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## Audit of USAID/Egypt's Accountability

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Report No. 6-263-92-09  
September 24, 1992



INSPECTOR  
GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT



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

September 24, 1992

**MEMORANDUM FOR USAID/Egypt Director, Henry H. Bassford**

**FROM:**

RIG/A/C, *Philippe L. Darcy*  
Philippe L. Darcy

**SUBJECT:**

Audit of USAID/Egypt's Accountability,  
Audit Report No. 6-263-92-09

Enclosed are ten copies of our audit report on USAID/Egypt's Accountability, Report No. 6-263-92-09.

We received your deputy's comments on a draft of this report and your written representations regarding the audited activities and have included them as an appendix to the report. However, the representations were limited with regards to an essential confirmation, and in accordance with A.I.D./Washington guidance, Mission staff directly responsible for the audited activities did not provide written representations to you or us regarding these activities. Thus, our answers to the audit objectives are qualified.

The report contains one recommendation with multiple actions required. Parts 1.2, 1.3, and 1.4 are closed upon issuance of the report. The remaining part 1.1 is resolved and can be closed upon issuance of the Mission Order to provide guidance for implementing the Audit Management and Resolution Program.

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

U.S. Mailing Address  
USAID-RIG/A/C Unit 64902  
APO AE 09839-4902

Tel. Country Code (202)  
357-3909

# 106, Kasr El Aini St.  
Cairo Center Building  
Garden City, Egypt

# EXECUTIVE SUMMARY

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## Background

A.I.D. requires financial audits to ensure that recipients of A.I.D. funds spend them in accordance with applicable laws and regulations. As these laws and regulations have evolved to provide more agency involvement in the financial audit process, A.I.D. has been reviewing its own guidance. This culminated in a March 1992 General Notice establishing specific responsibilities for the Agency and the A.I.D. Inspector General in the planning, implementation and follow up of audit. (See pages 1 and 2.)

The USAID/Egypt program receives funding of approximately \$815 million annually. As of September 30, 1991, USAID/Egypt had obligated approximately \$4.8 billion for 33 projects. As of October 14, 1991, about \$1.3 billion had been committed of which about \$754 million had been disbursed. (See page 6.) The project agreement dates ranged between August 1978 and May 1991 while the completion dates ranged from September 1991 to September 1998. The Mission is responsible for monitoring these projects and assuring that accountability is obtained over the use of those funds.

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## Audit Objectives

We audited active USAID/Egypt projects, contracts, grants, and cooperative agreements in accordance with generally accepted government auditing standards. (See Scope and Methodology, Appendix I.) We conducted our field work from July to December 1991 to answer the following questions:

1. Did USAID/Egypt comply with A.I.D. policy that requires the need for audits to be assessed in project papers and funds for needed audits to be included in project budgets? (See page 2.)
2. Did USAID/Egypt comply with A.I.D. handbook provisions to include audit requirements in project agreements, grants, cooperative agreements, and contracts? (See page 2.)

3. Did USAID/Egypt comply with Office of Management and Budget Circular A-73 and A.I.D. handbooks to ensure that financial audits of host government and non-government grantees were performed when required? (See page 2.)
4. Did USAID/Egypt comply with federal requirements to resolve and implement audit recommendations? (See page 2.)

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## **Summary of Audit**

The Director USAID/Egypt provided us with written representations covering Mission responsibilities, full and accurate disclosure of financial and management information, compliance with contractual agreements and other matters (The complete representation is contained in Appendix III of this report). The Director limited his representations to those which should be contained in the records under audit with regards to instances of irregularities, noncompliance and or violations of laws and regulations. Also, in accordance with A.I.D./W guidance, the Mission policy is that only the Director, not the officials directly responsible for the activities under audit, will provide written representations. (See Appendix I Scope and Methodology.)

Except for the effects on the audit findings and the Report on Compliance, if any, of not receiving acceptable representations as discussed above, we found that the Mission complied with three of four objectives with regards to A.I.D. policies and Federal requirements, in that (1) project papers included assessments of audit needs and estimates of audit costs, (2) grant agreements and contracts incorporated required audit clauses, and (3) the Mission had a system to resolve and implement audit recommendations. However, the Mission did not comply with Office of Management and Budget Circular A-73 and A.I.D. handbook procedures to ensure that financial audits of Government of Egypt grantees and non-government entities were performed. (See page 9.) As a result, the Mission did not have adequate audit coverage over disbursements of \$171 million or about 23 percent of its assistance portfolio. (See below.)

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## **Audit Findings**

### **Audit Needs Were Assessed and Funds Budgeted When Needed**

Project papers included assessments of the need for financial audits and estimates of budgeted audit costs. (See page 4.)

**Specified Audit Requirements  
Were Included in Documents**

Our review of 11 project agreements, 17 grants and cooperative agreements, and 13 contracts showed that the Mission incorporated the audit clauses required by A.I.D. handbooks. (See page 8.)

**USAID/Egypt Did Not Comply  
With Requirements**

USAID/Egypt did not comply with Office of Management and Budget Circular A-73 (Revised) and A.I.D. handbook requirements for yearly financial audits of non-U.S. government and non-government grantees receiving over \$25,000 in A.I.D. funds. (See page 9.)

**Audit Recommendation  
Resolution is Monitored**

USAID/Egypt complied with Federal requirements to resolve and implement audit recommendations. (See page 13.)

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**Summary of Recommendations**

The report recommends USAID/Egypt complete implementation of the A.I.D. Audit Management and Resolution Program. (See page 9 and 10.)

**Management Comments and Our Evaluation**

USAID/Egypt responded that it was completing implementation of the A.I.D. Audit Management and Resolution Program. (See Appendix III).

  
Office of the Inspector General  
September 24, 1992

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# INTRODUCTION

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## Background

Circular Number A-73 (Revised June 20, 1983), issued by the Office of Management and Budget (OMB), requires that government agencies provide adequate audit coverage of their programs. These requirements are included under A.I.D. Payment Verification Policy Statement Number 6 of December 1983 which requires assessment of audit needs and budgets for audits in project papers. Through amendments to A.I.D. Handbook 3 and the required standard agreement provisions therein, A.I.D. has extended these audit requirements to non-U.S. grant recipients of federal funds. Previously performed only by federal audit agencies, such audits may now be performed by federal auditors, non-federal auditors supervised by the Office of the Inspector General, or by non-federal auditors hired by the recipient.

Until recently, the responsibility for financial audit planning, execution and resolution rested with the Office of Inspector General (OIG). This responsibility was changed by the 1988 Inspector General Act Amendments which requires federal agencies to take a more active role in maintaining an effective audit management and resolution program. As a result of the Act and A.I.D.'s internal control assessments that identified lack of audit coverage as one of its highest risk areas, the Agency began to take more responsibility for the financial audit management process of planning, implementation and follow-up.

Consultations between A.I.D. and the IG culminated in the issuance of A.I.D.'s March 25, 1992, General Notice establishing an Audit Management and Resolution Program. This program puts the responsibility of required financial audits on agency management, and transfers the planning and implementation functions to the Agency. In addition, the program holds the Inspector General responsible for ensuring the quality control of financial audits.

In the fall of 1991, the Regional Inspector General for Audit/Cairo (RIG/A/C) provided the Mission with an inventory of U.S. and non-U.S. agencies and organizations subject to financial audit. Since, the Mission has begun to prioritize this inventory and to plan for audit coverage. RIG/A/C is working with the Mission in these efforts.

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The USAID/Egypt program receives funding of approximately \$815 million annually. As of September 30, 1991, USAID/Egypt's financial report indicated that the 33 projects with a termination date after August 1, 1991, had obligations of \$4.8 billion. As of October 14, 1991, about \$1.3 billion had been committed of which about \$754 million had been disbursed. These 33 projects represented the universe we tested to achieve the audit objectives that follow.

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## **Audit Objectives**

The Office of the Regional Inspector General for Audit/Cairo audited USAID/Egypt's compliance with A.I.D. policy, handbooks and OMB Circular A-73 to answer the following objectives:

1. Did USAID/Egypt comply with A.I.D. policy that requires the need for audits to be assessed in project papers and funds for needed audits to be included in project budgets?
2. Did USAID/Egypt comply with A.I.D. handbook provisions to include audit requirements in its project agreements, grants, cooperative agreements, and contracts?
3. Did USAID/Egypt comply with OMB Circular A-73 and A.I.D. handbooks to ensure that financed audits of host government and non-government grantees were performed when required?
4. Did USAID/Egypt comply with federal requirements to resolve and implement audit recommendations?

In answering these objectives, we tested whether USAID/Egypt followed applicable internal controls and complied with certain legal requirements. We designed tests to provide reasonable assurance that the answers to the above audit objectives were valid. We also included steps to detect abuse or illegal acts which could affect the audit objectives. When we found a problem areas, we performed additional work to:

- identify the cause and effect of the problem, and
- make recommendations to correct the condition and cause of the problem.

Appendix I contains a complete discussion of the scope and methodology for this audit.

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## **REPORT OF AUDIT FINDINGS**

Based upon discussions with Mission officials, the Director USAID/Egypt provided us with a written representation that USAID/Egypt is responsible for the internal control system and the fairness and accuracy of the accounting and management information relating to the audited activities and that, to the best of his knowledge and belief, USAID/Egypt had provided us all the financial and management information relating to the audit objectives. USAID/Egypt is unaware of any material instances where information provided had not been properly and accurately recorded and reported, and USAID/Egypt has complied with all contractual agreements that could materially affect Mission accountability. (The complete representation is contained in Appendix II to this report.)

Although the Director, USAID/Egypt provided us with these essential written representations, he did not provide us with acceptable representations as to whether he is aware of any instances of irregularities, noncompliance with A.I.D. policies and procedures or violations or possible violations of laws and regulations for the activities under audit. Instead, the Director limited his representations to that, to the best of his knowledge and belief, the records under audit should contain any instances of irregularities or noncompliance or violations. Also, in accordance with A.I.D./W guidance of May 13, 1992, the Mission policy is that only the Director will sign a letter of representation. Therefore, other USAID/Egypt officials directly responsible for the audited activities, in this case the Associate Director for Financial Management, did not provide written representations to the Director confirming essential information. Therefore our answers to the audit objectives are qualified to the extent of the effect of not having such representations, and we have disclaimed an opinion in our Report on Compliance.

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**Did USAID/Egypt comply with A.I.D. policy that requires the need for audits to be assessed in project papers and funds for needed audits to be included in project budgets?**

Except for the effect on audit findings, if any, of not receiving acceptable representations, as discussed on page 3, USAID/Egypt complied with A.I.D. policies in that need for audits were assessed in project papers and funds needed for audits were included in project budgets.

We have outlined below the Mission audit need assessments and budgets contained in the project papers, and an explanation of how the Mission plans to establish audit needs.

**Needs Assessments and Budgets**

Mission records showed that 10 of the 11 project papers reviewed contained assessments of audit needs and budgets for estimates of audit costs. One paper contained the assessment but the amount budgeted was to be established later, although the Mission identified the source from which the funds could be derived, in this case the project's studies and support budget.

A.I.D. Payment Verification Policy Statement No. 6, dated December 1983, requires that:

- project papers evaluate the need for audit and describe the audit coverage planned to be provided by the host government, A.I.D., or a public accounting firm.
- with certain exceptions funds be provided for audit unless it is reasonably assured that the host country will have the audit performed or audits are not warranted.

Mission records showed that the need for audit was evaluated and funding was to be provided. The language used in the project papers was as follows:

(1) Funds provided ... will be used to finance host country contracts with U.S. construction companies. ... resources will also finance AID Direct contracts for engineering services and technical assistance. Since the construction contracts are lump sum, competitively bid, fixed price contracts they are not subject to audit of costs except for any cost-reimbursement items. These contracts are, however, subject to audit for compliance with other AID regulations.

(2) Audits and assessments in compliance with AID requirements shall be periodically performed. Such services shall be contracted for with an independent CPA firm.

The following chart shows the dollars budgeted for audit, evaluation, and studies in relationship to the Life of Project (LOP) funding.

<b>Audit Funds Budgeted</b>			
<b>Budget Category</b>	<b>No. of Projects</b>	<b>\$ Budgeted (\$ Millions)</b>	<b>LOP Funding (\$ Millions)</b>
Audit	6	.672	1,242
Evaluation and Audit*	3	.676	1,082
Studies and Support**	1	1.700	670
<b>Total</b>	<b>10</b>	<b>3.048</b>	<b>2,994</b>

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\* Evaluation/Audit combined funds for the two activities. Therefore funds were not designated for audit specifically.

\*\* Studies and Support funds will be made available when an audit is needed.

Whether the Mission had set aside enough monies to cover audit needs was not an issue. USAID/Egypt pays for audits out of a special fund of local currency owned by the Government of Egypt (GOE) and jointly managed by the GOE and A.I.D.. Based on RIG/A/C experience in contracting for financial audits for the Mission, funds for audits have been readily available.

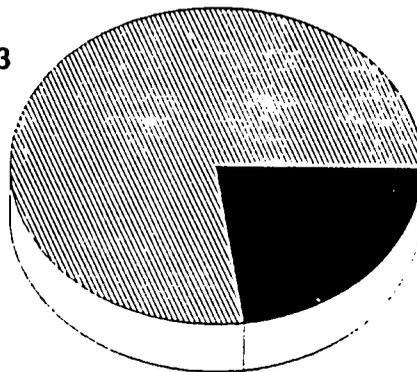
The needs assessment and funding in the project papers provide a starting point for identifying required financial audits of A.I.D.-funded recipients and the monies that will be needed to pay for those audits. Since projects can span over ten years, we believe actual audit needs become easier to identify as projects are implemented. Accordingly, we feel an effective audit management system should periodically reassess audit needs and costs. The March 25, 1992 General Notice directs the Mission to establish such a system and the Mission is doing so.

**Mission Progress in Establishing Audit Needs**

As noted earlier, the Mission now has an inventory of U.S. and non-U.S. agencies and organizations subject to financial audit. As of October 14, 1991, the inventory shows disbursements of \$754 million for ongoing agreements. These disbursements were distributed as follows:

**USAID/Egypt Audit Universe  
(in Millions)**

**U.S. and Others \$583**



**Egyptian Agencies \$171**

**Disbursements as of October 1991**

A.I.D./W is responsible for audits of U.S. based fund recipients. The Mission is responsible for audits of non-U.S. based recipients. The Mission has defined how many non-U.S. based recipients are to be audited and has established a list of needed audits. Most of the recipients are GOE agencies.

**Recipients Auditable Funds  
As of October 14, 1991**

	No. of Grantees	Cumulative Commitments (\$ Millions)	Cumulative Disbursements (\$ Million)
Egyptian Government Agencies and Governorates	32 4	\$279.4	\$167.6
Egyptian For-Profit Companies	6	9.6	3.5
Egyptian PVO's	2	.4	-0-
<b>Total</b>	<b><u>43</u></b>	<b><u>\$289.4</u></b>	<b><u>\$171.1</u></b>

The Mission fiscal year 1993 audit plan provides for financial audits of many of these recipients.

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## **Did USAID/Egypt comply with A.I.D. handbook provisions to include audit requirements in project agreements, grants, cooperative agreements, and contracts?**

Except for the effect on audit findings, if any, of not receiving acceptable representations, as discussed on page 3, USAID/Egypt complied with A.I.D. handbook provisions. This was evident by the fact that the 11 project agreements, 17 grants and cooperative agreements, and 13 contracts we tested incorporated the audit clauses required by A.I.D. handbooks.

The clauses for contracts require that: (1) sufficient books and records will be maintained to reflect all transactions, (2) such books and records will be maintained for three years after the final payment, and (3) all records shall be subject to inspection and audit. Project agreement clause language is essentially the same as that for contracts above, but adds a requirement to submit information and reports and have the books and records audited **regularly**. However, the language term "**regularly**" is not defined. Contractors and grantees are also required to include similar clauses in all subagreements.

Until May 1, 1992, the standard provision for non-government grantees (grants and cooperative agreements) required the recipient to: (1) maintain books and records which must accumulate and record all cost incurred and disclose any project cost supplied by other sources, (2) maintain these records for three years after grant expiration, (3) include similar language (requirements) in all subgrants valued in excess of \$10,000, and (4) agree to have the funds provided under the grant audited by an independent auditor during the course of the grantee's normal annual audit of the grantee's organization.

In April 1992, effective for grants signed on or after May 1, 1992, A.I.D. amended Handbook 3 to incorporate audit-related language required by the amended Inspector General Act of 1988. The language requires grantees (foreign government organizations) receiving \$25,000 per year or more to provide an independent audit of the grant funds and submit the reports to A.I.D. within 30 days of the audit completion. Existing agreements are to incorporate the revised clauses when they are amended to increase funding.

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**Did USAID/Egypt comply with OMB Circular A-73 and A.I.D. handbooks to ensure that financial audits of host government and non-government grantees were performed when required?**

USAID/Egypt did not comply with OMB Circular A-73 and A.I.D. handbook procedures to ensure that financial audits of Government of Egypt grantees and non-government entities were performed. However, as noted, in answer to the first audit objective of this audit report, USAID/Egypt is implementing an Audit Management and Resolution Program. In fact, the Mission started this effort before the March 25, 1992, General Notice was issued by the Agency. The program, once it is fully implemented, will ensure that these required audits are performed.

**OMB Circular A-73 Requirements**

USAID/Egypt did not comply with OMB Circular A-73 (Revised) and A.I.D. handbook requirements for yearly financial audits of the \$171 million disbursed to non-U.S., non-government and government grantees receiving over \$25,000 yearly in A.I.D. funds. In part, this occurred because: (1) until late 1991 the Mission provided audit suggestions but relied on RIG/A/C for planning of financial audits, (2) the Mission could not rely on the host country to ensure that required financial audits were conducted by its Central Audit Organization, and (3) A.I.D./W had not provided formal guidance on how the Mission was to provide audit management and resolution. RIG/A/C did warn the Mission in June 1990 that its accountability over host government grantees was substantially diminished because: (1) there appeared to be no assurance that grantees were maintaining proper records for audits, (2) the Mission or RIG/A/C could not confirm that the GOE Central Audit Organization complied with government auditing standards, and (3) although the audit organization may have occasionally reviewed financial records pertaining to A.I.D. activities, it had refused to provide reports on the results of its reviews. The Mission did not heed the warning. Because the Mission did not comply with requirements, it did not have adequate audit coverage over disbursements of \$171 million or about 23 percent of its portfolio.

On March 31, 1992, A.I.D established the Audit Management and Resolution Program. A.I.D. assigned responsibility for audit management and the development of a planning, implementation and follow-up system to A.I.D./W and the field missions. USAID/Egypt started to implement the program in the fall of 1991. In this program the IG's role is to determine that financial audits of A.I.D. recipients meet U.S. government auditing or other acceptable recognized standards and to provide missions with technical assistance in implementing the program.

**Recommendation No. 1: We recommend that the Director, USAID/Egypt, complete implementation of the A.I.D. Audit Management and Resolution Program guidance. Specifically the Mission must:**

- 1.1. **establish Mission operational guidance including the assignment of audit related responsibilities by the Management Control and Review Committee;**
- 1.2. **complete identification of the current audit universe;**
- 1.3. **develop an overall Audit Management Plan; and**
- 1.4. **schedule interim financial audits of A.I.D. fund recipients immediately to provide audit coverage while the Audit Management and Resolution Program is implemented.**

OMB Circular A-73 (Revised June 20, 1983), titled Audit of Federal Operations and Programs, requires that government agencies provide audit coverage of their programs in accordance with generally accepted government auditing standards. A.I.D. Handbook 13, Appendix 4D (Revised May 1991) requires that funds provided to non-U.S., non-government grantees be audited annually by independent auditors. A.I.D. Handbook 3 (Effective May 1, 1992) specifically added foreign government organizations receiving over \$25,000 yearly to the audit requirement and that audits must be performed in accordance with generally accepted government auditing standards.

As discussed under the previous audit objective, in accordance with the A.I.D. handbook, USAID/Egypt included clauses which gave the U.S. Government, or its agents, the right to conduct audits of non-U.S. recipients of A.I.D. funds. But the audit disclosed that, except for three audits of non-government organizations covering about \$2.0 million of disbursements, there was no evidence that the host government and non-government organizations representing about \$171 million of A.I.D. funds disbursed had ever been audited. The universe represented by these disbursements (15 of the 33 active projects) include 32 government or non-government organizations and 4 governorates (\$167.6 million) and 4 for-profit local organizations (\$3.6 million).

**The Mission depended on RIG/A/C for the planning of financial audits.** Until late 1991 the IG planned what financial audits could be accomplished by the local independent accounting firms under its non-federal audit program with input from the Mission. The Mission reported in the 1990 General Assessment that audit coverage was insufficient. This report was correct in view of the limited non-federal audit capability available in Egypt at that time.

RIG/A/C was trying to expand the non-federal audit program by establishing a financial audit capability in Egypt with reliable independent accounting firms. The firms needed to substantially improve their compliance with the audit standards required by the U.S. Comptroller General. This lack of capability limited the number of audits which could be performed and the quality of these audits. By 1991 the problems had been mostly overcome and independent accounting firms were providing better quality reports and some firms could accept additional work. Thus, during the first half of Fiscal Year 1992 as many financial audits were completed as for each of the preceding three years.

Contributing to the lack of coverage of GOE activities was the fact that the RIG/A/C non-federal audit workload was directed primarily at audits of U.S. contractor's local expenditures in Egypt.

These expenditures represented a substantial portion of the U.S. dollars spent on development assistance in Egypt and were not covered through audits of these contractors in the U.S. by cognizant audit agencies. This situation has since been remedied as the cognizant audit agencies are to include local expenditures in their audits of U.S. based contractors.

**The Mission could not rely on the Government of Egypt's Central Audit Organization to provide audit coverage of host government grantees.** In its 1990 General Assessment Report, USAID/Egypt stated that it was aware that the Central Audit Organization audited the GOE agencies. However, the Mission did not know to what extent these audits covered A.I.D. funds because the Mission (and the RIG/A/C) had been unable to obtain copies of the reports. In addition, Mission efforts to encourage the GOE to hire independent audit firms to audit host country contracts were not successful. Additionally, without access to audit reports, the Mission and the RIG/A/C do not know if the auditing standards used by the GOE audit organization would comply with the standards required by the IG.

Prior to the issuance of the March 25, 1992, General Notice **A.I.D./W had not provided guidance on how the Mission was to provide audit management and resolution.** Although A.I.D. handbooks incorporated audit clause language specific to agreements, grants, and contracts the guidance was not adequate to ensure that recipient audits were performed or reports were provided to the Mission. This situation was addressed in the Inspector General Act Amendments of 1988 which required federal agencies to take a more active role in maintaining effective audit management and resolution programs. In response, the Agency management officials worked closely with the A.I.D. Inspector General personnel to devise a program that would satisfy the requirements of the Act. Consultations between A.I.D. and the IG culminated in the issuance of the March 25, 1992, General Notice establishing an Audit Management and Resolution Program. By delineating clear responsibilities for the Agency, IG, and the field Missions, the General Notice should provide valuable guidance to USAID/Egypt's establishment of its audit management system.

**The Mission did not heed RIG/A/C June 1990 warning that the GOE was not complying with the grant agreement covenant for recipient audits.** In a **June 5, 1990**, memorandum to the Director, USAID/Egypt, RIG/A/C questioned whether the GOE was meeting the project agreement covenant on financial audits and suggested that the Mission's accountability over GOE grantees was substantially diminished because: (1) there was no assurance that grantees were maintaining proper records for audits, (2) the Mission or RIG/A/C could not confirm that the GOE Central Audit Organization complied with government auditing standards, and (3) although the audit organization may have occasionally reviewed financial records pertaining to A.I.D. activities, it had refused to provide reports on the results of its reviews. The RIG/A/C requested the Mission to answer within two weeks whether it agreed or disagreed with the RIG's view and what action it would take. The Mission replied in **February 1991** that it did not see a problem, in that the purpose of the covenant on audits was clear because it assured access to information the Mission needed to account for USAID financed goods and services. Also, the Mission believed it got the information it needed for accountability from the GOE or from internal sources. Finally, the Mission indicated the covenant helped it pressure the GOE to

make funds available for regular audits of this information. While the latter may be true, our audit found no evidence that such pressure had been exercised.

Without coverage of GOE A.I.D. fund recipients, the Mission does not have adequate audit coverage for over \$171 million of its portfolio. This coverage is vital if the Mission is to have adequate accountability over these funds. This fact is well recognized by USAID/Egypt and the Mission has begun to remedy this internal control weakness.

In conclusion, USAID/Egypt is responsible for ensuring that audits of non-U.S. government agencies and non-governmental entities are performed. Since the fall of 1991, before the A.I.D. guidance was issued, USAID/Egypt told us it had been working to establish a prioritized inventory of needed audits. USAID/Egypt needs to complete this work in compliance with the Agency's General Notice.

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**Did USAID/Egypt comply with federal requirements to resolve and implement audit recommendations?**

Except for the effect on audit findings, if any, of not receiving acceptable representations, as discussed on page 3, USAID/Egypt complied with Federal requirement to resolve and implement audit recommendations. The office of the Regional Inspector General for Audit/Cairo and USAID/Egypt have a system to jointly monitor recommendations and their resolution. Our experience indicates that this system has generally been effective.

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# REPORT ON INTERNAL CONTROLS

This section summarizes our assessment of internal controls for the audit objectives in our audit of USAID/Egypt's compliance with policies and procedures.

## Scope of Our Internal Control Assessment

We performed our audit in accordance with generally accepted government auditing standards, except that the USAID/Egypt Director did not provide us acceptable representations in all essential respects and, in accordance with A.I.D./Washington guidance, Mission officials directly responsible for the audited activities did not provide written representations relating to the activities to support the representation made by the USAID/Egypt Director. (A description of the representations USAID/Egypt made is included in the Scope and Methodology section of this report; and Appendix III contains the audit representation letter along with the Mission's response to this audit report.)

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

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

We focused our assessment of internal controls on those applicable to the audit objectives and not to provide assurance on the overall internal control structure. Furthermore, the limitations in the Mission's representations are sufficient to preclude an unqualified opinion on the reliability of the internal controls related to the audit objectives. Therefore, our opinions on the adequacy of internal controls are qualified to the extent of the effect such representations may have, if any, on our audit results.

For the purposes of this report, we have classified significant internal control policies and procedures applicable to each audit objective by category. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they had been placed in operation. We have reported these categories as well as any significant weaknesses under the applicable section heading for each audit objective.

### **General Background on Internal Controls**

Recognizing the need to emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Manager's Financial Integrity Act in September 1982. Under this Act and the Office of Management and Budget's implementing policies, the management of A.I.D., including USAID/Egypt, is responsible for establishing and maintaining adequate internal controls. Also, 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 controls and procedures for federal foreign assistance 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 and loss; 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 because: (1) changes in conditions may require additional procedures, or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

### **Conclusions for Audit Objective One**

The audit objective relates to USAID/Egypt's compliance with A.I.D. policies requiring assessments of audit need and budgeting project funds for audits. In planning and performing our audit of USAID/Egypt's compliance with A.I.D. audit planning and budgeting requirements, we considered the applicable internal control policies and procedures cited in A.I.D. Payment Verification Policy Statement No. 6. For the purposes of this report we have classified policies and procedures into the following categories: the project planning and budgeting processes.

Our test showed that the Mission applied internal controls on a consistent basis.

### **Conclusions for Audit Objective Two**

The audit objective relates to USAID/Egypt's compliance with A.I.D. handbook provisions to include audit requirements in project agreements and contracts. In planning and performing our audit of these agreements and contracts, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks 3 and 13. For the purposes of this report, we have

classified policies and procedures into the following categories: the contract and agreement preparation process.

Our test showed that the Mission applied internal controls on a consistent basis.

### **Conclusions for Audit Objective Three**

The audit objective relates to USAID/Egypt's compliance with regulations to ensure required audits are performed. In planning and performing our audit of USAID/Egypt's compliance with audit requirements, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks 3 and 13 and OMB Circular A-73. For the purposes of this report, we have classified policies and procedures into the following category: the project audit process.

We reviewed audit-related records in the USAID/Egypt project and financial management offices to determine the extent required audits of non-U.S. government and non-government grantees were performed. The records showed that USAID/Egypt had no adequate controls to ensure required audits were performed. USAID/Egypt's 1991 Internal Control Assessment report to the Assistant Administrator (November 26, 1991) showed that the Mission was aware of this problem and reported it as a material internal control weakness. Recommendation No. 1 of this audit report and the A.I.D. March 25, 1992, General Notice address immediate action which the Mission can take to ensure required audits are performed.

### **Conclusions for Audit Objective Four**

The audit objective relates to USAID/Egypt's compliance with requirements to resolve and implement audit recommendations. For this objective, the category of applicable internal controls are covered under audit objective three -- the project audit process.

Our test showed that the Mission applied internal controls on a consistent basis.

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# REPORT ON COMPLIANCE

This section addresses USAID/Egypt's compliance with applicable laws.

## **Scope of Our Compliance Assessment**

We conducted our audit in accordance with generally accepted government auditing standards. Although the Director, USAID/Egypt provided us with essential written representation, he did not provide us with acceptable representations as to whether he is aware of any noncompliance or possible violations of laws and regulations for the activities under audit. Instead, the Director limited his representations to that to the best of his knowledge and belief, the records under audit should contain any instances of noncompliance or violations. Also, in accordance with A.I.D./W guidance of May 13, 1992, the Mission policy is that only the Director will sign a letter of representation. Therefore, other USAID/Egypt officials directly responsible for the audited activities, in this case the Associate Director for Financial Management, did not provide written representations to the Director confirming essential information.

The limited representations on compliance and lack of written representations from officials directly responsible for the audited activities constitute a limitation on the scope of the audit and are sufficient to preclude us from giving an unqualified opinion on compliance with applicable laws and regulations. Therefore, we are disclaiming an opinion.

## **General Background on Compliance**

Noncompliance is a failure to follow requirements or a violation of prohibitions contained in statutes, regulations, contracts, grant and binding policies and procedures governing an organization's conduct. Noncompliance constitutes an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures in the A.I.D. Handbooks generally is not an illegal act but is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Compliance with the Inspector General Act Amendments and OMB Circular A-73 (Revised) are the overall responsibility of USAID/Egypt management.

### **Conclusions on Compliance**

As noted above, we have disclaimed an opinion on the Mission's compliance with laws and regulations. However, based on the information that USAID/Egypt did provide to us and the tests we were able to perform, we can report that USAID/Egypt was not complying with OMB Circular A-73 (Revised) to ensure that required audits of recipient funds were performed.

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## SCOPE AND METHODOLOGY

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### Scope

We audited USAID/Egypt's compliance with laws and its policies and procedures that require audits to be performed of grants, cooperative agreements, projects and contracts for the period January 1984 to December 1991. We conducted the audit in the offices of USAID/Egypt from July 1991 to December 1991 and covered systems and procedures relating to compliance with audit requirements of the Mission's projects that had a termination date after August 1, 1991. Our audit work was conducted in accordance with generally accepted government auditing standards, except as discussed below with regards to the extent of representations made by Mission officials.

Government auditing standards require auditors to obtain representation letters when the auditors deem it useful. The Office of the Inspector General has deemed that representation letters are necessary to support potentially positive findings. We requested USAID/Egypt's management to furnish written representation with regard to this audit assignment. Based upon discussions with Mission officials, the Director USAID/Egypt, provided us with a written representation that USAID/Egypt is responsible for the internal control system and the fairness and accuracy of the accounting and management information relating to the audited activities and that, to the best of his knowledge and belief, USAID/Egypt had provided us all the financial and management information relating to the audit objectives, USAID/Egypt is unaware of any material instances where information provided had not been properly and accurately recorded and reported, and USAID/Egypt has complied with all contractual agreements that could materially affect Mission accountability. (The complete representation is contained in Appendix III to this report.)

Although the Director, USAID/Egypt provided us with these essential written representations, he did not provide us with acceptable representations as to whether he is aware of any instances of irregularities, noncompliance with A.I.D. policies and procedures or violations or possible violations of laws and regulations for the activities under audit. Instead, the Director limited his representation to that to the best of his knowledge and belief, the records under audit should

contain any instances of irregularities or noncompliance or violations. Also, in accordance with A.I.D./W guidance of May 13, 1992, the Mission policy is that only the Director will sign a letter of representation. Therefore, other USAID/Egypt officials directly responsible for the audited activities, in this case the Associate Director for Financial Management, did not provide written representations to the Director confirming essential information. Therefore our answers to the audit objectives are qualified to the extent of the effect of not having such representations, and we have disclaimed an opinion in our Report on Compliance.

We limited our universe to the Mission's projects that had a termination date after August 1, 1991. We divided this universe into four categories: project agreements, grants and cooperative agreements, host country contracts, and A.I.D.-direct contracts. The universe was obtained from: (1) a computer printouts of active host country contracts from the contract services office, (2) a computer printout of direct contracts, grants, and cooperative agreements from the data management services office, and (3) a list of active project agreements from a Mission quarterly report. We selected the projects with a termination date after August 1, 1991, because it gave us the opportunity to examine active agreements and contracts in different stages of implementation and enhanced the likelihood that relevant documents and knowledgeable officials would be available.

Our tests included a sample of projects and a sample of grants and cooperatives agreements. For projects, we limited our sample to projects with funding of \$50 million or more. We selected a sample of 11 of the 33 project papers based on high dollar value (\$3.1 billion of \$4.8 billion) to review for the assessment of audit needs and funding provided in project papers. We reviewed 6 A.I.D.-direct contracts with values over \$5 million (\$132 million) and 7 host country contracts available at the Mission (\$420.3 million) related to the 11 projects to review audit clauses in the contracts and whether the audits were performed. We also reviewed the 17 active grants and cooperative agreements representing \$65.2 million in funding to determine if audit clauses were included and audits performed. We compared the standard provisions for agreements, grants, cooperative agreements, and contracts related to the audit clauses with the audit clauses in the sample. We verified the wording of the audit clauses and the effective date to answer audit objective two.

We used the audit universe developed by RIG/A/C which identified \$171 million (for 15 of 33 projects) disbursed to Government of Egypt agencies and non-government entities -- with disbursements over \$25,000 as of October 1991 -- to determine whether the Mission performed audits over such assistance.

We did not attempt to: (1) validate the financial information in the computer printout furnished by the Mission, (2) validate the information in the Mission quarterly report, or (3) review the documentation supporting disbursements for the agreements and contracts covered under this audit. In addition, we did not review preaward surveys or close-out audits because these areas were being audited and will be reported under the audit of contracting practices.

Our audit included a review of the Mission internal control system to ensure that the audit requirements were included in all projects, grants, cooperative agreements, and contracts and that the required audits were performed.

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## **Methodology**

Our criteria for selection of the audit sample were projects that had total obligations of \$50 million or more as of August 1, 1991 with a termination date after August 1, 1991, and signed after the December 1983 policy statement was issued. This resulted in a sample of 11 projects with total obligations of \$3.1 billion or 65 percent of the total obligations for USAID/Egypt's portfolio of 33 projects. We used this audit sample for audit objectives one, two and three.

### **Audit Objective One**

The first objective was to determine if USAID/Egypt included assessments of the need for audits in project papers and if project funds were budgeted for audits when necessary.

Because of the high dollar funding of projects in USAID/Egypt's portfolio, we selected projects with funding over \$50 million that were signed after December 1983 to determine whether assessments of the need for audits were included in the project papers as required by the policy statement issued in December 1983. We also examined budgets and budget amendments to the project agreements to determine if funds were budgeted for audits or whether amounts budgeted were increased or decreased.

We reviewed the Mission Controller's project files and an Active Awards Report provided by the Office of Data Management Services for the sample selected and determined which organizations or governmental entities were receiving project funds. With this information we determined which organizations had a need or requirements for audit that should have been budgeted in the project agreement. We believe government agencies receiving A.I.D. funds were considered to have a need for audit because we have no assurance that the Government of Egypt provides adequate audit coverage of these funds. We reviewed 17 grants and cooperative agreements, 7 host country contracts and 6 A.I.D.-direct contracts to determine whether project funds were budgeted for audit when necessary.

### **Audit Objective Two**

The second objective was to determine whether USAID/Egypt complied with A.I.D. handbook provisions by including specified audit requirements in project agreements, grants, cooperative agreements, and contracts. To accomplish this, we interviewed personnel in the USAID/Egypt project and contract offices who are responsible for preparing these agreements or reviewing them for compliance with A.I.D. requirements before they are executed. We also reviewed the agreements and contracts associated with the 11 projects active after August 1, 1991 (in our

sample) and the 17 grants and cooperative agreements to determine whether they included standard agreement provisions regarding audit requirements in effect at the time the documents were executed or amended.

**Audit Objective Three**

The third objective was to determine whether USAID/Egypt ensured that audits were performed as required.

To accomplish this objective we interviewed personnel in the USAID/Egypt project, contract, and controller offices to determine whether reports of required audits were on file for project agreements and contracts with GOE agencies and local A.I.D. fund recipients and whether USAID/Egypt used a system to track required audits and whether an individual had been designated to monitor compliance with audit requirements.

**Audit Objective Four**

To answer the fourth objective, we determined whether USAID/Egypt had established a monitoring system to ensure that audit recommendations were resolved and implemented. To accomplish this, we interviewed the USAID/Egypt controller and discussed the monitoring system with members of our own staff who have been involved in working with the Mission to track and close recommendations over the last few years.

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**MANAGEMENT COMMENTS  
AND OUR EVALUATION**

USAID/Egypt's response on the draft report is included in its entirety in Appendix III of this report. The Mission has also requested that its letter of audit representations be included as part of its comments. Therefore, this letter is also included in Appendix III. The Mission's response to the recommendations and actions proposed or taken are discussed below.

- Recommendation No. 1.1 - to establish Mission Operational guidance including the assignment of audit related responsibilities by the Management Control and Review Committee. USAID/Egypt formed a Mission Management Control and Review Committee in October 1991 which meets regularly. The Mission is preparing a Mission Order to provide operational guidance in accordance with AID/W guidelines dated March 31, 1992. Based on the above, we will consider the recommendation resolved. We will close the recommendation on receipt of the Mission Order.
- Recommendation No. 1.2 - to complete the current audit universe. In response to the recommendation the Mission provided a completed USAID/Egypt audit universe for all commitments over \$25,000 as of April 8, 1992. We consider Recommendation 1.2 closed.
- Recommendation 1.3 - to develop an overall Audit Management Plan. The Mission has developed this plan. We consider Recommendation 1.3 closed.
- Recommendation 1.4 - to schedule interim financial audits of A.I.D. fund recipients to provide some audit coverage while the Audit Management and Resolution Program is implemented. About 30 audits of GOE agencies and local fund recipients are planned for fiscal year 1993. Based on this plan, we consider Recommendation 1.4 closed.



CAIRO, EGYPT

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

AUG 19 1992

RECEIVED  
AUG 19 1992

MEMORANDUM

TO: Philippe Darcy, RIG/A/C  
FROM: George Wachtenheim, D/DIR  
SUBJECT: Audit of USAID/Egypt's Accountability

Following is the Mission's response to the following recommendations under the subject audit report:

Recommendation No. 1:

We recommend that the Director implement the A.I.D. Audit Management and Resolution Program guidance. Specifically the Mission is to:

- 1.1. establish Mission Operational guidance including the assignment of audit related responsibilities by the Management Control and Review Committee;
- 1.2. complete the current audit universe;
- 1.3. develop an overall Audit Management Plan; and
- 1.4. schedule interim financial audits of A.I.D. funds recipients immediately to provide some audit coverage while the Audit Management and Resolution Program is implemented.

Mission Response:

- 1.1. USAID/Cairo formed a Mission Management Control and Review Committee (MCRC) in October 1991 and is meeting at least

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- 2 -

every three months. Presently, the Mission is preparing a Mission Order that will provide operational guidance for USAID/Cairo's Audit Management and Resolution Program for the MCRC in accordance with AID/W guidelines dated March 31, 1992. This will include the assignment of audit related responsibilities by the MCRC. The Mission Order should be finalized and distributed in August 1992. Mission will provide the RIG/A/C a copy of the Mission Order for comments before it is finalized. Based on the above, Mission requests closure of recommendation 1.1.

- 1.2. The Mission in coordination with RIG/A/C, has developed and completed USAID/Cairo's audit universe for all commitments over \$25,000. For each commitment over \$25,000, the Mission has determined that the audit responsibilities and other pertinent information is in accordance with AID/W guidance dated March 31, 1992. Attached is a copy of the Mission's audit universe as of April 8, 1992 which was previously distributed to AID/W, IG/W and RIG/A/C. Based on the above, Mission requests closure of recommendation 1.2.
- 1.3. The Mission has developed an overall Audit Management Plan for FY 93. The Mission's Audit Management Plan for FY 93 was based on all commitments (Host Country recipients) over \$25,000 for which the Mission has responsibility for ensuring that financial audits are performed. Also attached (as part of the audit universe) is the Mission's Audit Management Plan for FY 93 that tentatively includes 30 Non Federal Audits (NFAs) and 5 recipient audits. The Mission's FY 93 Audit Management Plan was submitted to your office in April, 1992 for appropriate action. Based on the above, Mission requests closure of recommendation 1.3.

\* Mission's audit universe is on file at RIG/A/Cairo.



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- 1.4. The Mission in coordination with RIG/A/C, has immediately scheduled interim financial audits of AID funded recipients (Mission responsibility) to provide some audit coverage while the Audit Management Resolution Program is implemented. As of July 22, 1992, four (4) NFAs have been completed for host country recipients and another 14 NFAs of host country recipients are currently in process or planned for FY 92. Also, as stated in 1.3. above, the Mission is planning 30 NFAs and 5 recipient audits of Host Country recipients in FY 93. We believe that these actions will substantially improve the Mission's audit coverage of Host Country recipients. Based on the above, Mission requests closure of recommendation 1.4.

Att: a/s above



UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

APPENDIX III

Page 4 of 5

RECEIVED  
20 SEP 1992

SEP 20 1992

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Mr. Philippe L. Darcy  
Regional Inspector General  
for Audits  
Cairo, Egypt

Dear Mr. Darcy:

This Representation Letter is being issued in accordance with Agency guidance in response to the audit of "USAID Accountability" recently conducted by your Staff.

Based upon discussions with the Financial Management Directorate, to the best of my knowledge and belief, I confirm that all appropriate financial records in the possession and under the control of USAID/Cairo relating to the function being audited have been made available to you. To the best of my knowledge and belief, the records made available to you are accurate and complete, and they fairly represent the status of accountability within the Mission. To the best of my knowledge and belief, in conjunction with the confirmation in A, B, C and D below, those records, with respect to the referenced audit, should contain any instances of non-compliance or irregularities, or violations of laws and regulations as those terms may be defined by or perceived by the Inspector General. Specifically I confirm that:

- (A) USAID/Egypt is responsible for the internal control system, for the fairness and accuracy of accounting and management information for the function under audit. USAID/Egypt to the best of my knowledge and belief exercises its best efforts to ascertain and follow applicable U.S. laws and AID regulations and AID interpretations of those laws and regulations.
- (B) To the best of my knowledge and belief, and based on discussions and verbal representations by others in the Mission, USAID/Egypt has made available to you or otherwise provided you at your request all financial and management information related to the audit objectives.

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- (C) To the best of my knowledge and belief, except for any findings or other matters included in the audit report, USAID/Egypt is unaware of any material instances associated with the function being audited where financial or management information has not been properly and accurately recorded/reported.
- (D) To the best of my knowledge and belief, USAID/Egypt has complied with all contractual agreements, to the extent there are such agreements, which could have any material effect on Mission accountability.

Upon review of your draft report and following further discussion with my staff, I know of no events subsequent to the date of your draft report, (other than those which were included in our response to that report), which to the best of my knowledge and belief would materially alter the statements in (A) thru (D) above.

All representations made herein by me are made in light of my experience since my arrival at post.

I request that this Representation Letter be included as a part of the official management comments on the draft report and that it be published therewith as an Annex to the report.

Sincerely yours,



Henry H. Bassford  
Director

**APPENDIX IV****REPORT DISTRIBUTION**

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