This information is made available through exception reports, but is not something new. If CMT portfolio managers are checking on various "No Objection Letter" discrepancies, this is part of a systems check, but it is not pertinent to the audit report.

35. These comments are capricious. As stated several times previously, USAID/Egypt was the beneficiary of audit advice and counsel on numerous occasions. More importantly, it is a responsibility for the program manager (CMT) to take the actions necessary to effectively operate the program on a day-to-day basis. Waiting for an audit report is not an excuse for the lack of CMT action over the past several years.

36. RIG is responsible for determining whether actions taken or promised are sufficient to resolve or close recommendations. The recommendations will remain open officially until RIG determines when to close them.

37. CMT misses the point. The audit scope and the full tracking of CIP transactions is not available to determine that A.I.D. received commodities for which payment had been made. A systematic "tie in" between commodity disbursements from Washington and commodities that arrive in Egypt is needed. Although there may be recent system improvements, the linkage is still not apparent.

38. The Mission Order is essentially a rehash of the 1979 Mission Order with a few responsibility changes that have been in effect for several years. As for a survey of GOE's capability to account for arrivals, there is no evidence that the Mission performed such a review.

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39. RIG does not assume anything. Expanded end-use checks are needed, and should be conducted to assure integrity of the program and proper usage of commodities. There has been an obvious lack of interest regarding shipment arrivals, clearance and disposition that needs to be rectified on a permanent basis.

40. RIG is not suggesting dismantling anything. To the contrary, a viable end-use system is absolutely necessary. The audit recommendations are directed to strengthening the internal control systems.

41. RIG is encouraged that a system has now been set up that provides for reporting on the resolution of reported losses (See Office of Inspector General comments, page 21).

42. The statement that the "new Arrival Accounting System" had been designed and procedures implemented to prevent future accumulation of reported losses and damages is responsive to our concerns. However, an appropriate period is needed to ensure compliance (See Office of Inspector General comments, page 21).

List Of Recommendations

	<u>Page</u>
<u>Recommendation No. 1</u>	5
We recommend that USAID/Egypt account for all unverified Commodity Import Program commodity arrivals in Egypt.	
<u>Recommendation No. 2</u>	5
We recommend that USAID/Egypt, in coordination with A.I.D./Washington's Office of Financial Management, identify and develop data base modifications to allow effective reconciliation of Commodity Import Program disbursements with commodity receipt data recorded in the arrival accounting system.	
<u>Recommendation No. 3</u>	5
We recommend that USAID/Egypt reexamine the Government of Egypt's capability to operate an arrival accounting system that conforms to A.I.D. Handbook 15 and A.I.D. Regulation No. 1 requirements.	
<u>Recommendation No. 4</u>	12
We recommend that USAID/Egypt develop and revise, as necessary, yearly end-use plans that provide for comprehensive coverage of imported commodities, including those commodities with particularly high vulnerability for misuse or of concern to Mission management. The plans should be jointly developed and agreed upon by the Mission's Office of Financial Management and Office of Commodity Management and Trade, and include benchmarks for measuring performance.	

Recommendation No. 5 12

We recommend that the Office of Financial Management continue negotiation efforts with the Government of Egypt to expand end-use audit coverage through outside contract services.

Recommendation No. 6 12

We recommend that the Office of Commodity Management continue newly initiated follow-up efforts on reported end-use audit problems, and provide timely feedback to the Office of Financial Management regarding corrective actions needed and/or taken.

Recommendation No. 7 17

We recommend that USAID/Egypt Office of Commodity Management and Trade resolve all outstanding listed commodity losses and damages, and inform the Mission's Office of Financial Management of the resolution of reported losses or other actions taken.

Recommendation No. 8 17

We recommend that USAID/Egypt implement A.I.D. Regulation 15, Mission Order 15-3, and the Office of Commodity Management and Trade directive for handling, reporting and clearing commodity losses and damages.

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