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# AUDIT OF
# A.I.D. ADVANCES TO THE
# GOVERNMENT OF EGYPT

Audit Report No. 6-263-90-02
December 28, 1989

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

December 28, 1989

MEMORANDUM FOR D/USAID/Egypt, Marshall D. Brown

FROM : RIG/A/C, F. A. Kalhammer Kalhammer

SUBJECT: Audit of A.I.D. Advances to the Government of Egypt

The Office of the Regional Inspector General for Audit in Cairo made the above-mentioned audit and submitted it in draft for your comments, which are attached to this report as Appendix 1. In addition to copies for you and your Deputy, eight copies of the report have been forwarded to the Mission's Audit Liaison Official for appropriate distribution and action. The report contains one recommendation which is considered to be resolved upon report issuance. Please provide me with an update of the actions taken to address the recommendation within the next thirty days. The cooperation and courtesy extended to RIG/A/C's staff during the audit is very much appreciated.

## Background

Two years ago this office made a review of "project-related cash advances" which resulted in the issuance of Audit Report No. 6-263-87-14. A copy of the Executive Summary of that report is attached as Exhibit 1 to this report. In July 1988, USAID/Egypt issued Mission Order 19-5 in order to better regulate the use of project related advances.

In August 1988 USAID/Egypt and the Government of Egypt (GOE) executed Amendment No. 8 to the Memorandum of Understanding (MOU) governing the operations of the Special Account in Egypt. The account was established under the provisions of Sec. 609 of the Foreign Assistance Act. Local currency (Egyptian pounds) deposited into this account represents sales proceeds of goods (wheat, raw materials, intermediate products) purchased with A.I.D. cash transfer dollars or donated under A.I.D.'s commodity import program (CIP) valued at $200 million per year for use by Egyptian industry, in both the public and private sectors. While owned by the GOE, monies disbursed from the Special Account are programmed and used for purposes mutually agreed to between A.I.D. and the GOE. In 1988, for the first time, a large amount of these deposits (380 million pounds equivalent to more than

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$1/2 billion, perhaps, the rate in effect when the commodities arrived in Egypt)* was programmed and disbursed to the GOE for general budgetary support to several "development ministries" with which USAID/Egypt has close working relations, among them the Ministry of Agriculture.

In 1989 RIG/A/C made a review of USAID/Egypt's National Agricultural Research Project (NARP) No. 263-0152. The review included the record of GOE support for NARP as well as USAID/Egypt's disbursement of dollars under its $300 commitment to this project. The results of our audit of NARP may be read in RIG/A/C audit report No. 6-263-90-01, issued on 27 December 1989. However, our review of USAID/Egypt cash advances to that large project prompted us to isolate the issue of advances and expand its scope to include USAID/Egypt's generalized use of appropriated dollars to make local currency advances to the GOE.

## Audit Objectives and Scope

The audit was made by RIG/A/C to determine whether, in the present circumstances, USAID/Egypt's continued use of appropriated dollars to purchase local currency in order to make advances to the GOE in support of A.I.D. grant-funded projects is the most economical alternative in terms of cost to the U.S. Treasury. Using data accessible in USAID/Egypt's automated Mission Accounting and Control System (MACS), we analyzed the status of dollar-funded advances to the GOE over the past two fiscal years, that is, since issuance of RIG/A/C's previous report on this subject. The results of that analysis were also considered in the light of the eighth and latest amendment to the MOU governing the operations of the Special Account in Egypt, including the uses of monies disbursed therefrom as a result of USAID/Egypt's and the GOE's mutual programming of these resources. The audit was made in accordance with generally accepted government auditing standards.

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* At the time of this report US $1.00 = LE2.60, approximately; whereas the rate was LE2.30 in August 1988, LE.83 five years earlier, and LE0.70 earlier in the CIP program.

## Results of Audit

The review showed an initial decline in USAID/Egypt's dollar-funded advances to the GOE immediately following our previous audit. Subsequently, however, the level of advances has remained fairly even despite the fact that this method of financing has been officially described as "the least desirable" of all possible alternatives. Our analysis of the latest amendment to the Special Account MOU and the Mission Order issued as a result thereof revealed that the GOE has implicitly undertaken to provide such support as may be required for the efficient and effective implementation of A.I.D. projects in Egypt. We can therefore find no reason why A.I.D. should not seek to fund such advances from A.I.D.-generated local currency resources available in substantial amounts to the GOE. Moreover, we find the use of appropriated dollars to buy local currency, at a cost of almost $1 million in annual interest to the U.S. Treasury, to be quite uneconomical given the availability of hundreds of millions of pounds in the Special Account. These deposits come about as a result of A.I.D.'s $200 million per year CIP grants and, quite recently, in association with the use of A.I.D. cash transfer dollars to procure wheat for the GOE's food distribution system.

## USAID/Egypt's Summary Response

The Mission believes that the recommendation contained in the draft audit report has merit. In particular, it believes that project implementation could be enhanced if advances covering periods in excess of 90 days were made to implementing agencies that require advances. Since advances financed by A.I.D. may not exceed 90 days, an alternative source of funding would be advantageous. Accordingly, the Mission will seek the agreement of the Government of Egypt (GOE) to allocate a portion of the local currency resources available in the Special Account to fund advances for A.I.D. supported activities.

The Mission went on to observe that, while advances are the least preferred means of project financing, they are not only authorized but their level, when compared with USAID/Egypt's "pipeline" of over $2 billion, is not considered to be excessive. USAID/Egypt had several other observations on the contents of the following report, the full text of which has been included as Appendix 1.

## A Previous Audit Disclosed Problems in Managing Cash Advances

RIG/A/C Audit Report No. 6-263-87-14 described how project cash advances were not limited to the immediate cash needs of the recipients tested. Also, USAID/Egypt did not have an effective system for routinely following up on outstanding advances.

Project Officers and Office of Financial Management examiners did not appropriately analyze the justifications offered for advances, and consequently, contributed to the buildup of excess funds in the bank accounts of advancees. The lack of an effective follow-up system meant that advances were not recalled when excessive, and that some remained outstanding for many years. Moreover, based on responses to inquiries made during the audit, certain advances shown as outstanding on USAID/Egypt's records may have been settled, although the correct balances of others were questionable.

The foregoing audit report was issued on 30 September 1987. In July 1988, USAID/Egypt issued Mission Order 19-5 on the subject of "Project Related Advances" as part of its response to the audit report. According to Mission Order 19-5, and Financial Management Bulletin No. 3/88, cash advances, while clearly authorized, are identified as "the least desirable of all the financial methods of implementation." They involve greater risk to the U.S. Government, require close supervision, and incur interest costs. Mission Order 19-5 further states that "every effort should be made by the Project Officer and the Financial Analyst to implement projects in a way which will eliminate the need for advances," and that "this is especially true in the case of advances to the GOE."

## CIP Sales Proceeds Programmed for GOE Budgetary Support

In August 1988, USAID/Egypt and the GOE executed the eighth and latest (at this writing) amendment to the MOU which governs the operations of the Special Account in Egypt and the uses of local currency deposited therein. At the time the amendment was signed, the Special Account balance was estimated at nearly 700 million Egyptian pounds. By mutual agreement 380 million pounds were programmed for budget support to several "developmental ministries," including the GOE Ministry of Agriculture.

Subsequently in March 1989, USAID/Egypt issued Mission Order 1-8 on the subject of "Programming and Use of CIP Generated Egyptian Pounds." (A copy of this Mission Order is attached as report Exhibit No. 2.) Although the new procedures described therein included elimination of "earmarking" amounts from the Special Account specifically in support of A.I.D. dollar funded projects, it is clear that the GOE nevertheless undertook to provide adequate support for those projects as part of the "understanding" underlying the latest amendment to the MOU (see parts IV. B and V. C, Exhibit 2).

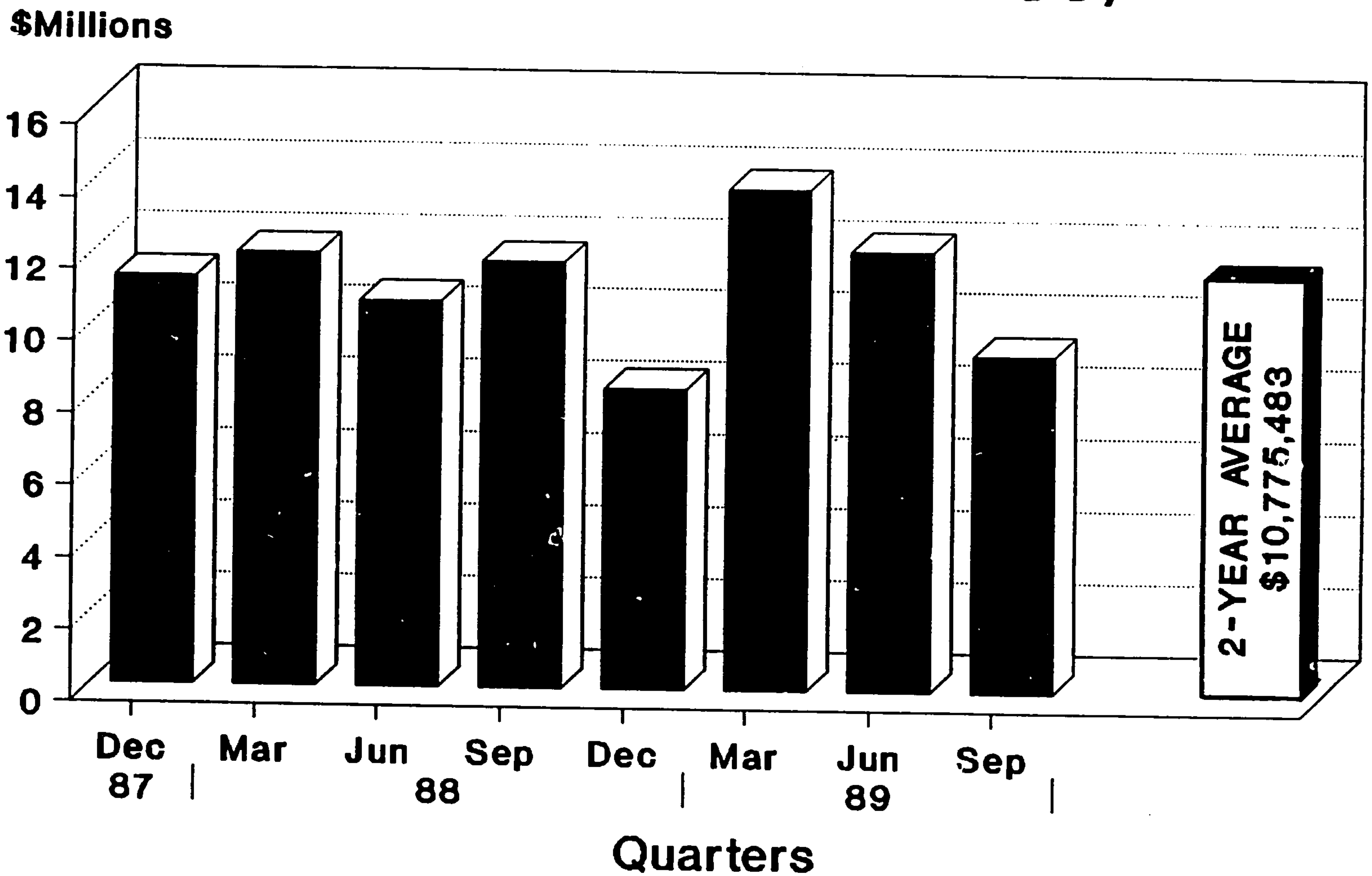
**Audit of National Agricultural Research Project (NARP 263-0152)**

RIG/A/C's review of NARP disclosed two deficiencies related to this discussion. Although the project had been operational since 1985, there was no evidence to suggest that the GOE had made its required contributions as stipulated in the project grant agreement. (This matter has been addressed in a separate RIG/A/C report on NARP.) Furthermore, it was found that USAID/Egypt had made substantial advances to NARP by using appropriated A.I.D. dollars to buy the local currency to make the advance disbursements. Moreover, many of the same problems reported previously with respect to project-related cash advances were found to have occurred under NARP. Exhibit 3 to this report provides more details about USAID/Egypt's advances to this project.

**Status of Advances Outstanding Portfoliowide**

The findings regarding management of cash advances under NARP prompted us to extend our procedures to include an analysis of all dollar funds disbursed in the form of local currency advances to the GOE. Exhibit 4 to this report, as depicted in the following graphic, presents the results of a computer-assisted analysis of USAID/Egypt's Mission Accounting and Control System (MACS) automated data base as it pertains to the subject under discussion. The figures presented in Exhibit 4 represent the quarterly balances of advances outstanding, by USAID/Egypt project, since the issuance of our previous report almost two years ago. It disclosed that despite an initial decline in advance balances subsequent to our last report, the amount of advances to the GOE had not diminished substantially thereafter, although the Mission's own regulation (Order 19-5) describes this financing method as "the least desirable." However, we did not attempt to analyze the adequacy of the Mission's controls over any advances except those made under NARP, as that was not the focus of this review.

# A.I.D. ADVANCES TO THE GOE *
## (10/01/87 - 09/30/89)



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* Details provided in Exhibit 4.

**Is USAID/Egypt's Use of Appropriated Dollars to Make Local Currency Advances to the GOE Economical?**

Although cash advances are an authorized form of A.I.D. project financing, they are also described as the least preferred of all the Agency's financing methods. In the context of current A.I.D. operations in Egypt, however, we question whether the Mission's practice of using appropriated dollars to buy pounds to make routine advances to the GOE is the most economical alternative available. Our reservations arise from the fact that each year for more than a decade now, Congress has appropriated substantial sums to purchase and send to Egypt raw materials and intermediate goods for use by Egyptian industry. The amount of this assistance currently runs at $200 million in grant funded commodities each year. Sales of these commodities result in local currency being deposited into the Special Account at the commercial bank rate of exchange in effect when the goods are imported into Egypt within five years of the A.I.D. financed commodities' arrival. So much local currency was being generated that the Mission determined it to be economically and politically prudent and necessary for USAID to agree to the GOE's use of its Special Account local currency to reduce its budget deficit, while at the same time furthering USAID's sectoral objectives.

In addition, the GOE has recently decided to use part of an August 1989 A.I.D. cash transfer of $115 million to buy wheat for its food distribution system. A partial payment of over 82 million pounds, against an expected total of about 195 million, had already been made into a separate Special Account, in accordance with the terms of the cash transfer agreement. No uses for these monies have yet been programmed.

Given this availability of substantial local currency resources, we would ask whether it is reasonable and justifiable to burden the American taxpayers with the cost* of using dollars appropriated to A.I.D. in order to buy pounds to make advances in support of A.I.D. grant-funded projects with the GOE. We believe the answer is obvious, and therefore make the following recommendation.

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* Nearly $1 million per year assuming a Federal cost-of-funds rate of 9% and average advances outstanding of $10,775,483.

**Recommendation No. 1**

We recommend that USAID/Egypt include among its local currency requirements to be obtained from the GOE Special Account such amounts as may be necessary to fund A.I.D. project advance drawdown needs. Preferably, the GOE would undertake to manage the disbursement and liquidation of such advances internally without USAID/Egypt's involvement, as this would save A.I.D. time and the U.S. Treasury money. However, if the GOE cannot or will not manage advance drawdowns for A.I.D. projects itself, USAID/Egypt should obtain an annual allocation of Special Account local currency to enable it to fund its projects' advance drawdown requirements. Another alternative would be to establish a rotating fund with a one-time allocation of Special Account funds that could be replenished from project monies as advances are liquidated.

USAID/Egypt's response to the draft recommendation follows:

> We do not believe that the answer to the question of how advances should be funded is self-evident. The local currency costs for which the advances in question are provided are costs AID agreed to finance with appropriated dollars. Advances are provided when the implementing agencies that incur the costs do not have sufficient budgetary resources to finance the costs initially and then to await reimbursement by AID. This lack of adequate budgetary resources is the identical constraint to economic development that claims a high priority in the programming of Special Account resources. The Mission agrees with the preference for using USG resources to finance costs on a reimbursement basis whenever possible, and thus we agree with the general thrust of the audit recommendation. Nevertheless we must recognize that the use of Special Account local currency to accomplish this purpose competes with other high priority uses of this local currency resource.

**OIG Comments**

The Mission's willingness to tackle this knotty issue with the GOE at a time when there are many demands on Special Account resources is indeed commendable. It recognizes not only the monetary cost of financing local currency advances with appropriated dollars but also the considerable cost in staff time and effort required to process, liquidate and monitor the Mission's portfolio of cash advances, which is not readily quantifiable, but nevertheless real.

We cannot, however, accede to the Mission's request to "soften" the report recommendation. In fact, we have modified it in order to clarify to the maximum feasible extent RIG/A/C's position in this matter. Based on RIG/A/C's understanding of the terms of the Bilateral Agreement between A.I.D. and the GOE, it is quite clear that A.I.D. has access to such amounts of local currency deposited into the GOE Special Account as it may require for its programs and operations. It is for the Mission to state those requirements, however. The pertinent section of the Bilateral Agreement follows:

> 3. In any case where commodities or services are furnished on a grant basis under arrangements which will result in the accrual of proceeds to the Government of the Arab Republic of Egypt from the import or sale of such commodities or services, the Government of the Arab Republic of Egypt, except as may otherwise be mutually agreed upon by the representatives referred to in paragraph 1 thereof, will establish in its own name a Special Account in the National Bank of Egypt; will deposit promptly in such Special Account the amount of local currency equivalent to such proceeds; and, upon notification from time to time by the Government of the United States of America of its local currency requirements for programs and operations hereunder, will make available to the Government of the United States of America, in the manner requested by that Government, out of any balances in the Special Account, such sums as are stated in such notification to be necessary for such requirements. (emphasis supplied)

**Audit of A.I.D. Advances to the Government of Egypt**

# EXHIBITS AND APPENDICES

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AUDIT OF
CONTROLS OVER PROJECT-RELATED
CASH ADVANCES OF USAID/EGYPT
Audit Report No. 6-263-87-14
September 30, 1987

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## EXECUTIVE SUMMARY

AID regulations permit advance payments in dollars or local currency to be made to contract, grant, and cooperative agreement recipients based on an analysis of the working capital required. The advance should be limited to the minimum amount needed for immediate disbursing needs, which has been defined for AID by the U.S. Treasury as being up to 30 days from the date received until expended, taking into consideration the reimbursement cycle. The period may be extended to 90 days when it is determined in writing that applying the 30-day rule would seriously interrupt or impede project implementation. USAID/Egypt generally issued 90-day advances, although on occasion project advances were made to cover periods of up to 1 year. At June 30, 1986, there were 207 project-related, unliquidated cash-advance balances totaling $18.6 million.

The objectives of this economy and efficiency audit were to determine whether: (1) cash advances were limited to recipients' immediate cash needs; and (2) an effective follow-up system was in place and working to resolve outstanding advances. The audit showed that advances were not limited to the immediate cash needs of all the recipients tested nor was an effective follow-up system in place. During the audit, the Office of Financial Management began focusing more attention on advances. Follow-up notices were sent out to some long-outstanding advance recipients and some advances were liquidated, but much more needed to be done to effectively control advances.

The conditions described in the report reflected the fact that USAID/Egypt provided advances beyond the recipients' immediate cash needs in both U.S. dollars and Egyptian pounds. Advancees consistently overestimated their cash requirements in all 10 of the cases examined in detail, and resulted in excessive advances of funds and the consequent buildup of bank account balances. Also, funds were transferred between advance accounts without appropriate USAID/Egypt review and approval. In another case, a 120-day advance that was approved, exceeded the maximum 90-day period allowed by AID regulations.

AID regulations require that federal funds be economically and efficiently used for authorized purposes and that qualified and continuous supervision is provided by the Mission to ensure that internal control objectives are



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achieved. U.S. Treasury and AID Cash Management Policies require that the cash management practices of recipient organizations are monitored so that cash is not maintained in excess of immediate disbursing needs.

The primary cause of the excessive advances was ineffective controls in USAID/Egypt Project Offices and the Office of Financial Management to ensure that AID and Treasury regulations were appropriately implemented. As of June 30, 1986, the failure to settle outstanding advances at the due dates cost the U.S. Government an estimated $854,000 in unnecessary interest. The size and number of advances should be reduced and economies achieved. We recommended implementing required procedures and better analysis of requirements. The Mission agreed with the thrust of these recommendations.

At June 30, 1986, USAID/Egypt had 207 project-related, unliquidated advance balances totaling $18.6 million, an average of about 2 1/2 advances per project. Of this amount, 165 balances totaling $16.2 million, or 87 percent, should have been liquidated in prior periods ranging from 1 month to over 8 years. In some cases, advances remained unused for more than 1 year. In response to confirmation letters sent during the audit, some advancees claimed they never received an advance from USAID/Egypt. Other advancees claimed that liquidation vouchers were submitted years earlier, or that the advances had already been refunded. Numerous recipients expressed disagreement with the balances recorded on the Mission's books.

AID regulations required the Mission to monitor the cash management practices of recipients to ensure that organizations reported regularly on the use of advances and demonstrated through such reporting that balances of advances were maintained in amounts commensurate with immediate disbursing needs. Excess balances were to be promptly returned to AID. If amounts due were not received promptly, collection follow-up notices were to be sent to the recipients not later than 45 days from the original billing date.

The principal reason for the failure to settle accounts when due, or shortly thereafter, was that USAID/Egypt did not establish the fundamental accounting controls required to safeguard the funds involved. The Mission, for example, did not regularly or routinely follow up on advances that were unpaid as of the dates they were to be liquidated. No aging analysis was regularly prepared so that management could readily identify advances that were outstanding for long periods of time. Also, no system existed for periodically verifying the balances recorded on Mission accounting records with advancees.

Unless USAID/Egypt improved its procedures and practices and provided the required continuous follow-up over unliquidated cash advances, the U.S. Government would continue incurring extra interest costs. We recommended that the Mission establish the required follow-up procedures, separate uncollectible accounts, and prepare aging analyses of the outstanding advances. The Mission agreed with these recommendations.

Office of the Inspector General

# MISSION ORDER

## UNITED STATES AID MISSION TO EGYPT

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|---|---|
| SUBJECT Programming and Use of CIP Generated Egyptian Pounds | ORDER NO. 1-8 |
| SUPERSEDES Mission Order 1-8 Dated February 13, 1989 | DATE March 2, 1989 |
| REFERENCE STATE 327494 (87) - Handbook 1, Part V (Policy Determinations), and Handbook 19, Chapter 5 | PAGE 1 OF 6 |

I. PURPOSE:

To establish Mission Policy concerning the programming and use of CIP generated Egyptian pounds and to prescribe controls to ensure proper utilization of such funds.

II. BACKGROUND:

As part of the annual Commodity Import Program (CIP) USAID/Egypt and the Ministry of International Cooperation (MIC) enter into an annual Memorandum of Understanding (MOU) which, among other things, sets forth the uses of funds generated from both public and private sector CIP's. The funds are deposited in a non-interest bearing account (Special Account) in the Central Bank of Egypt.

III. POLICY:

PD-5 and State (87) 327494 establish the guidance and controls required for the use of GOE owned local currency in AID programs. It is USAID/Egypt policy that agreement with the Ministry of International Cooperation will be reached on the use of funds on an annual basis according to the following priorities:

A- Support of USAID Administrative and Operational costs
B- Budget Support to specified development ministries or other government entities in furtherance of economic stabilization objectives
C- GOE contributions to AID dollar funded projects
D- Other ad/hoc mutually agreed upon uses in accordance with established controls and guidance

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IV. MEMORANDUM OF UNDERSTANDING (MOU):

A. It is USAID policy that the MOU will not be signed by MIC and USAID/Egypt prior the signing of the Public Sector CIP, and in most cases commitment documents will not be issued or disbursements made under the applicable public sector CIP agreement until the MOU has been signed by both parties.

B. MOU negotiations are normally undertaken by members from the USAID/Egypt Directorates of Financial Management and Program Development and Support, with assistance from the Legal Office and Technical Offices as required, and MIC. Negotiations should start as early as possible in the fiscal year and should be completed no later than March 31st. This permits adequate time to determine if there will be problems in meeting USAID/Egypt local currency requirements for ongoing projects. In this regard two concerns should be addressed; (1) Are USAID/Egypt projects included in the upcoming GOE budget and (2) are the amounts budgeted adequate to meet project requirements. The MOU will contain provisions that:

1. MIC will submit to USAID/Egypt a report that lists AID projects and amounts budgeted that are identified for inclusion in the GOE fiscal year budget, July 1st to June 30th. This report will be provided to USAID as soon as the information becomes available.

2. By September 30th each year, MIC will submit to USAID an expenditure report by project that reflects funds allocated to specific projects during the GOE fiscal year ended June 30th.

3. Whenever the cash requirements of a project fall below 30 day cash needs MIC, in coordination with the appropriate Ministry and USAID, will take necessary action to ensure that the project cash requirements are met from the Special Account.

V. PROCEDURES:

A. The amounts to be withdrawn from the Special Account in support of Section III A and B priorities established above will be determined during the MOU negotiations.

B. Budget Support:

1. It is anticipated that for the foreseeable future the single largest use of special account funds will be for budget support directed to developmental ministries and other government entities. During the course of the annual MOU negotiations

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USAID/Egypt and MIC (in conjunction with the Ministry of Finance) will agree on the amount to be earmarked for budget support. The specific Ministries or governmental entities to receive budget support will be identified at this time. The MOU will identify the total amount to be provided. The specific amount to be provided as budget support to individual ministries or governmental entities will be set forth in an exchange of letters between MIC and USAID/Egypt within thirty days of the signing of the MOU.

2. No later than 60 days after the signing of the MOU, MIC will, in conjunction with the Ministry of Finance, initiate action to allocate to the budget of the specified governmental entities and advise USAID/Egypt when such budget allocations have taken place. This notification procedure will become a part of the MOU. No later than 30 days after receipt by the specific government entity of the agreed-to budget allocation, MIC will obtain, with a copy to USAID/Egypt, advice that such budget allocations have been received by the government entity. USAID/Egypt will not require documentation for the movement of the amount allocated as budget support beyond the overall government entity level.

3. From time-to-time it may be in the best interest of US goals and objectives to provide budget support from the Special Account to an entity not identified in the annual MOU. With the written mutual agreement between MIC and USAID/Egypt such requests will be considered.

4. Should MIC request budget support for a governmental entity in addition to what was originally provided, the AD/PDS in consultation with the AD/FM is authorized to approve such a request if it does not exceed LE 5 million. If such a request exceeds LE 5 million, the Deputy Director or Director will approve the request.

5. Guidelines for approval of budgetary support to a given government entity have been provided in State (87) 327494. USAID's procedures, based upon these guidelines, are as follows:

a. USAID will annually undertake an assessment to determine which developmental entities are to be considered eligible for budget support based upon the criteria established in State (87) 327494. This assessment will normally occur during negotiation of the MOU. At the same time, USAID will assess actual performance of entities which had received budget support allocations in the past year. The assessment will take the form of an Action Memorandum, drafted by PDS/P with the help of knowledgable technical officers, addressed to the Director or to the AD/PDS and AD/FM

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(depending on the size of the request, as noted in VB 4 above). The Action Memorandun should be cleared by LEG, FM, and the relevant technical directorates. The assessment must provide sufficient evidence to assure USAID that:

(1) each government entity has adequate financial systems and accounting controls to utilize the funds properly and effectively; and

(2) each government entity is carrying out developmental activities consistent with USAID's own developmental strategy, and that these activities appear to be effective in achieving developmental objectives.

(3) If USAID has serious policy concerns regarding the programs of proposed Ministries/government entities, the Action Memorandum should describe these and note why budgetary support is still appropriate in light of these concerns.

6. Since USAID is concerned with assisting the GOE in reducing its budget deficit, there is no requirement that budget support be additional to the budget that would have otherwise been approved for the government entity. In fact, our preference is that it not be additional, since additionality detracts from the budget deficit reduction goal. At the same time, we recognize that while all ministerial budgets may be reduced as part of the government's program to reduce the budget deficit, our support of selected ministry budget means that their budgetary resources, while reduced will be reduced by less than they otherwise would be.

C. Project Support:

1. It is possible that at times a Ministry's budget allocation may prove to be inadequate to cover all of USAID local currency requirements. Should this be the case it is incumbent on the USAID project officer to ensure that the counterpart Ministry requests, in writing, from MIC (with a copy to USAID) additional funding in support of the project. The request should include how much was originally budgeted for the project, why the current shortfall occurs in the Ministry's budget and how much additional funding is required. MIC will normally forward this request to USAID for approval/concurrence. If within thirty days after receiving a copy of the ministry's request, MIC has yet to contact USAID, USAID will forward a copy of the request to MIC for approval.

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In general, USAID will not initiate such a request. It will be the responsibility of the Ministry involved. (It should be noted that before additional funds can be placed in a Ministry's budget, they must be accounted for in the annual plan by the Ministry of Planning, and added to the budget by the Ministry of Finance. Thus, several Ministerial actions are required. For this reason, project officers should make every effort to ensure that project needs are included in the GOE budget at the beginning of the GOE fiscal year.)

2. Project papers should not rely on the Special Account as a source of funding to support individual USAID supported projects. However, in the course of project implementation if a project appears to be running short of funds, and implementation will be jeopardized, after all GOE budget formalities have been followed, then an ad-hoc request for funding will be jointly considered by MIC and USAID using the procedures outlined in paragraph V.C.1 above.

3. All correspondence requesting funding from the Special Account to be used in support of individual USAID assisted projects will be signed by the PDS/P Office Director or PDS Associate Mission Director and cleared by the AD/FM. All such requests will have attached the Ministry's request to MIC.

4. In those cases where USAID/Egypt is utilizing funds to finance discrete local currency projects (i.e., projects not associated with USAID dollar funded projects), the project design, implementation, monitoring evaluation and audit/evaluation procedures will follow the special procedures USAID has developed for Special Account Projects (SAPs). These procedures are available from PDS/PS. SAPs will generally be discouraged, unless they are considered, by the Mission Director, to be of a priority equivalent to that of dollar-funded projects. In general, our goal is to avoid project proliferation because of their demands on USAID staff time. Budgetary support is the preferred use of special account funds in nearly all cases.

D. Trust Funds

AID has the authority to establish Trust Accounts for Host country owned local currency granted to the Mission pursuant to a Trust Fund Agreement. This agreement defines the uses to which the Trust Fund may be put. Also, the uses should be consistant with any specific statutory requirement applicable to local currency generated under the dollar assistance. In addition, we must apply the Federal Aquisition and AID Aquisition Regulations to any contractual action performed with such funds. Reporting and other accounting procedures are set forth in Handbook 19 Chapter 5.

Trust Funds are primarily used to help meet our local administrative cost and also are used like PD&S funds. Examples of the latter uses are; to facilitate project design, feasibility studies, do evaluations, end-use verification and non-federal audits.

It is not AID's intent that Trust Funds be used for discrete new projects but, if so used the same project design, implementation procedures, monitoring, etc., that apply to dollar funded projects will apply to the Trust Funded projects. In addition Trust Funded projects must be approved by the ANE Assistant Administrator.

Marshall D. Brown

Marshall D. Brown
Director

## USAID/Egypt Cash Advances to NARP

Summary - USAID is currently financing several programs for the National Agricultural Research Project (NARP) with local currency cash advances authorized through various Project Implementation Letters (PILs). USAID records showed that NARP unliquidated advance balances totalling 2.5 million pounds had been outstanding for at least six months (US$1 = 2.6 pounds, approximately). USAID policy per Handbook 1B, Chapter 15, is that advances cannot exceed 90 days. The slow liquidation of advanced funds is due mainly to problems in NARP's cash management system. The principal areas of concern are, 1) unrealistic cash budgeting, 2) slow distribution of funds to sub-activities, and 3) delayed reporting of field expenditures. This slow advance liquidation by the GOE contributed to serious delays in project implementation and is an unproductive use of USAID funds* resulting in unnecessary interest costs to the American taxpayers.

## Discussion

The cash advance problems experienced with NARP reemphasize why Mission Order 19-5 strongly discourages using cash advances. The following schedule summarizes those NARP advances which had unliquidated balances older than six months:

(All Figures in Pounds as of June 30, 1989)

| PIL # | Total Advances | Unliquidated Balance | Date of Last Advance |
|---|---|---|---|
| PA001 | 345,000 | 345,000 | December 1988 |
| PA002 | 128,000 | 128,000 | December 1988 |
| PA003 | 7,000 | 7,000 | December 1988 |
| 11 | 12,535,080 | 2,010,000 | January 1989 |
| Total | 13,015,080 | 2,490,000 | |

* USAID/Egypt requests that an Egyptian pound check be drawn by the U.S. Disbursing Office in Cairo from a local currency account that it maintains at a local bank. This account is replenished as needed by the sale of U.S. Treasury dollar checks to the same local bank. Ultimately, the pounds disbursed are "booked" as dollars disbursed by A.I.D. when the advances are liquidated. Thus, although the GOE entity receives local currency, A.I.D.'s dollar appropriations earmarked for Egypt are the source of the funds being advanced.

The first three PILs deal with NARP's Policy Analysis Program, which had not significantly liquidated any of its initial advances granted in December 1988. PIL II deals with the Research Support Program and had liquidated only L.E. 10.5 million of its L.E. 12.5 million advances received since December 1986. Our audit findings show that three major factors contributed to the slow take up of NARP advances and advance liquidations. They are:

1) Unrealistic Cash Budgeting - Operating budgets for cash expenditures are not realistic. In most cases monthly budgets, upon which advance requests are based, appear to be overly optimistic resulting in less liquidations than anticipated. For example, the last advance issued under PIL 11, was based on a 3-month cash budget for January-March 1989, of 3.8 million. Liquidations for the entire 6-month period January-June 1989, totaled only L.E. 1.8 million.

2) Slow Distribution of Funds to Sub-Activities - The Agricultural Research Center (ARC), where NARP Executive and Accounting Offices are located, has experienced difficulties making timely distribution of advance funds from USAID to the managerial level at which the funds are spent. For example, and advance for over L.E. 2 million under PIL II took about three months to completely distribute to sub-activities because the complete names of the payees were not available to the ARC Accounting Office. According to the ARC Accounting Manager, Egyptian banks will not clear checks if payee names contain an initial rather than having the entire name spelled out.

3) Delayed Reporting of Field Expenditures - Untimely reporting of expenditures from sub-activities to the ARC in Giza where the accounting records are maintained, is the main cause of the slow liquidation of advanced funds. ARC records show that all but L.E. 50.000 of the total unliquidated balance had been distributed to sub-activities as of May 31, 1989. However, the ARC policy is to have sub-activities submit expense reports on a monthly basis. It appears that this policy is not being enforced. The following examples illustrate specific cases:

- The Agricultural Research Station in Ismailia received an advance of L.E. 29,992 on September 21, 1988, but had not reported any subsequent expenses as of July 6, 1989.

- The Sakha Research Station received an advance of L.E. 90,839 in February 1989, and had not submitted an expense report as of July 6, 1989.

- The Vaccine Institute in Cairo submitted an expense report in July, 1989 for expenditures made in April 1989.

As a result, the Research Support Program has experienced significant delays due to erratic funding caused by the above problems. When Research Stations fail to report expenditures promptly, they tie up funds thereby reducing available working capital. Without working capital, NARP Administration has been unable to make additional advances to researchers who do report their expenditures in a timely manner. This tends to make researchers who previously reported promptly overly cautious about spending money in the future. The entire program was underspent by L.E. 5.5 million as of June 30, 1989.

Any unspent funds represent a non-productive use of those funds as none of the NARP bank accounts are interest-bearing. Productive use of advance funds is only possible if they are requested in reasonable amounts and used on a timely basis. Tying up unneeded funds also contributes to increased U.S. Federal borrowing and associated interest costs.

SUMMARY OF A.I.D. ADVANCES TO THE GOE
(10/01/87 - 09/30/89)

Exhibit 4

| PROJECT NO. | DEC 1987 | MAR 1988 | JUN 1988 | SEPT 1988 | DEC 1988 | MAR 1989 | JUN 1989 | SEPT 1989 |
|---|---|---|---|---|---|---|---|---|
| 2630016.00 | 45,852 | 45,852 | 45,852 | | | | | |
| 2630029.00 | 436,970 | 165,075 | 165,075 | 165,075 | 122,871 | 122,871 | 122,871 | 122,871 |
| 2600065.00 | 269,060 | 118,810 | 35,834 | 64,091 | 56,646 | 48,722 | 625 | |
| 2630066.00 | 13,700 | 13,716 | 13,440 | 564,716 | 13,440 | | | |
| 2630079.00 | 561,387 | 201,636 | 119,799 | 119,799 | | | | |
| 2630090.00 | 658,966 | 164,412 | 164,412 | 302,119 | 149,535 | 76,616 | 76,616 | 76,616 |
| 2630102.00 | | | | | | | 12,500 | 12,500 |
| 2630110.00 | 76,586 | 76,722 | 46,296 | 45,578 | 52,831 | 40,607 | 24,918 | 13,013 |
| 2630118.00 | 50,015 | 50,000 | 7,431 | 7,431 | | | 350,440 | 234,548 |
| 2630125.00 | 901,449 | 901,449 | 901,449 | 377,510 | 195,028 | 195,026 | | 52,366 |
| 2630132.00 | 143,115 | 338,231 | 341,550 | 298,564 | 349,092 | 378,176 | 313,772 | 578,303 |
| 2630136.00 | 28,340 | 35,497 | 64,376 | 27,735 | 30,758 | 81,362 | 46,775 | 191,295 |
| 2630137.00 | 585,355 | 696,588 | 437,762 | 67,747 | 122,785 | 314,791 | 199,288 | 235,816 |
| 2630139.00 | 4,701,505 | 5,406,039 | 4,308,385 | 6,452,510 | 3,813,700 | 8,557,229 | 6,548,561 | 4,796,376 |
| 2630140.00 | 71,972 | 99,991 | 80,905 | 87,787 | 130,906 | 49,934 | 330,209 | 247,835 |
| 2630142.00 | 25,645 | 25,645 | 25,645 | | | | | |
| 2630144.00 | 1,240,809 | 1,109,958 | 1,504,784 | 1,393,995 | 1,395,366 | 1,426,585 | 1,226,942 | 944,200 |
| 2630152.00 | 549,004 | 1,560,480 | 1,513,207 | 1,292,967 | 1,404,846 | 1,972,151 | 2,196,373 | 1,105,962 |
| 2630159.00 | 7,299 | 7,299 | | | | | | |
| 2630161.00 | 60,613 | 60,613 | 18,127 | 141 | | 850 | 850 | |
| 2630182.00 | 450,904 | 450,904 | 450,904 | | | | | |
| 2630201.00 | | | | | | | 78,952 | 13,036 |
| 2630203.00 | 74,415 | 38,812 | 48,306 | 26,566 | 127,127 | 217,040 | 199,488 | 134,495 |
| TOTAL | 10,952,960 | 11,567,730 | 10,293,540 | 11,294,331 | 7,964,931 | 13,481,961 | 11,729,180 | 8,759,231 |

According to the audit workpapers related to previous RIG/A/C report 87-14 on controls over project advances, the outstanding advances two years ago totalled about $14.1 million.

If one applies a 9% Federal cost-of-funds rate to the average quarterly balance of $10,755,483, the annual interest cost is $967,993

CAIRO, EGYPT

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

RECEIVED
17 DEC 1989



DEC 14 1989

M E M O R A N D U M

TO: Frederick Kalhammer, RIG/A/C

FROM: Marshall D. Brown, DIR Marshall Brown

SUBJECT: Formal Mission Response to Draft Audit Report
Audit of AID Advances to the GOE

The Mission appreciates the opportunity to comment on the draft audit report. We request that the following paragraphs be incorporated in the Executive Summary section of the final report.

"The Mission believes that the recommendation contained in the draft audit report has merit. In particular, we believe that project implementation could be enhanced if advances covering periods in excess of 90 days were made to implementing agencies that require advances. Since advances financed by A.I.D. may not exceed 90 days, an alternative source of funding would be advantageous. Accordingly, we will seek the agreement of the Government of Egypt (GOE) to allocate a portion of the local currency resources available in the Special Account to fund advances for A.I.D. supported activities. 1/

While we agree with the general thrust of the recommendation, we do not believe that the draft audit report adequately reflects the Mission's management of advances or the reasons for providing advances. The Mission has well-defined policies and procedures for providing advances. Mission Order 19-5 states that "advances shall be granted in accordance with A.I.D. regulations and shall be administratively controlled in accordance with the procedures outlined in this Mission Order." While the Mission Order recognizes that advances are "the least desirable" method of financing, it provides for circumstances and procedures under which appropriate advances will be approved. The relatively limited use of advances as a financing mechanism is reflected in the fact that the Mission is implementing a portfolio with a pipeline in excess of $2 billion with outstanding advances averaging only around $17 million.

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1/ This paragraph has been included in the report as the Mission's summary response to the audit. Other footnote numbers refer to RIG/A/C's replies to specific Mission comments which may be found under report Appendix No. 2.

Notwithstanding the relatively small average amount of outstanding advances in proportion to the size of the program, the draft audit report focuses on the fact that the advances have not diminished substantially since an initial decline following the issuance of Audit Report No. 6-263-87-14 in September of 1987. However, the report's analysis of the Mission's outstanding advances does not consider the project portfolio or the implementation schedule. Project 263-0139, Basic Education I, accounts for approximately 50 percent of all outstanding advances. In 1987, at the time of the last audit report on advances, one school was completed every other day under this project. At present, the GOE completes a school each day, which is a doubling of the project's output. These project implementation successes have been accomplished while maintaining the total amount of outstanding cash advances relatively constant.

The draft audit report asserts that "the GOE has implicitly undertaken to provide such support as may be required for the efficient and effective implementation of A.I.D. funded projects in Egypt." This statement is misleading if it is taken to imply that the GOE has or should assume the burden of financing all local currency costs of A.I.D. funded projects. In programs throughout the world, A.I.D., based on macroeconomic considerations and project goals and purposes, frequently agrees to use some portion of the dollars obligated for a project to finance local currency project costs. The statement also is misleading if it implies that A.I.D. financing of local currency costs should only be provided on a reimbursement basis. Implementing agencies normally do not have budgetary authority or the budgetary resources to bear these costs initially and await reimbursement. In such cases, the expenditure of dollars to acquire local currency to fund such costs on an advance basis is justified in accordance with Agency guidance and Mission procedures. Although both the Memorandum of Understanding on Special Account funds and existing Mission guidance authorize the programming of Special Account funds for counterpart contributions to A.I.D.-financed GOE projects and other development purposes as agreed to by the parties, such uses of Special Account resources are not intended to supplant A.I.D.'s commitment to finance local currency costs under A.I.D. funded projects, and to do so on an advance basis when properly justified under A.I.D. policy.

Finally, the Mission acknowledges that there were very serious problems in the liquidation of advances under NARP.

Slow liquidation resulted in part from the Agriculture Research Center's belief that liquidation vouchers could not be submitted to A.I.D. until all the documentation was received from the approximately 600 principal researchers working on the project. Although slow liquidation of advances does not always indicate that the original cash needs of the implementing entity were excessive, the Mission was concerned with the slow pace of liquidation and requested a US contractor to investigate the problem. When the contractor experienced difficulty in gathering the required information, we requested that RIG conduct a non-Federal audit. These Mission actions demonstrate due professional care in the management of advances to NARP and by extension to other project advances in the portfolio."

In addition to the above comments for the Executive Summary section of the final report, we submit the following for inclusion or modification of the draft report:

Page 2, last line -- It is not clear how L.E. 380 million equal $500 million. 2/

Page 7, under NARP line 2 ("Although the project ... report on NARP") -- The assertions about GOE counterpart contributions are not germane to the present audit, which deals in effect with the timing of A.I.D. expenditures of dollars to finance A.I.D.'s contribution to projects. Moreover, we have obtained evidence that the GOE has made substantial contributions. 3/

Page 9, ("The amount of this assistance currently runs at $200 million in grant funded commodities each year.") -- This statement is misleading. The USG provides foreign exchange to the GOE on a grant basis; however, the importers who utilize the foreign exchange do not obtain it on a grant basis. A.I.D.'s purpose under the Commodity Import Program is to provide critically needed foreign exchange to the GOE, and not to generate local currency for A.I.D. funded projects. Any local currency generated by the program is jointly programmed for the development needs of the GOE, including budget support, in accordance with A.I.D. policy. 4/

Page 9, ("so much .... future.") -- As has been covered in previous exchanges on the subject, the reason for USAID providing budget support was not because "so much local currency was being generated" but, in keeping with A.I.D.'s Supplemental Guidance on Programming Local Currency, 5/

the Mission determined that it was both economically and politically prudent and necessary for USAID to agree to the GOE's use of its 'Special Account' local currency to reduce its budget deficit, while at the same time furthering USAID's sectoral objectives.

Page 9, last sentence -- At the time that the cash transfer of $115 million was being programmed, USAID was aware that local currency would be generated if commodities were imported with the funds made available. Thus, it is inaccurate to state that the generation of these monies was "unanticipated." 6/

Page 10, first sentence ("superabundance") -- Again we do not agree that there was a superabundance of local currency resources given the GOE's budget deficit. In our opinion, budget support is a major programmatic developmental need and will continue to utilize significant amounts of available funds. 7/

Page 10 - We do not believe that the answer to the question of how advances should be funded is self-evident. The local currency costs for which the advances in question are provided are costs AID agreed to finance with appropriated dollars. Advances are provided when the implementing agencies that incur the costs do not have sufficient budgetary resources to finance the costs initially and then to await reimbursement by AID. This lack of adequate budgetary resources is the identical constraint to economic development that claims a high priority in the programming of Special Account resources. The Mission agrees with the preference for using USG resources to finance costs on a reimbursement basis whenever possible, and thus we agree with the general thrust of the audit recommendation. Nevertheless we must recognize that the use of Special Account local currency to accomplish this purpose competes with other high priority uses of this local currency resource. 8/

Page 10, Recommendation #1 -- We do not believe that the recommendation should require that "USAID/Egypt obtain the agreement of the GOE ..." Special Account local currency is owned by the GOE. Although bilateral agreement on the uses of this resource is required, A.I.D. does not have the right to dictate the terms of those agreements with the GOE. Accordingly, we believe the recommendation should read ".... seek to obtain the agreement of the GOE ...." 9/

Exhibit 3, page 2, Item 2: For example, "and advances for ... ARC Accounting Office"- While it took the GOE three months to distribute the entire LE 2.0 million provided under PIL 11, our analysis indicates that approximately 91% of these funds or L.E. 1.8 million was distributed within 45 days, inclusive of the 15 days necessary to clear a USG check through the banking system in Egypt. 10/

. 29'

## RIG/A/Cairo Replies to Specific USAID/Egypt Comments on the Draft Report

2/ The rate of exchange between the Egyptian pound (LE) and the US dollar was LE.70 and .83 = $1.00 during the early years of the CIP program. Local currency deposits are made over five years after arrival of the commodities at the rate of exchange in effect when the bank Letter of Credit or A.I.D. Letter of Commitment financing the commodities is opened. Thus, the value of the LE694 million Special Account balance at the time the Memorandum of Understanding governing local currency deposits was last amended (August 1988) was considerably greater than the amount that would result were the balance to be divided by LE2.30 (approximately) = $1.00, the exchange rate in effect at that time. LE380 million (55%) of the Special Account balance was programmed for GOE budget support for the first time then.

3/ The reference is relevant in that RIG/A/C's audit of NARP caused this special review to be made. Furthermore, we know of no reason why the GOE cannot budget/provide for its own advance financing needs which RIG/A/C feels should be included under GOE project support responsibilities. Finally, RIG/A/C has not accepted the Mission's response to the NARP report regarding the sufficiency of the GOE's support for that project. (See Audit Report 6-263-90-01)

4/ RIG/A/C's interpretation of Foreign Assistance Act Sec. 609 which requires the deposit of local currencies produced from the sale of A.I.D. donated commodities into a Special Account and their use for development purposes is somewhat more expansive than the USAID's.

5/ The text of the report has been amended to reflect the Mission's comments on this point. It seems obvious, however, that if there were only enough local currency deposits to cover A.I.D.'s operating expenses, support for A.I.D. and other donor projects, and local currency-funded development activities, such uses would take precedence over budget support to the GOE, as was the case prior to August 1988.

6/ Report text amended to reflect this comment.

7/ As above.

8/ Included verbatim as the Mission's response to the audit recommendation.

9/ The recommendation has been restated to clarify RIG/A/C's views in accordance with its understanding of A.I.D.'s right of access to Special Account resources as clearly set forth in the A.I.D.-GOE Bilateral Agreement.

10/ The statement that an advance of over LE2 million took three months to be distributed was based on an analysis of NARP's Research Support bank statements for the months February through May 1989, and an interview with the cognizant GOE financial officer. The bank account balance preceding the deposit of the advance in question (U.S. Treasury check # 028608 for LE2,114,468, dated 30 January 1989) was LE356,221. With no additional A.I.D. advances during the interim, the account balance did not again fall to that level until May. When questioned why it took so long to disburse the funds, the GOE financial manager stated that it took two to three months to issue checks to the 611 principal investigators funded by the advance whose complete names he often did not know, and who had to come personally and identify themselves to him in order to obtain their checks. The Mission's analysis may not have focused on bank balances, or may have been based on a later period when improvements were made to streamline this extremely cumbersome system. In any event, we can find no reason to modify the report exhibit.

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