Audit of Cost-Sharing by Egyptian Private Voluntary Organizations Participating in the Local Development II Project No. 263-0182

Audit Report No. 6-263-90-03
May 7, 1990

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

May 7, 1990

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

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

SUBJECT: **Audit of Cost-Sharing by Egyptian Private Voluntary Organizations Participating in the Local Development II Project No. 263-0182**

This report presents the results of our audit of cost-sharing under the above USAID/Egypt program. The report was provided to you in draft and your comments are included as Appendix 1. The report contains one recommendation which is considered resolved but open upon report issuance. Please advise me within 30 days of any additional information relating to actions planned or taken to implement the report. I appreciate the cooperation and courtesy extended to our staff during the audit.

Background

As of December 1989, USAID/Egypt had obligated over $28 million under subcomponents of its Local Development II program for grants to Egyptian private voluntary organizations (PVOs). Under this program USAID makes grants to governorates (provinces) in Egypt. According to applicable financial plans, the governorates are to contribute an amount equal to 5 percent of the USAID contribution; the combined funds ("grant fund") are used for grants to PVOs. The grants are to fund not more than 75 percent of any particular PVO project. Accordingly, participating PVOs are to contribute not less than 25 percent of the total cost of their projects.

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Audit Objectives and Scope

The Office of the Inspector General for Audit/Cairo made a compliance audit of cost-sharing under grants to private voluntary organizations (PVOs) participating in the Local Development II (LD-II) Program.

The audit reviewed the cost-sharing requirements contained in the applicable agreement and tested compliance with those requirements. Our review of internal controls was limited to the matters described herein. Other observations bearing on internal controls and other issues relevant to this activity are described in RIG/A/C Audit-Related Memorandum No. 6-90-006. The audit was conducted in accordance with generally accepted government auditing standards.

Results of Audit

The audit found that the financial plans developed for the LD-II PVO program and the cost-sharing required of PVOs and governorates did not conform to the language in the applicable agreement. The PVO program agreement and the project paper provided for the governorates of Egypt and USAID to contribute 5 and 95 percent of the grant fund, respectively. The grant fund was to finance not more than 75 percent of any PVO activity and PVOs were to contribute at least 25 percent of the total cost of their projects. However, in implementing the project the shares required of the governorates and PVOs were not computed in accordance with the wording of the program agreement. How this difference in computation came about could not be determined. Its effect, however, required the governorates and PVOs to provide the equivalent of about $2.57 million less, potentially, toward the total cost of the projects than they should have contributed.

The LD-II program agreement (Annex 1, Item III, 6) states that:

(a) the grant fund will be 95% capitalized by USAID and 5% capitalized by participating governorates; and

(b) PVOs receiving grants will be required to contribute at least 25% of the cost of their proposed projects.

However, the governorates' 5% share of grant fund capitalization and the PVOs' 25% share of project costs were computed in a manner that resulted in their respective shares amounting to only 3.8% (4.76% of fund capitalization) and 20% of total project costs, respectively.

For example, the financial plan for the program indicated that USAID/Egypt would provide $28,200,000 and the governorates the local currency equivalent of $1,410,000. As a result, the USAID and governorate shares of grant fund capitalization equalled 95.24% and 4.76%, respectively. This came about because the financial plan called for the GOE to provide 5% of the USAID contribution, not 5% of overall grant fund capitalization. The result is that the GOE was required to provide $74,210 less than the program agreement required. The computations follow.

Governorates' Contribution Assuming 95% USAID and 5% Governorate Grant Fund Capitalization

USAID	$28,200,000	95.00%
Governorates	1,484,210	5.00%
Grant Fund Total	$29,684,210	100.00%

GOE Contribution* Per Financial Plan

USAID/Egypt contribution	$28,200,000	95.24%
Governorates (5% of USAID contribution)	1,410,000	4.76%
Grant Fund Total	$29,610,000	100.00%

PVO contributions were to equal at least 25% of their total project costs. Consequently, the combined USAID/GOE grant fund should not exceed 75% of total program cost, but the grant fund total has been incorrectly computed at $29,610,000 instead of $29,684,210. Use of the latter figure as the grant fund total produces a total program cost of not less than $39,578,946 ($29,684,210/0.75), of which the PVOs should have contributed the equivalent of at least $9,894,736 (that is, $39,578,946 x 0.25).

However, GOE program guidance required PVOs to add not less than 25 percent of the USAID/governorates' contribution rather than 25 percent of the total cost of their projects. As a result, the PVO's overall were being required to contribute the equivalent of only 25% of $29,610,000 versus 25% of $39,578,948. The hypothetical difference, $2,492,236, could be substantial.

* Assumes a constant USAID/Egypt contribution of $28.2 million.

To summarize, the minimums required per the agreement and those required in actual implementation are compared below.

	Per Agreement		In Implementation	
Total Program Cost 1	$39,578,946	100.00%	$37,012,500	100.00%
USAID/Egypt Share 1/	28,200,000	71.25%	28,200,000	76.19%
Governorates' Share	1,484,210	3.75%	1,410,000	3.81%
Grant Fund 2/	(29,684,210	75.00%)	(29,610,000	80.00%)
PVOs' Share 3/	9,894,736	25.00%	7,402,500	20.00%
Total Differences		$2,566,446		

In view of the foregoing situation and after considering the Mission's comments on the draft of this report, we are making the following recommendation to ensure that cost-sharing under the PVO component of the LD-II PVO project is appropriate.

1/ Assumes a constant USAID/Egypt contribution, as shown.
2/ Non-additive subtotals.
3/ Some PVOs have contributed more than the required minimum.

Recommendation No. 1

We recommend that USAID/Egypt clarify the cost-sharing percentages allocated to GOE governorates and participating PVOs, as well as the base upon which each such percentage shall be calculated, under the PVO component of the Local Development II project, 263-0182.

Mission Comments *

The Mission disagreed with the draft recommendation but acknowledged that the project agreement contains conflicting descriptions of the required GOE contribution. The Mission contends that the drafters of the project agreement intended that the GOE contribute 5 percent of the USAID grant and not 5 percent of the grant fund capitalization. Therefore, the Mission suggested that the recommendation have it correct inconsistencies in the agreement and, in effect, have the agreement state that the GOE shall provide 5 percent of the USAID grant. The Mission conceded that it had not complied with the Project Agreement in computing PVO contributions and would amend the Project Agreement to facilitate project goals.

RIG/A/C's Response

Clearly, the Project Agreement contains conflicting descriptions of the required GOE share of the PVO grants. However, the Project Paper tends to support our opinion that the GOE's contribution be 5 percent of grant fund capitalization, not 5 percent of the USAID grant. Page 45 of the Project Paper states that the individual governorates would draw 95% of program funding from the USAID grant and 5% from their own resources.

* The original recommendation, modified as a result of the Mission's comments, urged that the cost-sharing allocations to the GOE and PVOs be based on the total cost of PVO projects, not the A.I.D. grant.

Regardless of what may have been intended by project designers, the action needed now is to eliminate the inconsistencies. Should the Mission seek to eliminate these by a formula that will require the GOE to contribute 5% of the USAID grant or 5% of grant fund capitalization?

The 25% matching percentage in use worldwide by A.I.D. takes its origin in FAA Section 110 which requires host countries to provide "25% of the costs of the entire program, project or activity . . . ." (emphasis supplied). Said requirement pertains to cost-sharing under A.I.D.'s Development Assistance account, not the Economic Support Funds made available to Egypt. But the spirit of the provision is quite clear as regards the base upon which the 25% contribution shall be computed: the cost of the project, not the amount donated by A.I.D. While RIG/A/C would urge the Mission to follow the method of computation used by A.I.D. worldwide in allocating the 5% and 25% matching requirements under the LD-II PVO program, we recognize that (a) it is not required under ESF program financing, and (b) it would entail extra work to keep track of the total cost of each PVO project. Accordingly, the Mission may choose the method of computation it desires provided it is consistently applied and adhered to by the other parties involved in the project.

The recommendation, which has been amended to reflect the Mission's response, is considered resolved but open pending rectification of the inconsistencies cited in this report.

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

APR 23 1990

RECEIVED
23 APR 1990

MEMORANDUM

TO: Frederick A. Kalhammer, RIG/A

FROM: Marshall D. Brown, DIR

SUBJECT: Audit of Cost Sharing by Egyptian Private Voluntary Organizations Participating in the Local Development II, Project No. 263-0182

USAID's local development PVO program began as a governorate level PVO block grant activity under the Neighborhood Urban Services Project (NUS) in 1982. Because of its success in urban areas, this activity was improved upon and expanded to all 26 governorates under the Local Development II Program (LD II), in 1986.

The LD II PVO activity funds local indigenous PVOs throughout rural and urban communities in Egypt to provide needed services for low income neighborhoods. To date under NUS and LD II, approximately 5,000 PVO sub-projects have been funded for a total of $27.7 million. Services provided by these PVOs include child care, vocational training, community health services, youth activities and services for the disabled and elderly. LD II's PVO block grant activity has been successful in decentralizing planning and decision making to the local level. Each governorate determines its needs and approves annual funding plans which are initiated at the village level and culminate with the formulation of a governorate level PVO plan. It is precisely this local level planning and implementation capacity that USAID seeks to build. Three cycles of successful planning and implementation of PVO block grant activities have been completed under LD II.

Under NUS and LD II each participating governorate has been required to contribute to the governorate level PVO block grant fund. After NUS, USAID's concern for sustainability resulted in the additional LD II requirement of a PVO contribution to each project funded by the PVO block grant fund.

Recommendation #1(a), with which we disagree, is based on Annex 1 Section III.6 of the Project Agreement. The drafters of the Project Agreement intended that the computational method described in Section 4.5 and Annex 1, Table 1 of the Project Agreement be used. This method was reiterated in PIL # 1, and has been used to implement this project. We believe that the audit report should identify and discuss these inconsistencies within the Project Agreement. Furthermore, as suggested by the Mission at the exit conference, the recommendation should call for the Mission to change the Sections of the Project Agreement as deemed appropriate by management to achieve project goals and achieve consistency in the Agreement.

In response to Recommendation # 1(b), we have indicated that we did not comply with the terms of the Project Agreement in computing PVO contributions and furthermore, that we will amend the Project Agreement, as with Recommendation 1(a), to facilitate the achievement of project goals.*

We believe the real issue to be "Do contributions made by the PVOs (and the GOE) result in a commitment on their part to the activity and does it propagate a PVO culture that addresses sustainability?" We believe that the current computational method combined with the requirement that PVOs fund all recurrent costs leads to sustainability. Furthermore, we are refining the cost-share criteria by requiring minimum cash (as opposed to cash or in-kind) contributions from the PVOs to further enhance achievement of this goal.

The method of computing both the GOE and PVO contributions has been implemented since 1986. It is understood by all parties concerned, and above all has worked well. While this method does not mirror, in all cases, what is in the Project Agreement it does not violate any legal statutes. As such, we believe, as we indicated at the exit conference, that the audit recommendations should require that management take steps to ensure congruency between implementation and the Project Agreement. This we believe will enable management to exercise its management prerogative to make management decisions. We will be amending the Project Agreement to reflect current practice.

OTHER COMMENTS:

(The comments made by the Mission in this space were deemed irrelevant to the issues under discussion.)

Page 6, Para 1: "The difference, $2,492,236, is substantial."

We believe the language leading to this statement should reflect that this is a hypothetical computation. The $2,492,236 reflected as the difference in the PVO contribution is based on the minimum contribution. It does not consider the contributions made by the PVOs that are above and beyond the minimum requirement. Furthermore, the report fails to disclose that the PVOs fund all recurrent costs regardless of what percentage they represent of the total sub-project cost.

* What the Mission intends to do about PVO cost-sharing is not clear to RIG/A/C based on this paragraph.

APPENDIX 2

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