
Audit of USAID/Egypt's Compliance With Lobbying Restrictions

Report No. 6-263-92-06
March 26, 1992





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

March 26, 1992

MEMORANDUM FOR D/USAID/Egypt, Henry H. Bassford

FROM :

Philippe L. Darcy
RIC/A/C, Philippe L. Darcy

SUBJECT:

Audit of USAID/Egypt's Compliance With Lobbying
Restrictions (Audit Report No. 6-263-92-06)

Enclosed are ten copies of the subject report. The report contains one recommendation which we consider resolved and closed based on recent actions taken by the Mission as a result of this audit.

In finalizing this report, we fully considered your comments on the draft report and have included them as Appendix II to this report. Regarding the impairments that Mission management placed on the audit by refusing to provide requested written representations, your comments reflect some misunderstandings of generally accepted government auditing standards.

The audit profession has been one of constant evolution, and the standards and the changes to those standards are not always understood by management. The application of generally accepted government auditing standards is not simply a matter of a layman reading a technical book, understanding the technicalities, and then applying this understanding. Rather, the application of those standards is a matter of the auditor's professional judgement which comes from organizational guidance, supervision, and the auditor's experience and training.

While there is no way that we can convey to you in an audit report everything that we have learned through years of audit experience and training, we have tried to address each of your misunderstandings in Appendix V to this report. We would hope that our

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comments will resolve these misunderstandings and that Mission management will provide the auditor all requested evidential matter in the future. Please understand that generally accepted government auditing standards do require us to report impairments placed on our audit by management and the impact of those impairments on our audit work.

Please feel free to call upon me to discuss these issues or any other matters of concern to you. I appreciate the courtesies extended to my staff during the audit.

Background

Title 31 of the United States Code was amended on October 23, 1989 by adding Section 1352, entitled "Limitation on Use of Appropriated Funds to Influence Certain Federal Contracting and Financial Transactions," which prohibits the use of Federally appropriated funds for lobbying activities. The general provisions of this law are:

- No appropriated funds may be used by the recipient of a Federal contract, grant, cooperative agreement, or loan to pay for influencing the award of a covered Federal action. (Covered Federal actions consist of contracts, grants, cooperative agreements, and loans.)
- Each person who requests or receives appropriated funds must certify that no prohibited payments have been or will be made.
- Each recipient of appropriated funds shall file a disclosure form if payments which would be prohibited have been or will be made from non-appropriated funds.

Section 1352 requires that each Federal agency "take such actions as are necessary to ensure that the provisions of this section are vigorously implemented and enforced..." It also requires the Office of Management and Budget (OMB) to issue guidance for agency implementation of the new requirements. Accordingly, OMB issued government-wide guidance on December 20, 1989 which indicated that certification and disclosure statements regarding lobbying activities were required for Federal contracts, grants, and cooperative agreements over \$100,000, and loans over \$150,000. The Federal Acquisition Regulation (FAR) was updated in January 1990 to reflect this guidance. The new FAR policy stated that Federal agency contracting officers were responsible for obtaining the required certifications and disclosures prior to making covered awards. This was to be done by including certain FAR provisions and clauses in solicitations and contracts.

Audit Objective

The objective of this audit was to answer the following question:

- Did USAID/Egypt comply with the requirement of 31 U.S.C. 1352 to implement procedures whereby USAID/Egypt will obtain the required certifications and disclosures from recipients of contracts, grants, cooperative agreements, and loans regarding prohibited payments for lobbying activities?

To achieve this objective we tested contracts, grants, and cooperative agreements awarded by USAID/Egypt to determine whether USAID/Egypt: (1) followed applicable internal control procedures, and (2) complied with certain provisions of laws and regulations pertaining to the objective. Our tests were sufficient to provide reasonable, but not absolute, assurance of detecting abuse or illegal acts that could significantly affect the audit objective. Our discussion of the scope and methodology for this audit is in Appendix I, and our reports on internal controls and compliance are in Appendices III and IV, respectively.

Audit Findings

We are not able to fully answer the audit objective because USAID/Egypt declined to provide us all the information essential for us to render a professional opinion. For example, USAID/Egypt management would not confirm to the best of its knowledge and belief that:

- it had provided us with all the essential information,
- the information it did provide us was accurate and complete, and
- it had followed A.I.D.'s policies.

A complete description of the essential information that USAID/Egypt would not provide or confirm is included in the Scope and Methodology section of this report. (See Appendix I)

Without these confirmations from USAID/Egypt, we cannot fully determine if USAID/Egypt did what it is required to do. Without such confirmations, we would, in essence, be stating that USAID/Egypt complied with A.I.D.'s policies and procedures when USAID/Egypt, itself, would not make such a statement. While we cannot state positively that USAID/Egypt followed its policies and procedures, this lack of a management confirmation would not preclude us from reporting on any problem areas that came to our attention.

Did USAID/Egypt comply with the requirement of 31 U.S.C. 1352 to implement procedures whereby USAID/Egypt will obtain required certifications and disclosures from recipients of contracts, grants, cooperative agreements, and loans regarding prohibited payments for lobbying activities?

As discussed above we cannot fully answer this audit objective. Mission records show that USAID/Egypt had a system to obtain required certifications and disclosures for certain contracts, but not for grants or cooperative agreements. Thus, for the majority of applicable Federal awards made by USAID/Egypt during fiscal year 1991, USAID/Egypt failed to obtain the required certifications and declarations.

USAID/Egypt Did Not Obtain Required Declarations From All Recipients

Section 1352 of Title 31 of the United States Code (31 U.S.C. 1352), which prohibits the use of appropriated funds for certain lobbying activities, requires Federal agencies to ensure that recipients of Federal contracts, grants, cooperative agreements, and loans file a declaration consisting of a certification and disclosure as defined in FAR 52.203. USAID/Egypt files included the required declaration for only six of 21 applicable awards made by USAID/Egypt during fiscal year 1991.

USAID/Egypt failed to request declarations from recipients of the remaining 15 awards, which totalled more than \$14 million, because of a misunderstanding on the part of USAID/Egypt concerning the applicability of the law to grants and cooperative agreements, and because contracting officers did not include the requirement in the solicitation documents for certain contracts.

Recommendation No. 1: We recommend that USAID/Egypt:

- 1.1 obtain required certification and disclosure declarations (defined in Federal Acquisition Regulation 52.203) from the recipients of the 15 awards identified in this report as lacking such declarations; and**
- 1.2 implement procedures to ensure that declarations by 31 U.S.C. 1352 are obtained from prospective recipients of appropriated funds before awarding new contracts, grants, or cooperative agreements which exceed \$100,000.**

Section 1352 of Title 31 of the United States Code (31 U.S.C. 1352), entitled "Limitation on Use of Appropriated Funds to Influence Certain Federal Transactions," bars the use of Federally appropriated funds or profits derived from these funds for lobbying activities. It charges each Federal agency to "...take such actions as are necessary to ensure that the provisions of this section are vigorously implemented and enforced..." The general provisions of this law are:

- No appropriated funds may be used by the recipient of a Federal contract, grant, cooperative agreement, or loan to pay for influencing the award of a covered Federal action. (Covered Federal actions include contracts, grants, loans, and cooperative agreements.)
- Each person who requests or receives appropriated funds must certify that no prohibited payments have been or will be made.
- Each recipient of appropriated funds shall file a disclosure form if payments which would be prohibited have been or will be made from non-appropriated funds.

Subpart 3.8 of FAR states that any recipient of a Federal contract, grant, loan, or cooperative agreement is required to furnish a declaration consisting of both a certification and a disclosure. The Office of Management and Budget issued guidance in 1989 which limited this requirement to Federal contracts, grants, and cooperative agreements over \$100,000, and loans over \$150,000. The specific requirements are contained in a provision in FAR 52.203-11, Certification and Disclosure Regarding Payments to Influence Certain Federal Transactions, and a clause in FAR 52.203-12, Limitations on Payments to Influence Certain Federal Transactions. According to FAR 3.804, a contracting officer shall obtain the required certifications and disclosures prior to the award of any contract exceeding \$100,000.

During Fiscal Year 1991, USAID/Egypt made 21 awards totalling about \$46 million for which these regulations would apply. They consisted of twelve contracts, six grants, and three cooperative agreements¹. We reviewed all 21 awards by examining files in USAID/Egypt's Office of Contracts Services. Files for only six contracts included the required certification and disclosure declaration. In those six cases the certification provision in FAR 52.203-11 was included as part of a standardized section of the contracts' solicitation document and was made effective by the contractor submitting a signed offer. The other 15 awards made by USAID/Egypt during fiscal year 1991, totalling more than \$14 million, did not include recipient certification and disclosure declarations required under 31 U.S.C. 1352.

¹ USAID/Egypt did not make any loans during fiscal year 1991 to which 31 U.S.C. 1352 would apply.

According to the Director of USAID/Egypt's Office of Contracts Services, USAID/Egypt did not receive the required declaration from the recipients of any grants or cooperative agreements because they did not think that those types of awards were covered by this legislation. Therefore, USAID/Egypt did not request declarations from those recipients. Regarding contracts, the director stated that he believed no certifications were obtained from recipients of six of the twelve contracts we tested because the cognizant contracting officers had failed to add the FAR 52.203 certification clause and disclosure reference to the standard provisions section of their computerized program used to generate contract solicitation documents.

The director indicated that he reviews contract files for contracts which exceed \$500,000, but that there is no review for contracts for smaller amounts. Four of the six contracts which lacked a declaration were for less than \$500,000. We believe that USAID/Egypt should obtain proper certification and disclosure declarations from the 15 recipients identified in this report as lacking such declarations and implement procedures to ensure that such declarations are obtained for all future applicable awards.

Management Comments and Our Evaluation

During the Exit Conference, the Director of USAID/Egypt's Office of Contracts Services stated that he agreed with our finding and that he had already initiated actions to implement the recommendation. Those actions included requesting certification and disclosure declarations from the 15 recipients identified by the audit as lacking such declarations, and ensuring that the required declaration is a standard element in all future contract and cooperative agreement solicitation documents and grant agreements.

USAID/Egypt's management comments on the draft audit report (included as Appendix II to this report) indicated that USAID/Egypt had obtained the fifteen certifications identified in the audit. USAID/Egypt also stated that they had modified sections in their uniform contract format to reflect the requirements for contractors' compliance with lobbying restrictions. USAID/Egypt requested that the recommendation be closed. Based on USAID/Egypt's response, we consider the two-part recommendation to be resolved and closed.

USAID/Egypt's comments also indicated that Mission management took exception to the IG position that their refusal to issue a representation letter constituted a scope limitation to the audit and precluded the auditors from issuing an unqualified opinion. Our response to this issue is presented in Appendix V of this report.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Egypt's compliance with Section 1352 of Title 31 of the United States Code in accordance with generally accepted government auditing standards except that management would not provide us with a representation letter confirming information essential to fully answer the audit objective. Management's refusal to make such representations constitutes a limitation on the scope of the audit.

Government Auditing Standards require auditors to obtain representation letters when the auditors deem them useful. The Office of the Inspector General has deemed that representation letters are necessary evidence to support potentially positive findings. We requested USAID/Egypt's management to furnish written representation with regard to this audit assignment. The Director of USAID/Egypt has declined to provide written representation for any audit until (1) resolution of a current unfair labor practice complaint filed by the Association of Foreign Service which apparently arose out of the initiation by the Inspector General of the letter of representation policy, and (2) receipt of final Agency guidelines to the field concerning the letter of representation policy.

The information that USAID/Egypt managers would not confirm in writing, to the best of their knowledge and belief, follows:

1. whether they are responsible for the internal control system, compliance with applicable laws and regulations, and the fairness and accuracy of the accounting and management information for the organization;
2. whether they have provided us with all the financial and management information associated with the activity or function under audit;
3. whether they know of any irregularities in the activity;

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4. whether they know of any material instances where financial or management information has not been properly or accurately recorded and reported;
5. whether they are aware of any instances of noncompliance with A.I.D. policies and procedures or violations of laws or regulations;
6. whether they have complied with contractual agreements, and
7. whether they know of any events subsequent to the period under audit that could affect the above representations.

The answers to the above types of questions are so fundamental to the basic concepts of auditing that it is not possible to render a positive opinion without them. Thus, if managers will not answer these basic questions and will not confirm their answers in writing through a representation letter, then we cannot risk giving a positive opinion. While we cannot render a positive conclusion without such representations, this lack of management confirmation does not preclude us from reporting on problem areas that came to our attention and we have done so.

We conducted the audit during the period October through December 1991 using as our criteria guidance provided by OMB, 1352 U.S.C. 31, and the Federal Acquisition Regulation (FAR). Our audit covered applicable Federal contracts, grants, and cooperative agreements over \$100,000 awarded by USAID/Egypt during Fiscal Year 1991, consisting of 21 awards for about \$46 million. Our audit was conducted in USAID/Egypt's Office of Contracts Services.

Methodology

To accomplish the audit objective, we reviewed procedures implemented by USAID/Egypt to meet the requirements of 31 U.S.C. 1352 by interviewing cognizant USAID/Egypt officials. We then determined the total covered Federal actions (contracts, grants, loans, and cooperative agreements) awarded by USAID/Egypt in fiscal year 1991 that should have complied with 31 U.S.C. 1352 by requesting a listing of such awards from USAID/Egypt's Office of Contracts Services. Consequently, we received a list of all Federal awards made by USAID/Egypt during fiscal year 1991.

To test for the presence of the required declarations, we identified from the list all applicable awards greater than \$100,000. They consisted of 21 awards -- twelve

contracts, six grants, and three cooperative agreements. Because we believed it to be a relatively simple process to review files in USAID/Egypt's Office of Contracts Services, and in order to obtain a high level of assurance, we decided to audit all 21 applicable awards. We reviewed USAID/Egypt files for the 21 contracts, grants, and cooperative agreements to determine if USAID/Egypt had obtained the required declarations.

For those files in which we did not find a signed certification, we asked officials in USAID/Egypt's Office of Contracts Services to attempt to locate the certification. We also asked USAID/Egypt officials to provide any declarations received from Federal recipients of expenditures which required declaration under 31 U.S.C. 1352.



UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

MAR 17 1992

MEMORANDUMRECEIVED
18 MAR 1992

TO: Philippe Darcy, RIG/A/C

FROM: George Wachtenheim, D/DIR

SUBJECT: Draft Audit Report on Audit of USAID/Egypt's Compliance
with Lobbying Restrictions

Discussed below are the general Mission comments on the requirement for a management letter and the actions the Mission has taken to close the two audit recommendations. We request that the General Mission Comments be published in the Mission's Comments Section of the final Audit Report. Thank you.

GENERAL MISSION COMMENTS

USAID/Egypt takes exception to the IG position that Management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes the auditors from issuing an unqualified opinion. A representation letter is not required under current professional governmental audit standards. The auditors, under generally accepted governmental auditing standards are able to design an audit plan to provide themselves reasonable assurance to answer each and every audit objective. The IG "Policy" in effect states that reasonable assurance can only be obtained through a representation letter. The IG policy imposes an artificial scope limitation and attempts to intimidate management into providing testimonial evidence. Testimony obtained through intimidation is contrary to the precepts of judging the competence of evidential matter contained in the GAO's audit field work standards. We believe the auditors have at their disposal, other valid, objective and reliable means of obtaining and verifying evidential matter to answer the types of questions, listed on page 20 and 21 of this report, which they deem fundamental to the basic concepts of auditing.

In 1988, the GAO issued the "Yellow Book" or new Governmental Auditing Standards. While representation letters are required evidential matter for financial audits, the GAO standards for performance audits states that "Auditors should, when they deem it useful, obtain from officials of the audited entity written representations concerning the relevance and competence of the evidence they obtain." (emphasis added) The IG however, has enacted a Policy which automatically precludes the auditor from rendering a professional opinion as to whether a audit objective has been met, when a representation letter is not provided by management. It is indeed unfortunate that an IG Policy negates the independence and professionalism of the individual auditor who is required under the fifth field work standard for performance audits to design and plan his/her work to obtain sufficient, competent and relevant evidence to afford a reasonable basis for his/her judgements and conclusions with respect to the audit objective. The policy challenges the validity of the hundreds of previous audit reports issued by the IG without a representation letter being provided by management.

Management's reluctance to issue a representation letter stems from the very nature of performance audits in AID. It is not Management's report that is being audited. The scope of the audit is broad and subject to change. The normative criteria for each objective is unknown to Management and/or subject to change. The activities under audit often have lives of over ten years with different cognizant managers at various periods of time.

These major differences vis-a-vis financial audits make it difficult for AID Managers to provide representation letters. During the course of this audit, USAID has provided the auditors with documents pertaining to its Internal Control Systems, made available all its files, and USAID personnel have spent countless hours cooperating with the auditors answering questions and being subject to interviews. Given the types of evidence presented and available to the auditors throughout the audit, and the various tests to which this evidence can be subjected in determining its sufficiency, relevance and competency, we believe it spurious to qualify an opinion based on a policy, which denigrates Management's good faith efforts as well as the professional judgement of the auditor in planning and conducting his/her audit work.

Recommendation No. 1:

We recommend that USAID/Egypt:

- 1.1 seek to obtain required certification and disclosure declarations (defined in Federal Acquisition Regulation 52.203) from the recipients of the 15 awards identified in this report as lacking such declarations; and
- 1.2 implement procedures to ensure that declarations by 31 U.S.C. 1352 are obtained from prospective recipients of appropriated funds before awarding new contracts, grants, or cooperative agreements which exceed \$100,000.

Mission Response:

On recommendation 1.1, we found three (3) certifications in our files. These were for the Fulbright Commission, Cairo Curative Care Organization and Galludet University. One (1) grant with Africare has expired.

We have notified the other eleven (11) organizations and these certifications are attached, along with the three (3) found in our files.

On recommendation 1.2, we have modified the Federal Acquisition Regulation Uniform Contract Format in Sections K and I to reflect the requirements for contractors' compliance with lobbying restrictions.

Based on these actions taken by the Mission Contracts Services Office, it is requested that these recommendations be closed.

Att: a/s

REPORT ON INTERNAL CONTROLS

This section of the report provides a summary of our assessment of internal controls for the audit objective.

Scope of Our Internal Control

We have audited USAID/Egypt's compliance with 31 U.S.C. 1352 regarding a certification to prohibit recipients of Federal awards from using appropriated funds for lobbying activities. The audit took place during the period October through December 1991.

We conducted our audit in accordance with generally accepted government auditing standards, except that management would not provide us with a representation letter confirming, among other things, its responsibility for the internal controls related to the audit objective or confirming whether or not there were any instances of noncompliance with A.I.D. policies and procedures or whether or not it had provided us with all the information related to this program.

Management's refusal to make such representations constitutes a limitation on the scope of the audit and is sufficient to preclude an unqualified conclusion on the reliability of the internal controls related to the audit objective. (A complete description of the representations that USAID/Egypt would not make is provided in the Scope and Methodology section of this report.)

Generally accepted government auditing standards require that we plan and perform the audit to fairly, objectively, and reliably answer the objective of the audit. Those standards also require that we:

- assess the applicable internal controls when necessary to satisfy the audit objectives, and
- report on internal controls assessed, the scope of our work, and any significant weaknesses found during the audit.

In planning and performing the audit, we considered A.I.D.'s internal control structure to determine our auditing procedures in order to answer the audit objective, but not provide assurance on the internal control structure.

General Background on Internal Controls

The management of A.I.D., including USAID/Egypt, is responsible for establishing and maintaining adequate internal control structure. Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Manager's Financial Integrity Act in 1982. This Act makes the heads of executive agencies and other delegated managers legally responsible for establishing and maintaining adequate controls. The General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

The objectives of internal control policies and procedures for federal foreign assistance programs are to provide management with reasonable, but not absolute, assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether a system will work in the future is risky given that conditions may change or the system itself may not be properly administered.

For the purposes of this report, we have classified significant internal control policies and procedures according to the audit objective by categories. For this objective, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risks to detect any reportable condition. Reportable conditions are those relating to significant deficiencies in the design or operation of the internal control structure which, in our judgement, could adversely affect USAID/Egypt's ability to assure that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports.

Conclusions for Audit Objective

This objective relates to whether USAID/Egypt complied with the requirement of 31 U.S.C. 1352 to implement procedures whereby USAID/Egypt will obtain declarations from recipients of contracts, grants, and cooperative agreements that they have not and

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will not make any prohibited payments. We reviewed USAID/Egypt's internal controls relating to this objective. We are not, however, able to conclude on the reliability of these controls, as management would not confirm in a representation letter essential information related to these controls.

Because of this lack of management information, we cannot, therefore, state positively that the internal controls relative to this audit objective are effective and can be relied on. However, based on the information that USAID/Egypt did provide to us and the tests that we were able to perform, we can only report that no significant internal control weaknesses came to our attention, other than USAID/Egypt's refusal to confirm essential information about its own internal controls.

REPORT ON COMPLIANCE

This section of the report summarizes our conclusions on compliance with applicable laws and regulations.

Scope of Our Compliance Assessment

We have audited USAID/Egypt's compliance with 31 U.S.C. 1352 regarding a certification to prohibit recipients of Federal awards from using appropriated funds or profits deriving from these funds for lobbying activities, during the period October through December 1991.

We conducted our audit in accordance with generally accepted government auditing standards, except that management would not provide us with a representation letter confirming to the best of their knowledge and belief (1) their responsibility for compliance with applicable laws and regulations, (2) whether or not there were any irregularities involving management or employees, (3) whether or not there were any instances of violations or possible violations of laws and regulations. (A complete description of the representations that USAID/Egypt would not make is provided in the Scope and Methodology section of this report.)

Management's refusal to make such representations constitutes a limitation on the scope of the audit and is sufficient to preclude us from designing our audit to provide reasonable assurance of detecting abuse and illegal acts and from giving an unqualified conclusion on compliance with 31 U.S.C. 1352.

Generally accepted government auditing standards require that we plan and perform the audit to fairly, objectively, and reliably answer the objective of the audit. Those standards also require that we:

- assess compliance with applicable requirements of laws, regulations and pertinent agreements when necessary to satisfy the audit objective, and
- report all significant instances of noncompliance and abuse, and all indications or instances of illegal acts found in connection with the audit.

Compliance with 31 U.S.C. 1352 is the overall responsibility of USAID/Egypt's management. We performed tests of USAID/Egypt's compliance with certain provisions of Federal laws and regulations.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, contracts, grants and binding policies and procedures governing the conduct of the audit entity. Noncompliance constitutes an illegal act when the source of the requirement not followed or prohibition violated is a statute or implementing regulation. Noncompliance with internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition and is included in our report on internal controls. Abuse is furnishing excessive services to beneficiaries or carrying out what may be considered improper practices, which do not involve compliance with laws and regulations.

Conclusions on Compliance

We reviewed USAID/Egypt's compliance with 31 U.S.C. 1352. However, as management would not confirm in a representation letter essential information related to such compliance, we cannot state positively that USAID/Egypt has complied. Further, based on the information that USAID/Egypt did provide to us and the tests that we were able to perform we found that USAID/Egypt has not fully complied, in all significant respects, with the provisions referred to in the preceding paragraph.

The results of our tests of compliance disclosed the following significant instance of noncompliance:

- USAID/Egypt made 15 Federal awards, each over \$100,000, during fiscal year 1991 without obtaining proper certification and disclosure declarations from recipients as required by 31 U.S.C. 1352.



RIG/A/CAIRO COMMENTS ON USAID/EGYPT PERCEPTIONS ABOUT PROFESSIONAL AUDIT STANDARDS

In commenting on USAID/Egypt management's refusal to provide requested written representations, the Mission said that: "*USAID/Egypt takes exception to the IG position that Management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes the auditors from issuing an unqualified opinion.*" The Mission then proceeded to support this position by detailing a number of management's perceptions on what generally accepted government auditing standards require. Because these perceptions are causing interference with the scope of our audit work and the auditors' application of auditing procedures deemed necessary for our audit objectives, the following comments address each of those perceptions.

MISSION PERCEPTION: "*A representation letter is not required under current professional governmental audit standards.*"

RIG COMMENTS: The Mission does not understand the requirements of generally accepted government auditing standards for representation letters. In reality, generally accepted government auditing standards require representation letters for all financial audits and require¹ that these letters be employed for performance audits "when deemed useful" by the auditors. Therefore, a correct understanding of the standards would be: **A representation letter is required under generally accepted government auditing standards for a financial audit and, when deemed useful by the auditors, is required under generally accepted government auditing standards for a performance audit.**

Representation letters are required by the Statements on Auditing Standards (SAS No. 19) of the American Institute of Certified Public Accountants (AICPA) for all financial audits performed in accordance with generally accepted auditing standards and have been used for years for financial audits both in the private sector and in the Government. The AICPA standards have been fully incorporated into generally accepted government auditing standards (Yellow Book) for financial audits, and the concepts embodied in those standards establish the foundation upon

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1. Although the Yellow Book uses the term "should", because of Mission management's misunderstandings we are avoiding the technical terminology by inserting "require". According to the Yellow Book, "When the term 'should' is used to describe the auditor's and/or audit organization's responsibility, this means that the standards that are applicable to the work and necessary to satisfy an audit objective are to be followed. Departures from applicable standards must be disclosed in the audit report." (Source: Yellow Book, page G-11)

which generally accepted government auditing standards for performance audits have been built.²

For performance audits, for example, representation letters are required, according to generally accepted government auditing standards, when deemed useful in answering an audit objective. The A.I.D. OIG (as well as several other OIGs) has deemed representation letters useful in answering the audit objectives now being established under our new systems audit approach.

The reason for this determination resides in the types of audit objectives currently being pursued by the OIG. According to generally accepted government auditing standards, "All audits begin with objectives and those objectives determine the type of audit to be conducted and the audit standards to be followed [Emphasis added]." The OIG has established new policies which require auditors to establish audit objectives which can result in the development of positive findings--a change from the "deficiency" auditing of the past where we mainly audited and reported on weaknesses and problems. Thus OIG audit reports can now provide positive "attestations"³ on A.I.D.'s performance. It is these new types of audit objectives which have, in effect, determined that the audit standard for representation letters be followed in all of our performance audits which began on or after July 1, 1991.

These new policies and these new types of objectives are based, in part, upon meeting a need expressed by A.I.D. management that A.I.D./OIG audit reports should report on the positive aspects of A.I.D.'s performance as well as the negative aspects. Therefore, to meet

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2. Source: Auditing Standards Established by the GAO--Their Meaning and Significance for CPA's, prepared by the Committee on Relations with the General Accounting Office, American Institute of Certified Public Accountants, 1973. "The GAO standards follow the same general organization as generally accepted auditing standards of the AICPA...The members of this Committee agree with the philosophy and objectives advocated by the GAO in its standards and believe that the GAO's broadened definition of auditing is a logical and worthwhile continuation of the evolution and growth of the auditing discipline."
 3. Source of terminology: Codification of Statements on Auditing Standards, AT Section 100, Attestation Standards, AICPA, 1990--"An attest engagement is one in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party...when a practitioner undertakes an attest engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides, procedures, statutes, rules, and regulations, the practitioner is obliged to follow this section and the applicable authoritative interpretive standards as well as those government requirements...An assertion is any declaration, or set of declarations taken as a whole, by a party responsible for it."

A.I.D./management's need by planning⁴ and performing such attestation-type work, the OIG has determined that the documentary evidence of management's representations/assertions,⁵ which is required under AICPA standards for attestations in financial audits, is also necessary for attestations in performance audits.⁶

MISSION PERCEPTION: *"The auditors, under generally accepted governmental auditing standards are able to design an audit plan to provide themselves reasonable assurance to answer each and every audit objective. The IG "Policy" in effect states that reasonable assurance can only be obtained through a representation letter. The IG policy imposes an artificial scope limitation and attempts to intimidate management into providing testimonial evidence. Testimony obtained through intimidation is contrary to the precepts of judging the competence of evidential matter contained in the GAO's audit field work standards."*

RIG COMMENTS: The Mission does not understand (1) generally accepted government auditing standards for planning an audit, (2) the purpose of OIG policy, (3) the difference between testimonial evidence and documentary evidence, and (4) generally accepted government auditing standards for due professional care.

According to generally accepted government auditing standards for planning an audit, "**The methodology selected needs to provide evidence that will achieve the objectives of the audit.**" If an audit objective only calls for auditing and reporting on weakness and problems, the OIG believes that the methodology for obtaining evidence to achieve this objective may not have to include an audit procedure for obtaining a management representation letter. However, if the audit objective calls for the auditors to develop and report positive findings--providing attestations upon which A.I.D. management, the U.S. Congress, and others can rely--the OIG has determined that the methodology for obtaining evidence to achieve this objective must include an audit procedure for obtaining a management representation letter to provide the additional documentary evidence and assurances called for by these attestations. For example,

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4. Source: Codification of Statements on Auditing Standards, AU Section 9326.03, AICPA, 1990--"the auditor develops specific audit objectives in light of assertions by management..."
 5. Source: SAS No. 19.
 6. Source of OIG policy determination: Codification of Statements on Auditing Standards, AICPA, 1990, page 763--"for years, attest services generally were limited to expressing a positive opinion on historical financial statements on the basis of an audit in accordance with generally accepted auditing standards (GAAS). However, certified public accountants increasingly have requested to provide, and have been providing, assurance on representations other than historical financial statements and in forms other than the positive opinion. In responding to these needs, certified public accountants have been able to generally apply the basic concepts underlying GAAS to these attest services."
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a common misconception in both the private sector and Government has been that the auditors are responsible for the internal controls they audit.⁷ To avoid such misconceptions when performing attestation-type work and to help protect the auditor from liability, the auditor is required to obtain written representations from management.⁸

OIG policy is specifically designed not to intimidate management but to implement generally accepted government auditing standards which, by law, we are required to follow. Under the Inspector General Act, the OIG is specifically required to provide policy direction for audits. Furthermore, under standards established by the President's Council on Integrity and Efficiency, the OIG is also required to establish audit policies which will ensure a consistent and proper application of auditing standards to the work of the OIG. Recently, under the direction of the President's Council on Integrity and Efficiency, the A.I.D. OIG policies, which include the policy on management representation letters, were reviewed by another OIG and were determined to be in accordance with standards.

The OIG policy on management representation letters is not directed at obtaining testimonial evidence but at confirming oral representations given to the auditors, indicating and documenting the continuing appropriateness of those representations, and reducing the possibility of misunderstanding concerning the matters that are the subject of the representations.

Our policies do require the auditor to obtain testimonial evidence to, among other things, ensure that the audit findings and conclusions are placed in proper perspective. Testimonial evidence is and always has been an essential part of any audit and, generally, the A.I.D. OIG has faced few problems in obtaining testimonial evidence. However, since testimonial evidence is the weakest form of evidence, our policies and generally accepted government auditing standards require the auditor to obtain other forms of evidence to sufficiently support the auditor's

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7. Source: James F. Antonio, Chairman of the Governmental Accounting Standards Board, William A. Broadus, Jr., Lead of Author of the 1988 revisions to the Yellow Book, General Accounting Office, Ronald J. Points, Price Waterhouse, during presentations and question and answer periods, during AICPA 6th Annual National Governmental Accounting and Auditing Update Conference, August 28-29, 1989, in explaining implementation of the "Expectation GAP" SASs, Findings and Recommendations of the Treadway commission, Reasons for revisions to Yellow Book, and reasons for SAS 55.
 8. Source: Codification of Statements on Auditing Standards, AICPA, 1990, AT Section 100.04-- "The practitioner who has assembled or assisted in assembling an assertion should not claim to be the asserter if the assertion is materially dependent on the actions, plans, or assumptions of some other individual or group. In such a situation, that individual or group is the "asserter", and the practitioner will be viewed as an attester if a conclusion about the reliability of the assertion is expressed.

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conclusions. For positive findings, the OIG policy on management representation letters is meant to ensure that the auditor obtains the additional documentary evidence required to support the auditor's attestations on the positive performance of management.

The auditor's efforts to advise management of potential scope impairments is **not** a matter of obtaining evidence through intimidation but a matter of the auditors following the standard for due professional care. The Yellow Book reference to intimidation is directed at cautioning auditors about situations where the presence of management, peers, or other circumstances could intimidate the interviewee from speaking freely. Under generally accepted government auditing standards for due professional care, the auditors are required to attempt to remove any impairment and, if not possible, disclose the impairment in the scope section of the report and the known effect it had on the results of the audit. The auditors' efforts to inform Mission management of our standards and of the impact from management's refusal to provide a management representation letter has been a matter of the auditors attempting to remove impairments as required by generally accepted government auditing standards.

MISSION PERCEPTION: *"We believe the auditors have at their disposal, other valid, objective and reliable means of obtaining and verifying evidential matter to answer the types of questions, listed [in the scope section] of this report, which they deem fundamental to the basic concepts of auditing."*

RIG COMMENTS: Although A.I.D. management is entitled to its belief, generally accepted government auditing standards assign to the auditor the responsibility for selecting and applying those auditing procedures which the auditor considers necessary under the circumstances. Auditors do select and apply a number of valid, objective, and reliable means of obtaining and verifying evidential matter. To draw conclusions on and attest to the positive aspects of Mission management's performance is where additional documentary evidence--a management representation letter--is needed.

For example, one of the written representations that we asked Mission management to provide was that, to the best of their knowledge and belief, they had provided us with all the financial and management information associated with USAID/Egypt's compliance with lobbying restrictions. Although Mission management refused to provide us this written representation, in responding to the draft of this report Mission management did provide the written representation that *"USAID has provided the auditors with documents pertaining to its Internal Control Systems, made available all its files, and USAID personnel have spent countless hours cooperating with the auditors answering questions and being interviewed."*

Although this written representation came close to what we requested, Mission management did not provide the requested explicit confirmation. Without this confirmation, we lack documentary evidence to reasonably support that (1) no essential documents pertaining to the internal control systems were withheld from us, (2) the files were not purged for the purposes of this audit, and

(3) Mission management did not withhold any essential testimonial evidence.⁹ As a result, we are unable to rely on the documents, files, and testimonial evidence to attest that, among other things, the Mission followed A.I.D. policies and procedures. The best that we can do is to report that, based on the evidence that the Mission did provide to us, no problems came to our attention, except for the problems noted in this report.

MISSION PERCEPTION: *"In 1988, the GAO issued the "Yellow Book" or new Governmental Auditing Standards. While representation letters are required evidential matter for financial audits, the GAO standards for performance audits states that "Auditors should, when they deem it useful, obtain from officials of the audited entity written representations concerning the relevance and competence of the evidence they obtain" (emphasis added) The IG however, has enacted a Policy which automatically precludes the auditor from rendering a professional opinion as to whether an audit objective has been met, when a representation letter is not provided by management. It is indeed unfortunate that an IG Policy negates the independence and professionalism of the individual auditor who is required under the fifth field work standard for performance audits to design and plan his/her work to obtain sufficient, competent and relevant evidence to afford a reasonable basis for his/her judgements and conclusions with respect to the audit objective. This policy challenges the validity of the hundreds of previous audit reports issued by the IG without a representation letter being provided by management.*

RIG COMMENTS: As previously stated, the Mission does not understand what is required under generally accepted government auditing standards and how those standards relate to AICPA standards with respect to management representation letters. In addition, the Mission does not understand (1) the use of the term "auditor" in the auditing profession, (2) generally accepted government auditing standards for independence, and (3) the evolutionary nature of the auditing profession and its standards.

9. To avoid additional misunderstandings, a few words of clarification are needed. Under generally accepted government auditing standards, the auditor is required to maintain an attitude of professional skepticism. This means neither assuming that management is dishonest nor assuming unquestioned honesty. Rather, the auditor recognizes that conditions observed and evidential matter obtained need to be objectively evaluated in answering the audit objective. (Source: Codification of Statements on Auditing Standards, AICPA, 1990, Section, AU 316.16)

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By not knowing how the auditing profession¹⁰ uses the term "auditor", Mission management has further misinterpreted generally accepted government auditing standards for performance audits. According to page G-1 of the Yellow Book, "auditor" refers to the auditor as well as the audit organization unless otherwise indicated. Thus, in the case of audit planning (the first field work standard), evidence (the fifth field work standard), or any of the other standards, the requirements are applicable to the auditor, the auditors, and the audit organization. The responsibility for properly planning, performing, and reporting an audit is not limited to an individual auditor, as perceived by Mission management.

Generally accepted government auditing standards for independence are not meant to require that an individual auditor, such as a new inexperienced auditor, be allowed by his/her organization to independently plan and perform an audit, draw conclusions, express opinions and report the results free from any supervisory or organizational oversight and guidance. Rather, generally accepted government auditing standards require supervision and organizational guidance. The standard for independence deals with factors of a personal nature which may bar an individual auditor from participating in an audit; factors which relate to how the audit organization is placed within a government entity, and external impairments. Examples of external impairments include: (1) "interference or influence external to the audit organization that improperly or imprudently limits or modifies the scope of an audit"; and (2) "interference external to the audit organization with the selection or application of audit procedures."

The audit profession is one of evolution, and the fact that the auditing standards change does not invalidate the results of previous audits. Contrary to the perception of Mission management, the Yellow Book was not established in 1988. The Yellow Book--generally accepted government auditing standards--was established in 1972 and was revised in 1974, 1979, 1981, and 1988.¹¹ Moreover, generally accepted government auditing standards supplement, not supplant, AICPA auditing standards which have evolved significantly since their origin in 1917.¹² In fact, AICPA assisted in the 1988 revisions to the Yellow Book, revisions which were coordinated

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10. Source for applicability to private sector: Codification of Statements on Auditing Standards, AICPA, 1990, AT Section 100.01--"A 'certified public accountant in the practice of public accounting' includes any of the following who perform or assist in the attest engagement...an entity..or by two or more of such persons if they choose to act together."
 11. Source: Forward section of the 1981 and 1988 versions of the Yellow Book, Participants Notebook, AGA videoconference, 10/12/88, pg.5.
 12. Source: Codification of Statements on Auditing Standards, AICPA, 1990, Appendix A.

with concurrent revisions to AICPA standards.¹³ These changes to auditing standards are in response to how the profession evolves in practice and in response to the changing expectations and needs of report users.¹⁴ For the A.I.D. OIG, the shift to attestation-type-audit work is new and is in response to the changing needs of A.I.D. management. However, to provide these attestations with reasonable assurance, the OIG has determined that reasonable auditing procedures are not available for ensuring enough valid and reliable (the Yellow Book definition of competent) evidence, if management refuses to explicitly confirm management's implicit assertions about the evidence.¹⁵

Let us look at just two of the basic implicit assertions which the auditor asked management to explicitly confirm and which management refused to confirm. We will then explain why these confirmations are needed.

Management was asked to confirm to the best of their knowledge and belief; that, for USAID/Egypt's compliance with lobbying restrictions, (1) there were no material instances where financial or management information had not been properly and accurately recorded and reported, and (2) there were no instances of noncompliance with A.I.D. policies and procedures or possible violations of laws and regulations.

Verifying the validity of these implicit assertions is absolutely essential in planning and performing the audit and in reporting attestations with reasonable assurance that the Mission had properly and accurately recorded and reported information, had followed applicable internal control policies and procedures, and had complied with applicable legal requirements. But, when management refuses to confirm the validity of these assertions, the auditor does not know whether (1) Mission records and reports are sufficiently valid and reliable, (2) Mission management is aware of known problems which the auditors did not find, or (3) Mission management just does not want to accept responsibility for the assertions. Despite all auditing procedures that are available to the auditor for planning and conducting the audit, management's failure to provide requested written confirmation of management's implicit assertions casts an unresolvable doubt upon the sufficiency of the auditing procedures and of the evidence obtained.

13. Source: See footnotes 7 and 11.

14. Source: See footnotes 7 and 11.

15. Source for distinction between implicit and explicit assertions: Codification of Statements on Auditing Standards, AICPA, 1990, AU 326.03--Assertions are representations by management that...can be either explicit or implicit.

Simply put, the auditor must disclaim providing an attestation on the validity of any assertion for which management has disclaimed confirmation.¹⁶

As noted before, in such a situation, the OIG can still report problems which came to the auditor's attention but cannot report that everything else concerning the audited activity is all right. To provide A.I.D. management attestations that the activities are all right, Mission management must be willing to lower our risks by accepting responsibility for the assertions.¹⁷

MISSION PERCEPTION: *Management's reluctance to issue a representation letter stems from the very nature of performance audits in AID. It is not Management's report that is being audited. The scope of the audit is broad and subject to change. The normative criteria for each objective is unknown to Management and/or subject to change. The activities under audit often have lives of over ten years with different cognizant managers at various periods of time.*

RIG COMMENTS: The Mission does not understand who and what we are auditing.

The OIG is auditing A.I.D. management's assertions, reports, internal controls, and systems. On June 16, 1991, in State 197372, the Inspector General provided the Mission detailed explanations, with questions and answers, on both the new audits of internal controls and the revised audit standards related to representation letters. Our performance audits are now auditing the performance of A.I.D. management. Again, this is in response to concerns expressed by A.I.D. management about the need for more functional audits.

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16. Source: Codification of Statements on Auditing Standards, AICPA, 1990, AU 333.11-- "Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion. Further, the auditor should consider the effects of the refusal on his ability to rely on other management representations [implicit assertions]."
 17. Source: Codification of Statements on Auditing Standards, AICPA, 1990, AT 100.39-- "In an attest engagement designed to provide the highest level of assurance on an assertion (an 'examination' [audit]), the practitioner's objective is to accumulate sufficient evidence to limit attestation risk to a level that is, in the practitioner's professional judgement, appropriately low for the high level of assurance that may be imparted by his or her report. In such an engagement, a practitioner should select from all available procedures--that is, procedures that assess inherent and control risk and restrict detection risk--any combination that can limit attestation risk to such an appropriately low level." AT 100.31--"Attestation risk is the risk that the practitioner may unknowingly fail to appropriately modify his or her attest report on an assertion that is materially misstated. It consists of (a) the risk (consisting of inherent risk and control risk) that the assertion contains errors that could be material and (b) the risk that the practitioner will not detect such errors (detection risk)."

For these functional audits, Mission management should be fully knowledgeable of the laws, regulations, policies, procedures, contracts, agreements, and the internal control systems that are related to Mission management's activities. The criteria and the related internal controls are not established by the auditors. The criteria are established in A.I.D. Handbooks, laws, regulations, etc. Although the individual projects and programs of a Mission may change frequently, Mission management systems change less frequently. When those systems are in need of change, as determined through Mission management's portfolio reviews, internal control vulnerability assessments, etc., it is the responsibility of the Mission Director to establish suitable management systems and to define those systems in the form of Mission Orders. Therefore, Mission management should be able to provide representations on activities and systems for which Mission management is the most knowledgeable source.

Given our new audit approach, the nature of a performance audit in A.I.D. should be of less concern to Mission management in deciding whether to provide a management representation letter. Although the scope of the audit can be broad and can be subject to change, the audit objectives and scopes are discussed fully with the Mission and any change is brought to the attention of the Mission. Furthermore, Mission management is not asked to provide a final management representation letter until a draft audit report--containing the objectives, scope and results of the audit--is provided to Mission management for review and comment. Although the activities under audit can have lives of over ten years with different managers, we are only asking current Mission management to provide a written representation on assertions which to the best of their knowledge and belief are true. For the purpose of attesting to the Mission's internal controls, for example, a violation of law which occurred ten years ago and which current Mission management is unaware of would be of less concern to the auditors than recent violations of law which current Mission management is aware of but has not documented in reports or in the Mission files.

MISSION PERCEPTION: *These major differences vis-a-vis financial audits make it difficult for AID Managers to provide representation letters. During the course of this audit, USAID has provided the auditors with documents pertaining to its Internal Control Systems, made available all its files, and USAID personnel have spent countless hours cooperating with the auditors answering questions and being interviewed. Given the types of evidence presented and available to the auditors throughout the audit, and the various tests to which this evidence can be subjected in determining its sufficiency, relevance and competency, we believe it spurious to qualify an opinion based on a policy, which denigrates Management's good faith efforts as well as the professional judgement of the auditor in planning and conducting his/her audit work.*

RIG COMMENTS: As previously stated, the Mission is confused about the requirements of the audit standards, the purposes of OIG policy, and why, in the auditor's judgement, a representation letter is required to ensure the relevancy and competency of the evidence needed for attestations. RIG/A/Cairo appreciates the efforts of USAID/Egypt management in providing the documents, providing access to Mission files and providing access to Mission personnel. Certainly, the issue here is not one of criticizing those good faith efforts, it is a question of

sufficient documentary evidence so the auditor can attest, in accordance with generally accepted government auditing standards, to things that Mission management has done well in managing USAID/Egypt's compliance with lobbying restrictions.

Furthermore, we note that the Agency's own interim GC guidance on representation letters issued in June 1991 encourages Mission management to provide management representation letters if management is "confident" in doing so:

If A.I.D. managers feel confident in making written audit representations specifically designed to a given audit activity they are encouraged to do so [State 180913, June 1991].

(The interim guidance also notes that signing a representation letter is a voluntary undertaking and that if managers have any uncertainty, they may consult with their cognizant legal advisor.) Thus, given our intent of meeting a need expressed by A.I.D. management and the Agency guidance encouraging the provision of representation letters so that we can do so, we find it difficult to understand that USAID/Egypt will not confirm management assertions such as:

- The Mission has provided the auditor all essential information related to USAID/Egypt's compliance with lobbying restrictions;
- Mission management is responsible for establishing and maintaining the internal controls over USAID/Egypt's compliance with lobbying restrictions; and
- Mission management is responsible for compliance with the laws, regulations, binding policies, contracts and agreements applicable to USAID/Egypt's compliance with lobbying restrictions.

Such assertions need to be confirmed in almost any audit where we, the OIG, are called to attest that a given Mission function or activity is working well (an "unqualified" or positive opinion). For these and the other assertions, the representation letter in and of itself does not of course provide all of the evidence for such an attestation;¹⁸ it is simply an audit procedure for assuring that (1) the auditor systematically covers the assertions in planning and performing the audit, (2) Mission management gives sufficient thought to confirming the validity of the assertions, and (3) the auditor accurately documents Mission management's response/confirmation.

18. Source: Evidential Matter: Auditing Interpretations of Au Section 326, Codification of Statements on Auditing Standards, AICPA, 1990, "Written representations from management are a part of the evidential matter the auditor obtains in an audit performed in accordance with generally accepted auditing standards...Obtaining such representations complements but does not replace other auditing procedures that the auditor should perform."

Thus, if Mission management is not confident in confirming these assertions and refuses to confirm the assertions, it should not be surprising that the OIG also would not be confident in providing attestations and would have to report that management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes the auditors from issuing an unqualified opinion.

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