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**Audit of USAID/Egypt's
Commodity Import Program**

Audit Report No. 6-263-91-06
August 18, 1991

USAID/Egypt's Commodity Import Program has provided \$4.5 billion to finance needed imports since 1975. In response to past audit recommendations, USAID/Egypt has developed various management systems, procedures and end-use checks which provide reasonable assurance that goods purchased have been received and that local currencies to be deposited in a Special Account in payment of imported commodities are so deposited. However, opportunities exist to enhance the efficiency and oversight of these systems, procedures, and end-use checks.

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

August 18, 1991

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

FROM :

RIG/A/C, F. A. Kalhammer



SUBJECT:

Audit of USAID/Egypt's Commodity Import Program
(Project No. 263-0201 and CIP Agreements 263-K-616 and
263-K-618)

Ten copies of our audit report No. 6-263-91-06 on the above project have been provided to you and your staff.

A draft of this report was provided for your review and comment. We have reviewed your comments on the draft report and considered them in the preparation of the final report. Your comments are included as Appendix II to the report.

The report contains eight recommendations, four with more than one part. The status of those recommendations at report issuance is as follows: Recommendations Nos. 1, 2, 4, 5, 6 and 7 are closed. Part 3.1 of Rec. No. 3 is unresolved, but part 3.2 is closed. As a result, Rec. No. 3 remains unresolved. Part 8.1 of Rec. No. 8 is resolved and part 8.2 is closed. Consequently, Rec. No. 8 remains resolved but open. No direct monetary recoveries are estimated to accrue from these recommendations which are procedural in nature.

Please provide a response to this report within 30 days indicating what further actions you have taken to address the open recommendations.

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

EXECUTIVE SUMMARY

A.I.D. has provided Egyptian importers with \$4.5 billion in Commodity Import Program (CIP) financing since 1975. This form of non-project assistance is intended to help lesser developed countries experiencing foreign exchange problems to sustain economic activities by financing needed imports. Importers can receive grant financing under two CIP programs depending on whether they belong to the public or private sector. We audited both CIP programs. The audit covered the CIP private sector program (Project No. 263-0201) from its inception in July 1986 through December 1990, and the two most recent public sector CIP grants, 263-K-616 and 263-K-618, for the period February 1988 through December 1990. USAID/Egypt financed commodities amounting to about \$651 million during these periods.

Between September 1990 and March 1991, we audited the public and private sector CIPs in accordance with generally accepted government auditing standards. The objectives of the audit are discussed on page 4 of this report, while its scope and methodology are discussed in Appendix I.

Our scope did not include assessing the economic impact of the program on either the public or private sectors, although private sector participation in the program has increased since our last audit. In conjunction with similar audits being conducted worldwide by the Office of the Inspector General, we sought to determine what improvements had been made in USAID/Egypt's CIP management since it was last audited (see RIG/A/Cairo Report No. 6-263-88-5 - August 31, 1988).

The audit disclosed that while USAID/Egypt had generally taken action to correct earlier reported deficiencies, certain problems continue to require management attention. We found that the Mission:

- has a system to assure itself that CIP commodities paid for arrive, but the system's arrival data were often seriously out of date (see page 9).
- had corrected previously reported deficiencies concerning end-use checks, but further action is needed because planned checks were not completed promptly, verbal statements were often relied upon to substantiate how commodities had been used, end-users were not always provided with A.I.D. emblems when suppliers failed to mark A.I.D.-financed commodities as required, and

A.I.D./Washington was not always advised when non-compliance with marking requirements was observed (see page 13).

- revised the procedures for depositing the local currency value of public sector commodity imports in the Special Account, but the Government of Egypt's (GOE) Ministry of Finance (MOF) calculated the amount of currency to be deposited in the Special Account using an incorrect exchange rate. Additionally, USAID/Egypt failed to document how it verified the accuracy of the amounts to be transferred to the Special Account (see page 18).
- designed certain procedures to ensure the timely deposit of local currency from private sector importers into the Special Account, but the GOE had not always enforced these procedures with all participating banks nor had it reconciled payments received with payments due (see page 22).
- conducted a review of CIP procedures, but did not actually test program controls and, consequently, did not identify the weaknesses identified in this audit (see page 29).

The report contains eight recommendations addressing the problem areas identified. The report also discusses our assessment of internal controls and relates problems found to weaknesses in internal controls (see page 30), and includes our report on USAID/Egypt's compliance with applicable laws regulations, and the terms of grant agreements (see page 35).

A draft of this report was provided to USAID/Egypt officials for comment. The Mission response concurred with and indicated that action had or would be taken on seven of nine recommendations. The Mission disagreed with two recommendations and requested that one of the two be deleted. We have acceded to this request. As a result, one recommendation remains unresolved.

The Mission's "overview statement" at the beginning of Appendix II states that the commodity import program, at \$200 million annually, will remain a significant component of A.I.D. assistance to Egypt and that efforts to transform it from a public to a private sector program will continue. Options identified for improving controls and efficiencies were welcomed by management. The Mission's entire response is included as Appendix II of the report.

Office of the Inspector General
Office of the Inspector General
18 August 1991

Glossary

A.I.D.	Agency for International Development
A.I.D./W	Agency for International Development/Washington
CBE	Central Bank of Egypt
CIP	Commodity Import Program
CMT	Office of Commodity Management and Trade, USAID/Egypt
DIB	Development Industrial Bank
FAA	Foreign Assistance Act
FMFIA	Federal Manager's Financial Integrity Act
GAO	General Accounting Office
GOE	Government of Egypt
IG/W	Inspector General/Washington
IMF	International Monetary Fund
L/C	Letter of Credit
L/COM	Letter of Commitment
LE	Egyptian Pounds
MIC	Ministry of International Cooperation
MOF	Ministry of Finance
OMB	Office of Management and Budget
PIL	Project Implementation Letter
RIG/A/C	Regional Inspector General for Audit/Cairo
USAID	A.I.D.'s Economic Assistance Mission in Egypt

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INTRODUCTION

Background

A.I.D. has provided Egyptian importers with \$4.5 billion in Commodity Import Program (CIP) financing since 1975. This form of non-project assistance helps less developed countries experiencing foreign exchange problems to sustain economic activities by financing needed commodity imports. More specifically, CIP assistance: (1) helps meet the import requirements needed to sustain public sector levels of consumption, investment, and production, and (2) increases investment in productive private sector enterprises. A secondary purpose is to generate local currency and make it available to the recipient governments for development activities. USAID/Egypt's Office of Commodity Management and Trade (CMT) has primary responsibility for monitoring the program which is administered by the Ministry of International Cooperation (MIC) and by participating banks.

The program serves both the public and private sectors. Importers receive financing in different ways depending on which sector they belong to. USAID/Egypt allocates a certain amount annually to finance imports by the public sector. The GOE develops a plan to allocate these funds among its different agencies which justify the commodities they wish to acquire with A.I.D. funding. Once GOE bid awards have been approved by the Mission, direct letters of commitment¹ are used to finance the transactions. When A.I.D. dollars are disbursed to finance the imports, the Mission advises the GOE of the amount of dollars disbursed and the Ministry of Finance then calculates the equivalent amount in Egyptian Pounds (LE) and deposits a portion of that amount in a Special Account in the Central Bank of Egypt. USAID/Egypt maintains a commodity arrival accounting system to monitor when the commodities are shipped, arrive, and clear port.

¹ A direct letter of commitment is a unique financial instrument between A.I.D. and a supplier or contractor under which A.I.D. makes payments directly to a supplier or contractor for eligible commodities and services furnished pursuant to a specific contract. The letter is assignable and can be used as collateral for credit.

USAID/Egypt uses bank letters of commitment² (L/COM) to finance imports by private sector importers. Importers apply directly to participating local banks for financing. The banks screen applications and query the Mission as to whether it has any objections to proposed transactions. Upon receipt of a letter from USAID/Egypt that it has no objection to the commodities being financed, the local bank issues instructions to a U.S. bank establishing a letter of credit³ to finance the imports.

The importer makes a local currency down payment equivalent to at least 20 percent of the letter of credit (L/C) value. When the U.S. supplier is paid, the 80 percent balance of local currency is collected either immediately, after a grace period, or according to an approved installment plan. The participating bank is responsible for collecting and depositing these local currencies to the Special Account when due.

The public sector program has been financed under annual grants. We audited two of the most recent public sector grants, 263-K-616 and 263-K-618, made on February 9, 1988 and June 21, 1989, respectively. The private sector CIP has been financed under a project (No. 263-0201) approved in July, 1986. We audited the project from its inception through December, 1990.

As of December 31, 1990, \$859 million had been obligated and \$651 million expended under the private sector program and the two public sector grants. USAID/Egypt records show that \$659 million had been obligated and \$508 million expended under the private sector program, while \$200 million had been obligated and \$143 million expended under public sector grants 263-K-616 and 263-K-618.

The local currency equivalent of the amounts disbursed by A.I.D. for the commodities is deposited in a Special Account maintained by the Central Bank of Egypt (CBE). The accuracy and timeliness of these deposits is the monitoring responsibility of the Mission's Financial Management Office, which also conducts end-use checks of the imported commodities.

² A Bank Letter of Commitment evidences an agreement between A.I.D. and a U.S. bank under which A.I.D. authorizes the bank to make payments to a contractor or supplier for eligible commodities and services. A.I.D. reimburses the bank for payments made and pays a fee for its services.

³ A Letter of Credit is a commonly used commercial instrument issued by a bank under a buyer's instructions authorizing the seller of goods to draw a specific sum of money under specified terms, usually the receipt by the bank of certain documents within a given time.

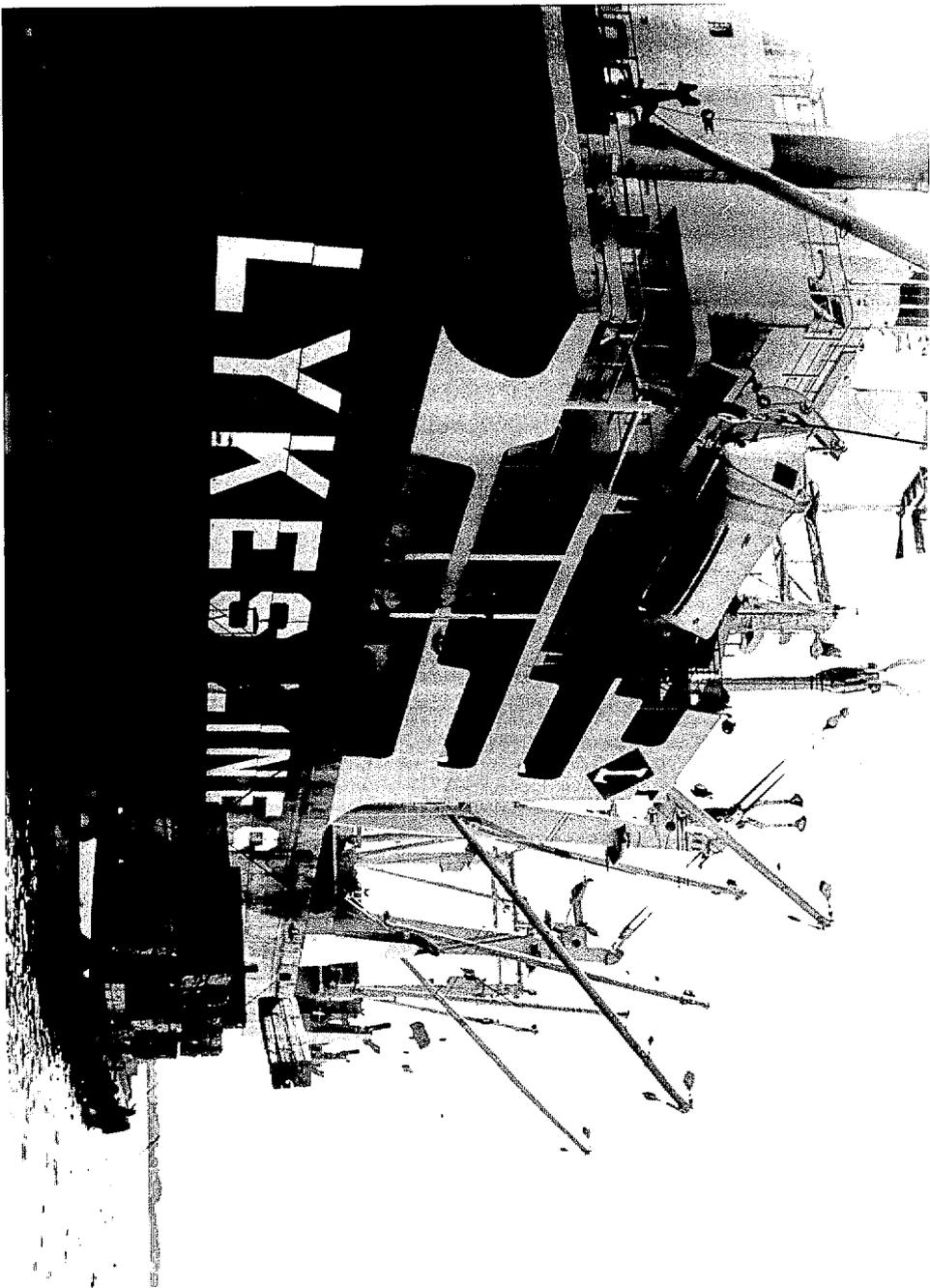
Amounts on hand in the Special Account are periodically programmed by the Mission and the MIC for a variety of uses. Since 1988 the principle use of CIP local currency generations has been to provide budgetary support to selected GOE Ministries with which the Mission jointly sponsors developmental activities. The Special Account monies were last programmed on July 11, 1990. The balance in the Special Account from CIP sales proceeds on June 30, 1990 was LE747 million. The rate of exchange on that date was LE2.65 = US\$1.

Audit Objectives

The Regional Inspector General for Audit/Cairo audited the USAID/Egypt public and private sector CIPs to answer the following objectives:

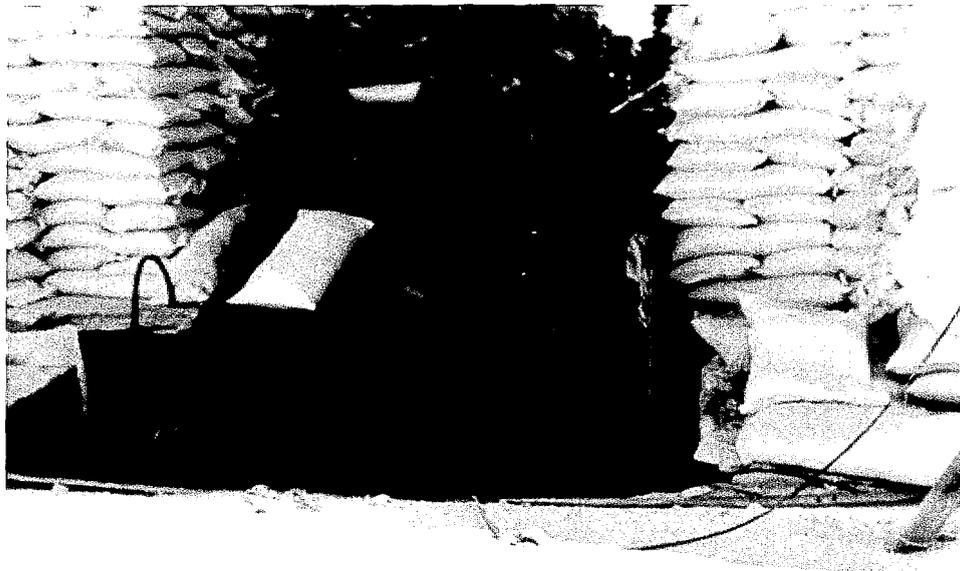
1. What has been the progress of the CIP program?
2. Did USAID/Egypt have a system to assure itself that commodities it paid for arrived?
3. Has USAID/Egypt acted to correct prior end-use check deficiencies?
4. Has USAID/Egypt corrected previously reported deficient controls over public sector CIP-generated Egyptian pounds?
5. Has USAID/Egypt corrected previously reported deficient controls over private sector CIP-generated Egyptian pounds?
6. Did USAID/Egypt exercise adequate control over the programming and withdrawal of Special Account funds?
7. Did USAID/Egypt, through its internal control review procedures, identify and resolve internal control weaknesses in its CIPs?

These audit objectives included an assessment of internal controls and a review of compliance with laws and regulations relating to the audit objectives. When we found that the USAID met the responsibilities for an area, we did not perform additional work. However, when responsibilities were not met, we performed additional work to confirm that the problem existed and limited our conclusions only to the items tested. Appendix I contains a complete discussion of the scope and methodology for this audit.



A.I.D. Financed Lumber Being Unloaded at Alexandria

5



**End-Use Checker's Photos of Grain Importer's Facilities
Near Helwan (South of Cairo) -- November 1990**

REPORT OF AUDIT FINDINGS

What has been the progress of the Commodity Import Program?

The economic objective of USAID/Egypt's Commodity Import Program (CIP) has been to help meet the Egyptian economy's need for imported equipment and raw materials. A.I.D. provides the required foreign exchange on a grant basis to buy the goods and services to support economic stability and stimulate growth.

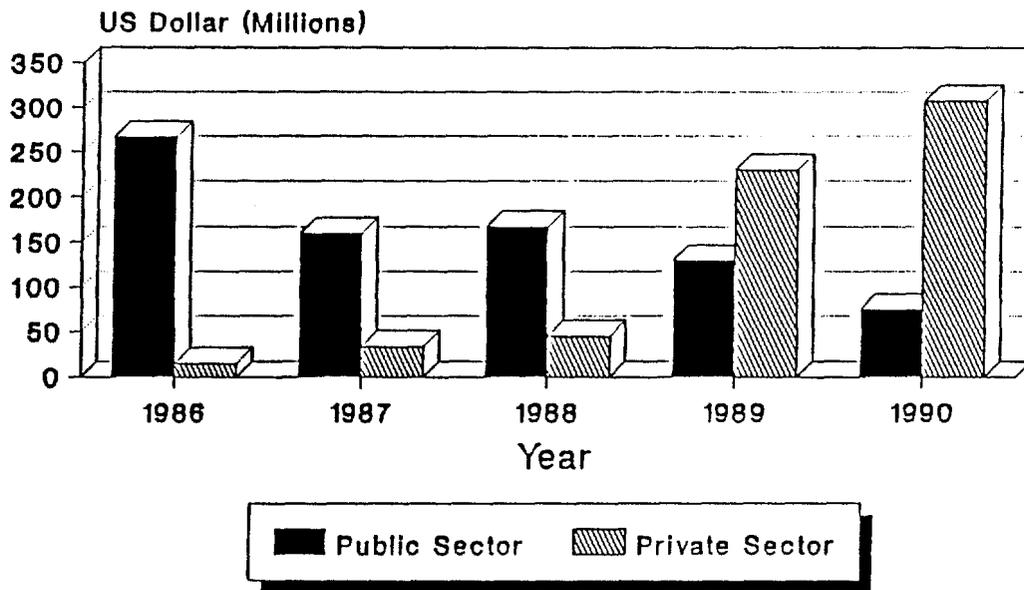
In addition to providing needed foreign exchange, the CIPs support USAID/Egypt's broader economic strategy to develop exports of Egyptian agricultural and industrial products. With the completion of an International Monetary Fund (IMF) Standby Agreement in April 1987, Egypt began implementing a structural adjustment program requiring sustained high levels of private sector investment in new economically productive activity. CIP financing provided flexible balance-of-payments assistance needed during the adjustment period to sustain the Egyptian economy.

In accordance with its current emphasis on support for the private sector, USAID/Egypt has shifted CIP financing from the public to the private sector. Funding for public sector CIP grants had been one-half the total \$200 million in CIP assistance mandated in the Agency's annual appropriations bills for fiscal years 1987-1989, but is expected to decline to \$25 million as a greater share of CIP funds are allocated to the private sector. The shift in A.I.D. financing from the public sector to the private sector financing is apparent in the following chart.

PUBLIC/PRIVATE SECTOR CIP

Financial Instruments Issued

January 1986 - December 1990



We did not attempt to evaluate the effectiveness of the public and private sector CIPs in stimulating growth. We did, however, assess whether USAID/Egypt had made progress in improving its management of the program. In making substantial tests of commodity import transactions, we found no instance in which tested transactions were not completed, satisfactorily. We also found that USAID/Egypt had revised certain of its systems' controls and procedures regarding commodity arrivals, local currency deposits, and end-use checks. However, as disclosed in the following sections of this report, further improvements are possible.

Did USAID/Egypt have a system to assure itself that commodities it paid for arrived?

USAID/Egypt had a system that provided reasonable assurance, based on prudent business practice, that CIP commodities it paid for arrived. Our tests of \$50 million in commodity shipments failed to disclose any cargoes that failed to arrive. We did, however, find that at the start of the audit the commodity arrival data maintained by the Mission were highly inaccurate due to data entry delays caused by staff vacancies and an increase in program activity. During the audit the Mission took action to update some of the arrival information. Maintaining current arrival data is a continuing problem. The Mission needs to address this situation by correcting the staffing problems and/or adopting alternatives to the current system of entering data and/or adjusting the amount of information maintained.

Recommendation No. 1: We recommend that USAID/Egypt correct the deficiencies underlying the CIP arrival data entry backlog, and/or assess whether conditions permit the Mission to implement streamlined commodity arrival tests.

Maintaining Current Arrival Data in The Mission's Commodity Arrival System Will Remain a Potential Problem

USAID/Egypt has a commodity arrival accounting system to identify whether CIP cargoes have been shipped, have arrived, and have cleared Egyptian customs at ports of arrival. During our audit we found that while USAID/Egypt had been fairly effective in identifying arrived cargoes, significant delays had occurred in entering corresponding information into the commodity arrival accounting system. As a result, the system was not providing management with accurate and timely reporting on shipments. The backlog in data entry, for example, resulted in more than \$74 million in long expired L/C shipments to be **reported** as undelivered, even though the shipments had arrived as much as 18 months previously.

USAID/Egypt officials stated that this was a temporary situation and that it was taking action to correct the problem. They claimed the backlog in data entry occurred because data entry staff had devoted their efforts to an increasing volume of new private sector CIP applications, and because data entry staff turnover temporarily reduced office efficiency. We believe that timely data entry will continue to be a problem. However, USAID/Egypt has various options available for streamlining this workload and reducing the data it maintains on arrivals.

A.I.D. procedures require that either the recipient country or the Mission maintain a system of records on the arrival and disposition of A.I.D.-financed commodities. Because of the size (by far the largest in the world) and complexity of its CIP activities, USAID/Egypt has elected to maintain its own system of records. Mission staff in Alexandria are primarily responsible for determining if A.I.D. cargoes have arrived and cleared the ports of entry. Cairo staff are responsible for entering the collected data into the commodity arrival accounting system data base.

The Mission's commodity arrival accounting system incorrectly showed many shipments being en route to Egypt although they had already arrived.

The Mission's system is designed to identify shipments of commodities that relate to each approved L/C or direct L/COM and to determine if those shipments arrived, were unloaded, and cleared the port of arrival. The system is not designed to verify that the arrived shipments contained all items paid for or that the goods met bid specifications. The system relies on the importers to identify shortages or damaged goods since they are naturally interested in receiving the commodities they paid for in local currency as ordered. End-use checks are employed to confirm the arrival of goods. This system complies with the requirements specified in A.I.D. Handbook 15.

The Mission's commodity arrival accounting system incorrectly showed many shipments being en route to Egypt although they had already arrived. For example, we identified \$74 million in shipments financed by L/Cs or L/COMs that had expired in 1987, 1988 and 1989 which were shown as not having arrived. We tested \$50 million of the \$74 million and found that all \$50 million had arrived. Moreover, the Alexandria office staff had previously confirmed arrival of most of the sampled shipments.

We supplemented Alexandria's confirmations with our own by obtaining documentation or confirmation from the shipping agents or importers that all shipments had arrived. Furthermore, officials of various banks participating in the CIP program advised that in no instance were they aware of shipments that had not arrived, although arrivals sometimes included damaged or short-landed cargo.

Arrival data as reported by USAID/Egypt's arrival accounting system was out-of-date and of limited use because of (1) turnover in Cairo data entry staff and (2) an increase in program activity as a result of which the staff concentrated on the approval of new L/Cs and L/COMs instead of the timely entry of arrival data furnished by Alexandria. If Cairo staff had entered all the data previously supplied by the Alexandria office, the

system could have produced reports identifying CIP transactions for which shipping information was **actually missing**, or confirmation that arrival or port clearance had not in fact taken place.

While USAID/Egypt has had problems in maintaining timely commodity arrival data, it is important to recognize that the cargoes reported as not having arrived **had in fact arrived**. This arrival record can be attributed, in part, to the control inherent in the importers' vested interest in their cargoes and the fact that such shipment controls are standard commercial practice. While A.I.D. is concerned with the arrival and receipt of what is paid for, public and private sector importers, if anything, have even greater interest in receiving the commodities they have paid for, provided they have not engaged in any improprieties.

In view of the importers' vested interest in commodities, USAID/Egypt does have an option of streamlining the current commodity arrival system, especially considering the decrease in the volume of distressed cargo⁴ in recent years. Further, CMT officials advised us that only one public sector ministry continues to be delinquent in clearing goods from port. Additionally, more timely data entry appears possible.

An alternative to Cairo staff's entering commodity arrival data into the system would see the Alexandria staff transmitting information via floppy disk or modem to Cairo. The Alexandria office has begun to develop its staff's capabilities in computer use. With further training such direct input of arrival data could reduce some of Cairo's data entry workload.

In summary, while the Mission's arrival accounting system is designed to provide adequate data for monitoring commodity arrivals, it has not accurately reflected the status of arrivals because arrival data gathered by the Alexandria office were not entered into the Mission's arrival accounting system timely. Since data entry backlogs have been a recurring problem, the Mission should consider alternatives to expending Alexandria staff resources in collecting commodity arrival and clearance information. Potential alternatives include:

- improving the CMT Office's proficiency and timeliness in data entry;
- developing the Alexandria office's capability to compile and transmit arrival data via floppy disk or by modem for direct entry into the commodity arrival information system data bases rather than requiring CMT to enter all data from documents provided by Alexandria;

⁴ A distressed cargo is one that has neither been processed through customs nor removed from customs within 90 calendar days of arrival.

- having participating banks or importers advise USAID/Egypt when the importer receives A.I.D.-financed goods; and
- discontinuing the verification of all arrivals, and adopting management-by-exception or sampling techniques instead of the current labor-intensive system. Such techniques could include:
 - making periodic random visits to participating local banks or importers to determine if any arrival problems exist;
 - conducting periodic sample tests of bank records to confirm that banks have received shipping documents; and
 - requesting banks to provide a monthly negative assurance statement that no arrival/port clearance problems have been detected, or if they have occurred, to identify the importer and L/C involved.

Management Comments and Our Evaluation

The Mission stated that it had initiated efforts to correct the vacant data entry position but that a rapid disbursement of \$150 million during the audit increased that data entry backlog. However, the Mission has subsequently reduced the data entry backlog and initiated actions to minimize if not correct future backlogs. In expressing its gratitude for the auditors' suggestions, Mission representatives stated they were considering certain operational modifications such as having the Alexandria office becoming a primary point of data entry.

We accept the Mission's planned actions and preventive measures as responsive to the recommendation. Recommendation No. 1 is considered closed.

Have management actions corrected prior end-use check deficiencies?

USAID/Egypt has partially corrected end-use deficiencies by developing improved criteria for selecting importers to be subjected to end-use checks; developing an annual end-use check plan; hiring contractors to perform end-use reviews; and following up on identified problems.

However, for the items tested, USAID/Egypt has not fully provided the assurances needed because it had not: (1) completed planned end-use checks, (2) always relied on physical inspections of commodities or relevant documentation to substantiate how commodities were used, or (3) taken corrective actions in all cases in which non-compliance with marking requirements was detected. A.I.D. Guidance and Handbooks do not require end-use checks to be completed within a specific time frame. Our review of the checks indicates that they would be more effective and reliable, however, if done more-timely and not years after the goods arrived. The review of all importer transactions regardless of age has been an accepted practice whose merits have not been questioned. We believe there is a need to concentrate the limited end-use checks on more recent imports.

Recommendation No. 2: We recommend that USAID/Egypt:

- 2.1 conduct end-use checks of commodities to be used in manufacturing or sold soon after the commodities arrive so that evidence of use and/or sale can be properly verified; and**
- 2.2 require end-use checkers to report the extent to which they independently verify the use or sale of commodities in lieu of relying on importers' verbal statements.**

Recommendation No. 3: We recommend that USAID/Egypt:

- 3.1 supply end-users with emblems and request they affix same for the seven violations mentioned in this report and adopt procedures for ensuring that when equipment is found unmarked, the deficiency is corrected; and**
- 3.2 report the one unreported instance of non-compliance with marking requirements in 1990 to A.I.D./Washington.**

USAID/Egypt Needs to Conduct Public and Private Sector End-Use Checks More Timely

The Mission's method of planning end-use checks resulted in their being conducted more than a year after commodities had been sold, consumed, or converted to other uses. Furthermore, a third of the end-use checks planned over the last two years were postponed by up to a year thereby extending the hiatus between the goods' arrival and end-use checks of them. Because of delays in the planned checks, importer records documenting the status of the commodities were not always available. As a result, the end-use checker relied primarily on the verbal statements of the importer as to how CIP goods were used.

If end-use checks were to focus on recently arrived commodities, they would not have to rely on verbal confirmations, but would be able to verify actual commodity use in importers' records and/or by physical inspection of the commodities.

End-use reports on equipment utilization were satisfactory. They noted whether machinery was inspected, had been received in good or damaged condition, was appropriately marked, and was operating or not operating. However, reports of end-use checks on commodities imported by the private sector that had been sold, consumed, or used in a manufacturing process were often vague as to what the end-use checker had actually observed. For example, the reports were often unclear as to whether or not the checkers relied on interviews with the importers or had confirmed importers' statements in company records. Interviews were relied on because the commodities and records pertaining to commodity use or sale were not available for inspection.

The commodity was often physically unavailable to the checker because the checks are not always conducted promptly. To illustrate, during the last two years USAID/Egypt has been unable to complete all checks scheduled during the year for which they were planned. In FY1990 USAID/Egypt completed only 26 of 40 planned checks. Furthermore, those 40 included fourteen originally planned to be made in FY1989. Some of the FY1990 checks were for commodities that had arrived several years previously.

Normally, when USAID/Egypt prepares for an end-use check, it collects data on all letters of credit for which an importer has obtained A.I.D. financing, even if the shipments occurred five years previously. Since records are generally either not

available or easily accessible for such old transactions (records are to be maintained for only three years), the end-use checker is able to obtain only verbal confirmation from the importer that the goods were received and used. In our opinion, reliance on an importer's verbal confirmation that the commodities were sold or used is of limited value and the end-use report should at least disclose this limitation. If end-use checks were to focus on recently arrived commodities, they would not have to rely on verbal confirmations, but would be able to verify actual commodity use in importers' records and/or by physical inspection of the commodities.

An alternative might be to sample only recently arrived shipments. Limited sample testing would be possible if the end-use checkers were able to visually confirm the use of goods in production or inspect the goods at resale outlets. Under such a system, end-use checks of older transactions could be performed by telephone. This alternative would provide the advantage of having end-use checks conducted at far less cost and with greater coverage of total commodity arrivals. Implementation of these alternatives and more specific reporting would make the end-use checks more meaningful.

USAID/Egypt Needs to Promptly Follow Up on Marking Problems Detected



Seven of the 18 Public sector end-use audits conducted by USAID/Egypt reported commodities not having been marked with A.I.D.'s "Handclasp" emblem (left) as required. USAID/Egypt did not always communicate this problem to the grantee, the importer or to the supplier in order to obtain compliance.

Our end-use check of \$2.8 million in medical equipment purchased by two public sector importers under 11 L/COMs disclosed that while the medical equipment was being used, it had not been marked with USAID handclasp emblems as required in A.I.D. Handbook 15. A contractor had performed end-use checks of the medical equipment earlier and also reported that

the equipment was being used, but that labels had not been affixed to the medical equipment. We performed a follow-up check of the same equipment to confirm the contractor's finding and to determine whether the marking deficiency had been corrected.

Where USAID/Egypt end-use checks identify non-compliance with marking requirements, the Mission is to initiate corrective action described in A.I.D. Handbook 15 by communicating the matter to the borrower/grantee or supplier. The action taken may be as simple as: (1) informing the borrower/grantee of non-compliance and requesting that it comply with marking requirements, or (2) reporting the violation on A.I.D. 1450-1, "Report of Violation-Marking Requirements" to A.I.D./Washington's Office of Procurement. USAID/Egypt officials advised us they do not communicate marking violations to the borrower/grantee, but instead report such violations to A.I.D./W. **In our view, it is important to identify American taxpayer-financed commodities as such even if the supplier fails to do so, and even if the Mission must arrange for appropriate marking after the fact.**

Our review of the seven reports with marking violations disclosed that the USAID had prepared six 1450-1 reports to A.I.D./W, but had not reported the seventh violation. Further, Washington had not replied specifically to five of the six 1450-1 reports. Instead, A.I.D./W's Office of General Counsel advised the Mission of general remedial actions A.I.D. can take against the suppliers.

The General Counsel's response pointed out the unenforceable nature of current A.I.D. marking requirements and described the difficulty in obtaining corrective action from the supplier. General Counsel recommended that if the Mission determines the supplier to be at fault, it should advise the supplier by letter that A.I.D. is considering filing a refund claim against him. However, General Counsel also pointed out that A.I.D. Handbook 15 has dropped a reference to obtaining refunds, and now states only that A.I.D. "will take or propose appropriate actions."

In our view the use of a letter to warn a supplier, who previously agreed to abide by the marking requirements, is insufficient. We believe that the marking requirement language placed in the L/COM should be strengthened. In a 24 April 1991 memorandum to the commodity monitoring group in Washington, USAID's CMT Office commented on the lack of penalties imposed when suppliers fail to comply with marking requirements. CMT suggested several alternative policies for dealing with marking violations:

- USAID/Egypt could place first offense suppliers on a prior review list and repeat offenders on the Debarment List for a year; or
- USAID/Egypt could nullify the supplier's bond citing the suppliers' non-compliance with the contract as justification.

Management Comments and Our Evaluation

The Mission was in agreement with Recommendation No. 2.1 but noted that they might be unable to perform all end-use checks before commodities were sold or used in manufacturing due to the time required to extract and confirm arrival information. The Mission stated that end-use audits of manufacturers basically involved record verification but that record-keeping by small operators may be limited or non-existent. The Mission noted that it had hired a CPA firm to assist it in developing efficient and effective sampling techniques for end-use checks and if an acceptable sampling technique was devised, it would be utilized.

We realize that the arrival accounting system lacked current data due to data entry delays and that it will not always be possible to inspect a recent arrival of commodities before they are used or sold. The intent of the recommendation is to have the Mission prioritize transactions so that end-use checks have a greater potential for confirmation of commodity uses by visual inspection or record examination rather than oral testimony. We have taken the Mission's response as a commitment to move towards more timely end-use checks and have closed the recommendation accordingly.

The Mission agreed with Recommendation No. 2.2. It stated that the scope of work provided to contractor's performing end-use checks will be modified to require contractors to report to USAID the extent to which they independently verified the use or sale of commodities. *The recommendation is therefore closed.*

The Mission disagreed with Recommendation No. 3.1. The Mission stated that USAID had no responsibility to supply emblems for CIP equipment nor did it have funds to procure such emblems. Additionally, the Mission suggested USAID action would be more appropriately directed at applying rigorous sanctions against suppliers who fail to mark their equipment adequately.

We agree that A.I.D. Handbooks do not hold the Mission responsible for marking unmarked CIP equipment. However, the purpose of A.I.D marking requirements is to identify A.I.D. financed equipment as having been donated by the American taxpayers. When equipment is found unmarked, we believe that the Mission -- in addition to seeking sanctions against the supplier, which might include billing him for the cost of marking the equipment -- should mark the equipment or have it marked. The recommendation is therefore considered unresolved.

The Mission has taken action on Recommendation No. 3.2. *It is closed.*

Has USAID/Egypt corrected previously reported deficient controls over public sector CIP-generated Egyptian pounds?

USAID's Office of Financial Management corrected problems reported in a 1987 audit report on the Mission's monitoring and controls regarding the Special Account by revising public sector CIP procedures for monitoring the deposit of Egyptian pound commodity sales proceeds.

The new procedures, dated October 5, 1988, require the GOE to compute and deposit Egyptian pounds in the Special Account based on CIP dollar disbursements reported by USAID/Egypt. USAID/Egypt is thereby relieved of ensuring that individual importers deposit the pounds and need only confirm the GOE deposit. Under the revised system:

- Importers deposit funds to an interim account with the GOE's Ministry of Finance (MOF) rather than directly to the Special Account.
- USAID/Egypt receives a monthly disbursement report of CIP dollar disbursements from A.I.D./W and reports that information to the MOF.
- MOF computes the local currency equivalent of the CIP dollar disbursements and transfers 25 percent of the amount from the interim account to the Special Account and provides USAID/Egypt with statements and deposit slips evidencing deposits in the Special Account. The remaining 75 percent of disbursements is scheduled for deposit subsequently in 5 equal annual installments. MOF advises USAID/Egypt of the dates when the deposits are due.

USAID/Egypt can therefore ensure that MOF is accurately making local currency deposits to the Special Account by reconciling MOF reported deposits and amounts due for deposit with amounts actually deposited per bank statements. However, our tests of this revised system disclosed three problems. First, MOF calculated local currency to be deposited in the Special Account incorrectly because the procedure for collecting local currency made the application of the stipulated exchange rate impractical. Second, USAID/Egypt failed to identify the MOF calculation errors or document how it tested MOF's calculations of the LE amounts to be transferred to the Special Account. Lack of supervision of the undocumented tests caused the error to go undetected. Third, CIP disbursement data from Washington was received late because of Washington production problems, postal delays, and a lack of Mission follow-up to request that reports be faxed or cabled when delays beyond 30 days occurred. There is a need to: change the stipulated exchange rate specified in the controlling implementation letter; document tests of MOF calculations; and request disbursement data when it is not received within 30 days.

Recommendation No. 4: We recommend USAID/Egypt revise the pertinent Project Implementation Letter (PIL #5) so that the GOE's Ministry of Finance will use the highest rate which is not illegal on the date of the importer's deposit to the interim account.

Recommendation No. 5: We recommend USAID/Egypt document its verification of Ministry of Finance's computation of local currency amounts to be deposited.

Recommendation No. 6: We recommend that USAID/Egypt request A.I.D./Washington to forward disbursement reports if they are not received within 30 days.

USAID/Egypt Needs to Amend Instructions for Calculating the Egyptian Pound Equivalent of CIP Dollar Disbursements.

MOF calculated local currency to be deposited in the Special Account using an incorrect exchange rate. It used the market exchange rate effective on the date of deposit rather than on the L/COM issue date, as prescribed in the pertinent project implementation letter (PIL) #5. This results in over deposits in some months and under deposits in others depending on exchange rate fluctuations. The use of the rate effective on the L/COM issue date as prescribed in PIL #5 poses a problem for MOF because MOF collects a deposit from importers prior to issuance of the L/COM. If MOF uses the exchange rate on the L/COM issue date rather than the down payment date, it will usually be faced with a gain or loss unless it were to collect or refund any difference from/to the importers.

PIL #5, dated March 14, 1989, requires that the exchange rate on the L/COM issue date be used. MOF, however, calculated the deposit due at the market exchange rate effective on the date of the importer's deposit. We reviewed computations for four of the 22 months ending September 1990, and noted over-deposits amounting to LE362,997 in three months and an under-deposit of LE14,219 in the fourth.

USAID/Egypt officials advised us that it was not possible or practical to use the rate effective on the L/COM issue date because importers deposited down payments prior to the issuance of the L/COM. By using the rate on the date the importer made the down payments, MOF can assure itself that it will not need to transfer more or less to the Special Account than the amount it received from the importer. PIL #5 should be modified to require use of the exchange rate on date of importer's payment rather than on the L/COM date.

USAID/Egypt Failed to Document How It Verified the Local Currency Deposit of Public Sector Commodity Import Values

USAID/Egypt officials stated they had verified that MOF had correctly calculated the equivalent LE amounts deposited but failed to document these verifications. Without such documentation the Mission lacks reasonable assurance that the amounts have been deposited timely or computed accurately. General Accounting Office standards for internal controls in the Federal Government provide that all transactions and significant events are to be clearly documented and the documentation be readily available for examination. We believe documentation of USAID/Egypt's verification of MOF calculations is an important internal control as it provides evidence of the specific calculations tested and who in the Mission performed such verifications. Failure to verify the amount deposited could result in importers making less than the required deposit in the Special Account.

During the 22 months ending September 1990, MOF deposited LE51.2 million in the Special Account under grant 263-K-616. USAID/Egypt officials stated that they had tested and verified MOF's calculations, but had not documented who, when, how, and to what extent they tested the calculations. As a result, we could not determine why the Mission's verifications failed to recognize the use of exchange rates for dates other than the L/COM issue date. USAID/Egypt's verification actions should have noted such inconsistencies. If USAID/Egypt were to document its verification, it would be assured that discrepancies such as those noted above would not go unreported.

Late Receipt of A.I.D./W Disbursement Reports Delayed the Deposit of Local Currency

USAID/Egypt was late in reporting disbursements to MOF because it was not receiving the monthly A.I.D./Washington disbursement report within 30 days. Consequently, MOF was also late in computing and making deposits as required. We estimate that the delay was approximately seven months and involved LE3 million.

As of November 1990, USAID/Egypt's statement of deposits due from MOF was current only as of April 1990. USAID/Egypt had not received a calculation from MOF of amounts due for the 6-month period ending November 1990. USAID/Egypt officials explained that the seven-month delay occurred because: (1) A.I.D./W had failed to provide the disbursement report that would have allowed USAID/Egypt to advise MOF of actual disbursements; (2) delays in preparing the letter of advice to MOF; and (3) MOF delays in replying. The late receipt of A.I.D./W reports resulted in MOF's computation and deposit of local currencies to be delayed by an average of 3.8 months. This problem of late receipt of disbursement data could be substantially reduced if USAID/Egypt would follow-up on reports not received in 30 days.

Management Comments and Our Evaluation

The Mission concurred in Recommendation No. 4 -- that PIL#5 should be revised -- but stated that it would require the date of Financing Request, rather than the date of importer's deposit to the interim account, to be used in determining the appropriate exchange rate. *Accordingly, Recommendation No. 4 is closed. The readers of this report should also be aware that funds on deposit in the Special Account at the CBE earn no interest.*

The Mission stated that it had begun to verify and document, by sample tests, MOF calculations as recommended. *Recommendation No. 5 is therefore closed.*

The Mission stated that it would, as suggested in Recommendation No. 6, contact A.I.D./W whenever disbursement reports were not received when due. However, the Mission noted that the problem of late disbursement reports appeared to be due more to delays in A.I.D./W producing the report rather than delays in arrival of the report at the Mission. *Recommendation No. 6 is closed.*

Has USAID/Egypt corrected previously reported deficient controls over private sector CIP-generated Egyptian Pounds?

USAID/Egypt failed to correct control deficiencies over private sector CIP-generated Egyptian pounds.

For the items tested, we determined that USAID/Egypt has an adequately designed system to monitor private sector CIP-generated local currency. However, the system was ineffective because USAID/Egypt did not enter local currency deposit data into the system. Also, while USAID/Egypt had designed certain procedures that would ensure the timely deposit of installment payments, it has not insured that the GOE enforced these procedures with all participating banks nor always reconciled payments received with payments due. The Mission needs to consider alternatives to its current monitoring system and to have the GOE strengthen its review of participant bank compliance.

Recommendation No. 7: We recommend that USAID/Egypt, in consultation with the Government of Egypt and the Central Bank of Egypt, establish effective monitoring controls over private sector Commodity Import Program deposits, to include:

- 7.1** at least annual visits to each participant bank by a Central Bank of Egypt inspector to verify compliance with the Private Sector Commodity Import Program General Circular;
- 7.2** annual reporting by participating banks to advise the Central Bank of Egypt and USAID/Egypt of the dates that: (a) letters of credit were opened and (b) down payments and installments were collected and remitted to the Central Bank.

Recommendation No. 8: We recommend that USAID/Egypt:

- 8.1** obtain an accounting from Development Industrial Bank and Central Bank of Egypt regarding local currencies due and paid on Development Industrial Bank letters of credit financed under Letters of Commitment 20105 and 20120.

8.2 advise Development International Bank that its future participation in the program will not be approved until it:

- (a) authorizes Central Bank of Egypt to draw down its account automatically when amounts are due, and**
- (b) agrees to reduce its delays in depositing down payments to the Special Account to 4 days or less.**

USAID/Egypt and the GOE Failed to Reconcile Amounts Due with Amounts Received or Enforce Bank Compliance

Participant banks were generally depositing local currency as required. However, certain internal controls remain weak because USAID/Egypt failed to enter a significant amount of the deposit data into its data base. As a result, its system failed to correct previously reported monitoring problems. Additionally, while USAID/Egypt had designed certain procedures to help ensure that installment payments are deposited when due, the CBE failed to enforce these procedures with all participating banks and failed to reconcile payments received with payments due. Our tests of 11 of 25 participating banks disclosed that one bank -- Development Industrial Bank (DIB) -- failed to comply with CIP deposit procedures.

The rules and procedures for utilizing USAID financed private-sector CIP funds are detailed in General Circular No. 1, dated March 14, 1989, issued by the GOE Minister of International Cooperation. The Circular states that any bank participating in the CIP shall:

- collect a twenty percent down payment in Egyptian pounds from importers when a letter of credit is opened;
- collect balances due after an optional grace period or the period of financing expires;
- pay **immediately** into the Special Account at the CBE all down payments, principal repayments, and interest collected or due; and
- authorize CBE to draw down (withdraw) from its account any amounts of interest and principal due.

To monitor whether the banks are depositing Egyptian pounds, USAID/Egypt has CBE provide bank statements for the Special Account. These statements include deposit slips supporting participating bank deposits. USAID/Egypt has developed a data base that would enable it to track the deposit of local currency against each letter of credit opened under the private sector CIP.

For the monitoring system to be effective, however, the Mission should: (1) input deposit data into its data base in a timely manner; (2) determine if deposit data for all letters of credit issued have been received; and (3) regularly reconcile amounts due with amounts deposited. We found that USAID/Egypt had not: (1) updated its data base regularly; (2) determined if deposit slips had been received for all letters of credit; or (3) reconciled amounts due with deposits received by the CBE. Staff was unable to devote adequate time to updating the data base and thus confirming that deposits were made for all L/Cs. Insufficient time/staff also prevented USAID from reconciling amounts due with deposits received by the CBE.

Although we were able to confirm that participating banks were generally timely in depositing local currency collected, the USAID system was of limited value in monitoring deposits.

While the private sector CIP program had approved \$494 million in letters of credit at the time of our audit, the Mission's system had data on only \$276 million. It failed to reflect data on 812 L/Cs. Although we were able to confirm that participating banks were generally timely in depositing local currency collected, the USAID system was of limited value in monitoring deposits.

We believe that the task of entering data into its system so that the Mission can monitor local currency deposits is beyond the capability of available assigned staff. Assigned staff explained that higher priority work prevented them from entering data into the system in a timely manner. Furthermore, the Mission may find it more productive to implement an alternative system rather than continue with the system it has designed. This would see limited annual testing of bank records to verify whether compliance with General Circular No. 1 is being achieved.

While USAID/Egypt's monitoring system lacked current data to enable us to test participating bank compliance with CIP deposit requirements, we were able to test participant bank and CBE records and concluded that:

- banks were depositing the local currencies due, and with one exception (DIB) were depositing funds timely,
- while neither USAID nor CBE identified local currencies due or reconciled amounts due with amounts deposited, the control weaknesses have apparently not resulted in any significant losses, insofar as we could determine.

Because DIB was known to have performed poorly, USAID/Egypt had reduced funds provided to it before we reviewed DIB's records. However, DIB remains an eligible CIP participant and is currently accountable for local currencies due the Special Account. Our test of DIB records revealed that it had routinely delayed depositing local currencies into the Special Account. Specifically, DIB:

- delayed paying CBE down payments collected from importers;
- paid CBE installments **semiannually** rather than when received;
- failed to authorize CBE to draw down DIB's account for amounts due;
- provided CBE with insufficient information on the letters of credit to which its remittances applied.

Our work at DIB was limited to tracing the payment of local currencies collected and paid on ten letter of credit transactions. Our review revealed that DIB was taking approximately 30 days to transfer down payments to CBE. This included:

- 20 days to instruct an intermediary (Bank of Alexandria) to advise CBE to draw down DIB's account for down payments collected, and
- almost 10 days for the Bank of Alexandria to act on DIB's instructions.

Of the 11 banks we visited, DIB was the only bank that required such a long lead time to prepare bank advices related to down payments collected, and the only one to communicate them through an intermediary rather than directly to CBE. DIB officials stated that, if required to do so, they could report the instructions directly to CBE. This would reduce some of the delay; however, the preparation of DIB's original advice needs to be expedited.

In addition to DIB's delay in depositing importer down payments, we found that when DIB collected remaining balances due, it held such funds for periods of 1 to 8 months before depositing them with the Special Account. Semiannual deposits of these collections were made on 6/29/89 and 2/26/90. The following table illustrates DIB's delays in depositing funds.

**DIB Installment Payments Collected
and Deposited with CBE**

Sample Transaction	Date Installment Collected	Date of Semiannual Deposits	Deposit Delays in Months
1	02/13/89	06/29/89	4
2	02/03/89	06/29/89	4
3	03/17/89	06/29/89	3
4	05/15/89	06/29/89	1
5	05/16/89	06/29/89	1
6	05/26/89	06/29/89	1
7 ^s	05/18/89	06/29/89	1
	06/26/89	02/26/89	8
8	05/24/89	06/29/89	1
9	06/23/89	02/26/90	8
10	07/14/89	02/26/90	7

DIB officials said they were willing to change their payment system to meet USAID requirements.

We also reviewed controls at CBE to determine why DIB's late payments were not identified and corrective action taken. Our tests found that CBE had a system to follow-up on installment payments **which participating banks had advised CBE were due**. However, this system did not provide assurance that the banks had deposited all down payments collected nor advised CBE of all installment payments due.

⁵ Two shipments under one letter of credit.

CBE officials stated they did not verify whether the banks report all the local currency down payments and installment payments due, but acted only on advice furnished by the banks. Furthermore, CBE officials confirmed that participating banks were obliged to authorize CBE to withdraw installment payments when due, but CBE lacked the authority to enforce compliance.

The effect of the USAID and CBE internal control weakness is that banks might not deposit all local currencies when due. However, our limited tests at 11 banks indicated that there was only one exception among the 11 participating banks in depositing local currencies when due.

In conclusion, improved reporting and inspections by CBE could correct this deficiency. Additionally, USAID/Egypt needs to obtain an appropriate accounting of DIB's deposit of local currencies and restrict its future participation until correction of past problems is achieved.

Management Comments & Our Evaluation

The Mission advised MIC and MOF of the contents of Recommendation No. 7.1 and requested MOF to instruct CBE to have inspectors, at least semiannually, verify participating bank compliance with deposit requirements. *It is unclear, however, whether MOF or CBE agreed to such verifications.*

In response to Recommendation No. 7.2, the Mission consulted with MIC and MOF and agreed to a MIC proposal that would provide for the participating banks to provide various reports to MOF and CBE that would permit USAID/Egypt to satisfy the intent of Recommendation No. 7.2.

The Mission was taking action to satisfy the requirements of Recommendation No. 8.1 and stated that it would request closure when the data were obtained. It concurred in Recommendation No. 8.2 and stated that it would implement the recommendation if DIB was to be granted any further funding under the program.

Recommendation Nos. 7.1, 7.2, and 8.2 are considered closed and Recommendation No. 8.1 resolved. We plan to make a follow-up review of MOF/CBE inspections within one year.

Did USAID/Egypt exercise adequate control over the programming and withdrawal of Special Account funds?

USAID/Egypt exercised adequate controls over the programming and withdrawal of Special Account funds by (1) participating in the programming of local currency deposits, (2) approving withdrawals, and (3) monitoring Special Account bank statements to confirm that the withdrawals were for purposes mutually agreed to by A.I.D. and the GOE.

Foreign Assistance Act (FAA) Section 609 and A.I.D. Policy Determination No. 5 provide guidance on the permissible uses of CIP-generated local currencies and the role A.I.D. Missions are to play in programming those currencies. Briefly summarized: A.I.D. Missions are to participate in any programming; the purposes programmed are to be authorized in the FAA; and Missions are to monitor withdrawal of the currencies.

We found that USAID/Egypt agrees on programmed uses, approves withdrawals of funds, and reviews bank statements and supporting documentation related to deposits and withdrawals from the Special Account. Unauthorized withdrawals have occurred but were detected and redeposited. We did not audit expenditures to confirm that funds were used only for the purposes programmed. However, **we concluded that the Mission had exercised adequate controls over funds on deposit in the Special Account, and that those funds had been programmed for purposes authorized by the FAA.**

We therefore have no recommendations regarding the programming of local currency.

Did USAID/Egypt, through its internal control review procedures, identify and resolve internal control weaknesses in its CIPs?

The Mission's internal control review procedures did not identify or resolve CIP internal control weaknesses.

The Mission's 1989 assessment of CIP internal controls did not identify control weaknesses related to commodity arrivals, local currency deposits, or end-use checks because the Mission did not actually test its controls but merely assumed that actions taken on weaknesses previously identified by the Regional Inspector General for Audit/Cairo (RIG/A/C) had corrected the problems.

USAID/Egypt Did Not Conduct Tests of Internal Controls

According to the Federal Manager's Financial Integrity Act, Federal agencies are required to conduct a self-evaluation of internal controls annually. USAID/Egypt completed its self-evaluation in October 1989, 5 months after the RIG/A/C had closed prior audit recommendations regarding arrival and use of commodities, the deposit of local currency, and the conduct of end-use checks. During this audit, we reviewed the same controls and identified weaknesses relating to commodity arrival, CIP end-use checks, and verification of the deposit of local currency which were not identified during the Mission's assessment. The Mission's assessment did not identify or document these weaknesses because they had not performed tests of internal controls, as required by OMB Circular 123, dated August 4, 1986. As a result, the weaknesses continued to exist at the time of our audit.

If the Mission were to test internal controls as part of its periodic self-evaluations, it would increase the likelihood that internal control weaknesses would be identified.

Management Comments and Our Evaluation

USAID/Egypt requested we delete our draft recommendation because they believed it was inappropriate, as it was not activity-specific. Additionally, USAID/Egypt stated that guidance for the periodic internal control evaluations was provided by A.I.D./Washington and that the Mission had complied with that guidance in conducting and documenting self-evaluations.

While the Mission could, and in our view, should have conducted and documented tests of pertinent CIP controls, they were not obliged to do so, and we have deleted the recommendation from the report. It would be our suggestion that future A.I.D./W internal control guidance include a requirement that assessments include tests and that their results be documented.

REPORT ON INTERNAL CONTROLS

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

Scope of Our Internal Control Assessment

We have audited USAID/Egypt's public sector Commodity Import Program (CIP) grants (263-K-616 and 263-K-618) for the period February 1988 through December 1990 and the private sector CIP grant for the period August 1986 through December 1990, and have issued our report thereon.

We conducted our audit in accordance with generally accepted government auditing standards which require that we plan and perform this audit to fairly, objectively, and reliably answer the objectives of the audit. 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 limited our assessments of internal controls to those controls applicable to the audit's objectives and not to provide assurance on the auditee's overall internal control structure. We classified significant internal control policies and procedures by the following categories: arrival of commodities, use of commodities, deposit of CIP generated local currency, programming, and withdrawals of CIP local currency, and Mission assessments of internal controls. For each category, 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 risk. We have reported each category as well as any significant weaknesses under the applicable audit objective.

General Background on Internal Controls

The management of A.I.D. including USAID/Egypt, is responsible for establishing and maintaining an internal control structure. Recognizing the need to reemphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Manager's Financial Integrity Act (FMFIA) in September 1982. This Act, which amends the Accounting and Auditing Act of 1950, makes the heads of executive agencies and other managers, as delegated, legally responsible for establishing and maintaining adequate internal controls. The General Accounting Office (GAO) has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

In response to the FMFIA, the Office of Management and Budget (OMB) has issued guidelines for the "Evaluation and Improvement of Reporting on Internal Control Systems in the Federal Government." According to these guidelines, management is required to assess the expected benefits versus related costs of internal control policies and procedures. 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. In implementing the FMFIA, the Mission evaluated the internal control structure in place in October 1989 and noted certain weaknesses.

Reportable conditions are those relating to significant deficiencies in the design or operation of the internal control structure which, in our judgment, 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 are obtained, maintained, and fairly disclosed in reports. In doing this audit, we found certain problems that we consider reportable under the above standards.

Conclusion for Audit Objective One

The first audit objective was to gather and verify information concerning the progress of the public and private sector CIPs. We noted no reportable conditions that related to this audit objective.

Conclusions for Audit Objective Two

The second audit objective was to determine if USAID/Egypt had a system to assure itself that commodities paid for arrived. We assessed whether the Mission had an arrival accounting system that complied with A.I.D. Handbook 15. We reviewed the Mission's internal controls for documenting that commodities paid for were shipped, arrived, and cleared customs. Our tests showed that the Mission's controls were logically designed and consistently applied except that data were not entered into the system timely. We concluded that the arrival accounting system would have met A.I.D. Handbook 15 requirements if data were entered into the system timely. We could not determine if this problem was temporary or if it existed at the time of the Mission's internal control assessment. It was not reported in the internal control assessment as a weakness.

Conclusions for Audit Objective Three

The third objective was to determine if management had corrected prior end-use check deficiencies. We assessed whether Mission action to correct prior end-use deficiencies resulted in compliance with A.I.D. Handbook 15. We reviewed the Mission's internal controls relating to the planning, execution and reporting of end-use checks of the use and disposition of commodities. Our tests showed that the Mission's planning and delayed implementation of its end-use checks prevented it from providing the level of assurance such checks are intended to achieve.

Conclusions for Audit Objective Four

The fourth objective relates to actions taken to correct previously reported deficient controls concerning USAID/Egypt's monitoring of the deposit of public sector CIP-generated Egyptian pounds. We assessed whether Mission action to correct this deficiency was adequate and resulted in compliance with grant procedures. We reviewed the Mission's internal controls relating to the deposit of CIP-generated local currency. Our tests showed that the Mission's corrective action resulted in controls that were logically designed but not consistently applied. The Mission failed to include documentation of verification actions or identify that incorrect exchange rates were routinely being used to compute deposits in the Special Account. These deficiencies were not identified as weaknesses during the Mission's 1989 assessment of internal controls.

Conclusions for Audit Objective Five

The fifth objective relates to action taken to correct previously reported deficiencies concerning USAID/Egypt's monitoring of the collection and deposit of private sector CIP-generated Egyptian pounds. We assessed whether Mission action to correct this deficiency was adequate and resulted in compliance with grant procedures. We reviewed the Mission's internal controls relating to the deposit of CIP-generated local currency.

Our tests showed that the Mission's corrective action resulted in controls that were logically designed but not consistently applied because (1) staff lacked time to input needed data, and (2) reconciliations of Egyptian pounds due and deposited were not made. Since the system was expected to correct the monitoring deficiencies and the Mission did not test the system's implementation as part of its assessment, the implementation weaknesses were not recognized and were therefore omitted from the assessment.

Conclusions for Audit Objective Six

The sixth objective relates to action taken to program and use CIP-generated Egyptian pounds. We assessed whether Mission action to correct the prior reported deficiencies was adequate and resulted in compliance with Section 609 of the Foreign Assistance Act and A.I.D. Policy Determination No. 5. We reviewed the Mission's internal controls relating to programming and use of local currency, and our tests showed that the agency's controls were logically and consistently applied. Therefore, we limited our tests to confirmations that the currencies were programmed and withdrawn for authorized purposes only. We concluded that the system was adequate and in compliance with A.I.D. Handbooks.

Conclusions for Audit Objective Seven

The seventh objective relates to the Mission's internal control assessment procedures and their effectiveness in identifying weaknesses. We reviewed the Mission's procedures relating to internal control assessments. The Mission reported that CIP internal controls were adequate, but did not perform any tests to confirm the controls. Our audit showed that the controls for monitoring commodity arrivals and deposit of local currency were properly designed but were not properly implemented. Our tests identified continuing weaknesses not identified by the Mission. If the Mission had tested controls as required by OMB Circular A-123, we believe it likely that it would have identified some of the control weaknesses we identified.

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A material weakness is a reportable condition in which the design or operation of the specified internal control element does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial report on project funds being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal controls would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We, however, found no weaknesses that had a material impact, but believe that: (1) the

lack of a reconciliation of amounts of local currency due with deposits and (2) inadequate confirmation of end-use checks and arrival of commodities could result in potential material impact.

REPORT ON COMPLIANCE

Scope of Our Compliance Assessment

We have audited USAID/Egypt's public-sector Commodity Import Program (CIP) grants (263-K-616 and 263-K-618) for the period February 1988, through December 1990 and the private sector CIP grant for the period August 1986 through December 1990, and we have issued our report thereon.

We conducted our audit in accordance with generally accepted government auditing standards which require that we plan and perform the audit to fairly, objectively, and reliably answer the audit objectives. Those standards also require that we:

- assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives) and
- report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

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 entity conduct. Noncompliance constitutes an illegal act when the source of the requirement not followed or prohibition violated is a statute or implementing regulation. Abuse is furnishing excessive services to beneficiaries or performing what may be considered improper practices, which do not involve compliance with laws and regulations.

Compliance with laws, regulations, contracts, and grants applicable to the CIP is the overall responsibility of USAID/Egypt's management. As part of fairly, objectively, and reliably answering the audit objectives, we performed tests of USAID/Egypt and host-government compliance with certain provisions of Federal laws, regulations, or grants.

However, our objective was not to provide an opinion on overall compliance with such provisions.

Conclusions on Compliance

The results of our tests of compliance disclosed the following instances of noncompliance with grant provisions:

- MOF calculated deposits due at the market rate in effect on the date of the importer's deposit rather than at the exchange rate on the Letter of Commitment issue date, as required in project implementation letter #5 under the Public Sector CIP.
- In its monitoring of the procedures adopted by CBE to implement General Circular #1, related to the Private Sector CIP, USAID/Egypt failed to ensure that CBE reconciled amounts due and collected by participating banks with amounts actually remitted by the banks, or that CBE was enforcing or had the authority to enforce the terms of the General Circular.

Except as described, the results of our tests of compliance indicate that, with respect to the items tested, USAID/Egypt, participating banks, importers, and the GOE complied, in all significant respects, with the provisions referred to this report.

SCOPE AND METHODOLOGY

Scope

We audited the USAID/Egypt public and private sector CIP's in accordance with generally accepted government auditing standards. The audit covered the private sector CIP grant for the period August 1986 through December 1990 and the public sector CIP grants (263-K-616 and 263-K-618) for the period February 1988 through December 1990. USAID/Egypt financed commodities amounting to \$651 million during these periods.

Our audit work conducted from September 1990 through March 1991 included work at USAID offices in Cairo and Alexandria, the Alexandria port authority, forwarding agents, public and private sector importers, and participating Egyptian banks. Our audit included tests of private and public sector CIP shipments valued at approximately \$95.5 million. Our work included reviewing documentation and source records on shipments, arrivals, port clearances, records of deposits due, deposits of local currency, end-use checks, programmed currency, Special Account withdrawals, computerized arrival data, and obtaining testimony from USAID officials, bank officials, and importers. We tested computerized data to source documents, confirmed the availability of documentation supporting deposit and withdrawal data, traced data to independent sources, and confirmed data in interviews with independent parties. Additionally, we matched data bases maintained by different USAID offices. Our review included tests of internal controls related to the arrival and disposition of commodities and the deposit and withdrawal of CIP generated Egyptian pounds to and from the Special Account. Our audit did not include commodity assistance under A.I.D. projects.

Methodology

Audit Objective One

Audit objective one consisted of examining grant assessments and gathering and verifying information to determine the status of the Commodity Import Programs. We relied primarily on USAID/Egypt financial records and reports we extracted from the Mission's Accounting Control Systems. We verified the data in this system by testing data to supporting source records.

Audit Objective Two

To address audit objective two we (1) determined that, because of additional requirements, USAID/Egypt elected to maintain its own arrival accounting system rather than rely on the GOE's; and (2) reviewed the Mission's system to determine if there were controls in place to account for the receipt of commodities.

We tested the monitoring system to determine if it provided accurate and complete data supported by documentation. We identified the specific documents used to record the arrival of commodities and determined how arrival data related to payment data. We reviewed a sample of public and private sector commodities on the basis of paid vouchers and randomly tested 69 transactions amounting to about \$46 million to determine whether posting documents and automated arrival accounting records used in recording arrivals fully accounted for commodities paid for. We sorted the data in the system to determine the extent that commodities were reported as not having arrived (309 shipments amounting to \$74 million). The sort identified a universe of shipments that should have arrived but were reported as not having arrived. We followed up with appropriate importers, banks, and Mission staff and records to confirm whether the non-arrival status was correct. Our tests included 150 of the 309 shipments valued at \$50 million. This included shipments selected at random as well as selected high value shipments to ensure reasonable coverage of the shipments reported as not having arrived. We reviewed the corrective action taken on previous audit recommendations and if the action was ineffective, we attempted to determine the cause.

Audit Objective Three

To address audit objective three we (1) reviewed Mission guidance on end-use checks, the annual end-use plan, and reviewed 9 of 26 end-use reports completed; (2) performed our own end-use checks of 11 importers to independently confirm their receipt and use or sale of commodities; and (3) determined whether previously identified marking violations were corrected. Where corrective action was ineffective, we attempted to determine the cause. We reviewed only 9 of 26 reports as this was adequate to determine the extent to which the reports provided actual confirmation of the use of goods and to identify how old the transactions being reviewed were. We limited our own checks to 11 as that was the maximum we could perform in the time allowed.

Audit Objectives Four and Five

To address objectives four and five we (1) reviewed GOE and participating bank compliance with procedures described in the GOE General Circular 1; (2) documented procedural changes to the GOE's accounting system concerning the collection and deposit of local currency proceeds for the public sector; (3) determined if procedures ensured that local currency was properly collected and deposited; (4) interviewed Mission and participating bank personnel to determine how local currency was controlled and deposited; and (5) determined if systems and reports provided sufficient and accurate information to monitor deposits.

To determine if reports were adequate for monitoring deposits, we compared USAID public and private sector records on approved L/Cs and L/COMs with monitoring reports, bank statements and deposit slips, and randomly tested these reports for accuracy and completeness. For the public sector, we randomly tested (four) MOF calculations of the LE equivalent of CIP dollar disbursements due to be deposited. In general, our tests of private sector deposits involved 11 of 26 banks participating in the program. The tests of eleven banks showed that banks tested were the local currencies required although one was late in making deposits. Based on these findings and the bank statements available for the other 15 banks, we deemed the samples adequate. Our tests of bank deposit records were also confirmed with CBE.

Finally, we reviewed previous audit recommendations and evaluated actions taken by management to address problems identified. If previously reported problems existed, we attempted to determine the underlying reasons.

Audit Objective Six

To address audit objective six we (1) reviewed Section 609 of the Foreign Assistance Act and A.I.D. Policy Determination No. 5 which provide the guidance for programming and use of local currency; (2) reviewed the purposes for which the local currency were programmed; (3) determined if the approved uses of local currency were in compliance with guidance; and (4) determined if controls permitted USAID/Egypt to determine if withdrawals from the Special Account were for agreed purposes. We also reviewed corrective action taken on previous audit recommendations contained in our audit report No. 6-263-87-09 "Audit of USAID/Egypt Controls Over the Special Account" and if the action was ineffective, we attempted to determine the cause. Our review included random tests of the documentation of bank withdrawals, the purposes of the withdrawals, and the purposes for which funds were programmed in amendments number 3 through 11 to the Memorandum of Understanding governing the Special Account. We limited our tests to confirmations that the currencies were programmed and withdrawn for authorized purposes only.

Audit Objective Seven

To address audit objective seven, we reviewed the fiscal year 1989 Mission assessment to determine the extent to which the Mission's review of internal controls identified, tested, documented, and resolved control weaknesses in its CIPs. Our review included all Mission assessment questions related to the CIP. We sought documentation the Mission would have prepared in testing CIP controls but, as noted in the report, no testing had been conducted.



CAIRO, EGYPT

Appendix II

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

RECEIVED
29 JUL 1991

MEMORANDUM

TO: Frederick A. Kalhammer, RIG/A/C

FROM: George A. Wachtenheim, A/Director

SUBJECT: Audit of USAID/Egypt Commodity Import Programs
(Project 263-0201, CIP Agreements K616 and K618)

EXECUTIVE SUMMARY

The Commodity Import Program was the first program undertaken in Egypt following the restoration of the A.I.D. program in 1975. Infrastructure at the time had been badly neglected or damaged as a result of misguided policies and the wars with Israel. The program was used in roadbuilding, telecommunications, railroad transportation, power generation, land reclamation, and irrigation. It also provided supply commodities such as feed grains, food products, coal, packaging materials, and newsprint. At its peak, the CIP accounted for \$350 million of the Mission's OYB of \$815 million. Disbursements made over the life of the program total \$4.1 billion.

The Private Sector CIP has been a major success in achieving the Mission's program objectives. It is presently obligated at a level of \$825 million, of which transactions totalling \$734 million have been approved. It has firmly established the private sector as a viable and expanding alternative to government supply channels. The program has also been used in support of capital investments in steel rolling mills, drip irrigation, seed multiplication plants, a complete outpatient clinic, and others in the field of food processing, medicine, and light industry.

Since 1988 (with the exception of 1989, when the Private Sector CIP was funded at \$200 million and the Public Sector at \$100 million) the combined total for the Public Sector and Private Sector CIPs has been set at \$200 million, with a declining portion going to the Public Sector CIP (\$50 million in FY 1991, \$25 million in FY 1992).

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The audit conducted during the Fall of 1990 was particularly timely, as it comes after the radical transformation of the CIP from a public sector to a private sector program. It was also welcomed because it helped us assess the efficiency of the new database installed in Alexandria as well as the new integrated arrival accounting system in Cairo. The deficiencies identified have largely been corrected. At the same time, we welcomed the presentation to management of alternative approaches to continuing the vital task of arrival accounting. We are presently giving these approaches serious consideration.

Provided below is the Mission response to the subject report.

Recommendation No. 1

We recommend that USAID/Egypt correct the deficiencies underlying the CIP arrival data entry backlog, and/or assess whether conditions permit the Mission to implement streamlined commodity arrival tests.

Mission Response

The Mission's effort to correct the CIP arrival data entry backlog was initiated prior to the subject audit. The backlog referred to was largely created during the audit period because of the rapid disbursement of funds during the period. In the period preceding the audit, the backlog was a minor problem. By the time the audit was completed, we had brought all data up to date. In the spring of 1990, the USAID Commodity Management and Trade Office (CMT) began its aggressive campaign of collecting commodity import data from private sector banks. This resulted in the arrival of data faster than CMT's ability to post the information into the database system. Also, during the period the audit was underway, we disbursed another \$150 million under the Private Sector CIP program, flooding the database system with additional arrival transactions and increasing our backlog. Last but not least, the key data entry position in the arrival accounting staff was vacant between February and December 1990.



With respect to maintaining an updated CIP arrival database, CMT has initiated certain actions to minimize, if not prevent, the occurrence of future backlogs. In connection with obtaining appropriate information on private sector CIP transactions, we initially requested AID/Washington to require U.S. correspondent banks to instruct the suppliers to provide appropriate information such as the bank letter of commitment number and the letter of credit number, on the bills of lading or airway bills to facilitate identification and immediate posting by USAID of shipments under the appropriate transaction. AID/Washington, however, indicated that it would be difficult to lay another requirement on the banks. As an alternative action, we have requested by letter each of the participating local banks to instruct their U.S. correspondent banks to provide the information (Attachment 1). It is too early to evaluate the results of this action at this time.

In addition, CMT is designing computer-generated utility report programs that would facilitate research and posting of arrival transactions reported by our Alexandria Office. Presently, the first utility report generated has enabled CMT personnel to identify at least half of the arrivals that could not be initially identified by the computer system. Other utility reports with variation of data are being designed to assist in identifying the majority of the remaining arrivals.

Also, we are considering the option of having our Alexandria office "on line" and its becoming the primary point of data entry. However, this cannot be accomplished until the Local Area Network (LAN) is installed and the reliability of the communications system between Cairo and Alexandria is tested.

Based on the fact that our arrival accounting data are again up to date and that we have taken action to resolve the deficiencies in the system, we request that recommendation 1 be closed.

Recommendation No. 2

We recommend that USAID/Egypt:

- 2.1 make more timely end-use checks of commodities to be used in manufacturing or sold so that evidence of their use/or sale can be properly verified.

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2.2 require contractors hired to perform end-use checks to report the extent to which they independently verify the use or sale of commodities in lieu of relying on importers' verbal statements.

Mission Response

2.1 In conducting end-use audits, USAID follows an end-use plan that is prepared annually and is modified from time to time during the year based on various factors such as the type of commodities and/or importers that need to be checked, and special requests from CMT. Your recommendation that we perform timely end-use audits, that is, focusing on recently-arrived commodities, may be difficult to achieve because our end-use audits depend on information extracted from the arrival accounting database system including confirmation from the Alexandria office that commodities have been received. By the time we have completed gathering all the necessary information for the end-use review, commodities could have been already sold or have become part of manufactured goods.

End-use audits on commodities imported for resale or raw materials used in manufacturing basically involve record verification. The availability of records varies from one importer to another depending on the nature of the importer's activity and its size. A manufacturing company that owns a factory and a warehouse would probably keep records on receipt, storage, production and sales pertaining to AID commodities, but a small private sector trader may keep minimal or no records at all. Many of these importers sell the commodities even before actual arrival at the port. USAID believes that private sector importers, traders in particular, have the ultimate interest in using CIP commodities promptly and effectively especially in countries like Egypt where exchange rate fluctuations do not benefit the importer.

Prior to this audit, USAID hired the services of a CPA consulting firm to develop for us an effective and efficient sampling technique for our end-use checks. We have recently received the report and are currently reviewing its feasibility. As soon as we have made the determination and if the technique is found acceptable, we will start implementation.

Based on the above, we recommend closure of this recommendation.

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2.2 USAID agrees with this recommendation. The Controller's Office will modify the scope of work provided to contractors performing end-use checks to include a clause that requires contractors to report to USAID the extent to which they independently verify the use or sale of commodities. The clause will also require the contractor to inform USAID of the documents that have been reviewed and whether the information provided in the final report is based on actual document verifications or verbal statements. It should be noted, however, that oral confirmations will continue to be an acceptable form of verification in those cases where records are not available. As soon as the scope of work is revised, we will request closure of this recommendation.

Recommendation No. 3

We recommend that USAID/Egypt:

- 3.1 supply end-users with emblems and request they affix same whenever an end-use check detects a marking deficiency;
- 3.2 report the one unreported instance of non-compliance with marking requirements in 1990 to AID/W.

Mission Response

3.1 We do not agree that it is USAID's responsibility to supply AID emblems for CIP commodities. According to AID Handbook 15 Chapter 9, USAID is responsible for assuring that the appropriate AID marking requirements are contained in USAID issued authorizations and agreements, and for monitoring compliance. We do not budget for marking emblems. Furthermore, the emblems have to conform to certain standards in terms of specific size, type and durability for certain categories of commodities. The manufacturer or supplier is responsible for affixing the appropriate emblems in accordance with the standards established by A.I.D. We have, however, initiated action on an alternative approach--that of applying rigorous sanctions against suppliers who fail to mark their equipment adequately. Attached is a copy of a memorandum to AID/Washington on that subject (Attachment 2). Based on the above discussion, we request closure of recommendation 3.1.

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3.2 The one instance of noncompliance with marking requirements referred to in the recommendation has been reported to AID/Washington (see Attachment 2). Based on this action, we request closure of recommendation 3.2.

Recommendation No. 4

We recommend USAID/Egypt revise PIL # 5 to instruct MOF to use the highest rate which is not illegal on the date of the importer's deposit to the interim account.

Mission Response

USAID/Egypt has determined that the date of the Financing Request, rather than the date of the importer's deposit to an interim account, is the more practical date to use in determining the appropriate exchange rate for CIP transactions. We have sent MIC a PIL under each of the unexpired Public Sector CIP Grants advising the Ministry of the new procedure for exchange rate calculations. A similar PIL was also sent to MIC in connection with the Private Sector CIP. Under this new procedure, the average rate for all free rate transactions of the previous day will be the rate used to determine the exchange rate for a particular CIP transaction. Attachments 3 and 4 are copies of the above mentioned PILs. Accordingly, we request that recommendation 4 be closed.

Recommendation No. 5

We recommend USAID/Egypt document its verification of MOF's computation of local currency amounts to be deposited.

Mission Response

USAID has already started documenting its verification of the accuracy of MOF's computation of local currency deposits to the Special Account. These verifications are on a sampling basis only. We do not wish to increase the work load on USAID personnel responsible for monitoring the Special Account since one of the reasons for establishing the new repayment system was to shift the burden over to the GOE. Our records documenting our verifications are available for your examination. Based on the above, we request closure of this recommendation.

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Recommendation No. 6

We recommend that USAID/Egypt request AID/Washington to forward disbursement reports by telegram or facsimile when they are not received promptly.

Mission Response

AID/Washington is in fact forwarding disbursement reports via facsimile. This is not so much the problem as the time it takes AID/Washington to prepare these reports. Fortunately, we expect that this problem will disappear shortly, as we currently have only two active Public Sector CIP grants for which we require data from Washington for reconciliation. For all other current grants and all future grants we are able to obtain the data directly from USAID's MACS system without delay. At any rate, we will request disbursement reports via telegram/facsimile whenever AID/Washington reports are delayed. Based on the above, we request that recommendation 6 be closed.

Recommendation No. 7

We recommend USAID/Egypt consult with the GOE/CBE in order to establish effective monitoring controls over private sector CIP deposits, to include:

- 7.1 at least annual visits to each participant bank by a CBE inspector to verify compliance with the CIP General Circular;
- 7.2 not less than annual reports by participating banks to advise CBE and USAID/Egypt: the date L/Cs were opened, the dates down payments and installments were collected, and the dates they were remitted to CBE.

Mission Response

7.1 USAID has advised both MIC and MOF of the content of this recommendation and requested MOF to instruct CBE to send CBE inspectors at least twice a year to the local participating banks to verify compliance with the CIP General Circular. Attachment 5 is a letter to MIC on CBE inspectors verifying compliance with the CIP General Circular. Based on this action, we request that recommendation 7.1 be closed.

7.2 USAID, after consultation with MIC and MOF, agreed to the MIC proposal to have all participating banks provide both MOF and CBE with information stated in Item 23 of the General Circular. Information required for submission by local banks under Item 23 of the Circular exceed the required information in recommendation 7.2. The Circular provides that failure to meet such requirement by local banks may result in suspension or termination from the program. In addition, USAID agreed to provide MOF with monthly transaction reports to assist MOF in adequately monitoring local currency deposits. Attachment 6 includes copies of correspondence with MIC on reporting requirements by local banks. Based on the above, we request closure of recommendation 7.2.

Recommendation No. 8

We recommend that USAID/Egypt:

- 8.1 obtain an accounting from DIB and CBE regarding local currencies due and paid on DIB letters-of-credit financed under L/COM 20105 and 20120.
- 8.2 advise DIB that its future participation in the program will not be approved until:
 - (a) it authorizes CBE to draw down its account automatically when amounts are due.
 - (b) it agrees to reduce its delays in depositing down payments to 4 days or less.

Mission Response

8.1 The problems cited in the audit report regarding DIB performance were mainly related to the delayed deposit by DIB of local currency collections to the Special Account maintained by the CBE. The Controller's Office has available records showing local currency deposits in the CBE on DIB letters of credit financed under L/COM 20105 and 20120. However, we need to obtain from DIB additional documentation for the remittance of certain local currency installment collections for our review. We will notify you as soon as we have completed our accounting review, at which time, we will request closure of recommendation 8.1.

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8.2 CMT has advised DIB that its participation in the CIP program has been suspended (see Attachment 7). The DIB has received no new funds since L/COM 20120. In the future, if USAID decides to reinstate DIB participation, DIB would be required to provide evidence of compliance to the General Circular as a precondition for additional financing. Based on this action, we request closure of recommendation 8.2.

Recommendation No. 9

We recommend that USAID/Egypt conduct and document tests of internal controls in implementing periodic self-evaluations of its internal controls.

Mission Response

USAID/Egypt's periodic internal control evaluations are conducted in accordance with the guidance provided by AID/Washington. The agency's Management Control Review Committee (MCRC) in Washington develops A.I.D.'s five-year management control plan in accordance with the requirements of the Federal Managers' Financial Integrity Act and the OMB Circular A-123. MCRC provides the annual implementation guidance to all the missions overseas. In conducting the 1989 vulnerability assessment cited in the audit report, USAID/Egypt adhered to the guidance provided by Washington. Furthermore, we believe this recommendation to be inappropriate for inclusion in this audit report. It is not project-specific and more properly belongs in a functional-type audit of our internal control process of self-evaluation. Based on the above discussion, we request that recommendation 9 be deleted in its entirety or be closed.

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July 3, 1991

National Bank For Development
Mr. Abdel Aziz Salem
Manager
Letter of Credit Department
5, El Borsa El Gedida Street
Cairo

Dear Mr. Salem:

Your assistance is needed to improve our ability to track the arrival of commodities financed by USAID under the Private Sector Commodity Import Program.

To accomplish this, it would be very helpful if your letter of credit to your U.S. correspondent bank would include the requirement that all bills of lading show (1) the USAID transaction number, (2) your bank letter of commitment number, and if possible, both (3) the letter of credit number assigned by your bank and (4) the U.S. correspondent bank as well as (5) a request for the inclusion of the suppliers invoice number - when it becomes available.

If you have any observations, or if you wish to discuss this request, please contact the USAID Portfolio Manager for your bank.

Sincerely,


Joseph Van Meter
Project Officer
Commodity Management
and Trade

Draft:TI/CMT: J Van Meter:NG____
Bank.105

UNITED STATES GOVERNMENT

memorandum

DATE: April 24, 1991 *Cut*
 REPLY TO
 ATTN OF: OD/TT/CMT, Arthur J. Laemmerzahl
 SUBJECT: AID-Marking

TO: Mr. Anatole T. Bilecky
 MS/OP/CCMS/M
 USAID/Washington
 Room 1408, SA-14
 Washington, D.C. 20523-1415

ATT

Attached, for your review and action are eleven (11) copies of Report
 Violation - marking requirements - which are part of End-Use Report No

The AID-Financed medical and scientific equipment which have marking
 violations were procured under Loan 036 and Grant K-603. Those procurements
 are more than ten (10) years old. However, this should not be a reason for
 AID-MARKING not being affixed to the equipment.

A.I.D. Regulation 1, Section 201.30 (d) (1) (i) states that "The emblem
 placed on the commodities shall be as durable as the trademark, commodity or
 brand name affixed by the producer; ... consignee." The brand names are
 normal metal tags with the brand name embossed as well model and serial
 numbers affixed to the equipment.

The regulations state that A.I.D. Markings are required, but the regulations
 do not indicate what the penalties will be if suppliers do not comply to this
 procurement. Since this requirement needs to be enforced by USAID, a policy
 needs to be implemented. A possible policy might be as follows:

1. The first offense by the supplier would put the supplier on the USAID
 prior review list;
2. The second offense would put the supplier on the Debarment list for a
 year; or
3. If USAID is serious about enforcing this A.I.D. Regulation 1
 requirement, it can be done by more drastic means. The drastic part
 is to pull the supplier's performance bond. The justification for
 this action is based on the fact that the supplier did not comply
 with the contract. This of course involves cooperation with the
 importers to ensure that enforcement is uniform in each instance of
 non-compliance.

Please advise us of your views as well as the action taken on this outstanding
 problem.

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UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

April 28, 1991

③

Dr. Hassan Selim
Administrator of the Department for
Economic Cooperation with U.S.A.
Ministry of International Cooperation
8 Adly Street, 7th Floor
Cairo, Egypt

Subject: A.I.D. Public Sector CIP Grants
Grant 607 Implementation Letter No. 17
Grant 616 Implementation Letter No. 7
Grant 618 Implementation Letter No. 7
~~Grant 620 Implementation Letter No. 3~~
Exchange Rates

Dear Dr. Selim:

The purpose of this letter is to obtain your concurrence to modify those articles of General Circular No. 8, issued on 26/12/84, which relate to exchange rates applicable to the Public Sector Commodity Import Program (PUCIP). These modifications are required as a result of recent Government of Egypt exchange rate policy reforms which are now being instituted, and to provide guidance to participating banks and importers.

With your concurrence USAID proposes that the local currency repayments for the PUCIP transactions shall be calculated and fixed at the average closing rate of exchange determined by the secondary market as reported by Reuters Financial News Service for the day on which the Financing Request (FR) is signed by MIC.

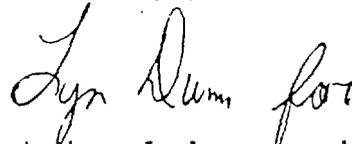
By instituting this rate the PUCIP will be using a publicly reported rate which is understood by importers, bankers and government. It will also make PUCIP procedures consistent with those already instituted for the Private Sector CIP (PRCIP). Because it is a reported rate, it will also provide the degree of control and accountability which is needed to ensure that deposits into the Special Account are accurate.

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- 2 -

If you are in agreement with these modifications, please sign this implementation letter and return a copy to this office.

Sincerely yours,



1) Arthur J. Laemmerzahl
Office Director
Commodity Management & Trade
Trade and Investment

Dr. Hassan Selim
Administrator of the Department for
Economic Cooperation with U.S.A.

53

FEB 20 1991

Dr. Hassan Selim
Administrator
Department of Economic Cooperation
with U.S.A.
Ministry of International Cooperation
8, Adly Street
Cairo

Subject: Private Enterprise Credit
CIP Private Sector 263-0201.1
Implementation Letter No. 33
Exchange and Interest Rates

Dear Dr. Selim:

The purpose of this letter is to obtain your concurrence to modify those articles of General Circular No. 1, issued on March 14, 1989, which relate to exchange and interest rates applicable to the Private Sector Commodity Import Program (PRCIP). These modifications are required as a result of recent Government of Egypt exchange and interest rate policy reforms which are now being instituted.

Modifications affecting applicable exchange rates and credit terms are needed in order to administer the Program in a manner consistent with the new reforms and to provide guidance to participating commercial banks and importers.

The first area of the Program affected by the policy reforms is that of exchange rates. With your concurrence USAID proposes that the local currency repayments for PRCIP transactions shall be calculated and fixed at the average closing rate of exchange determined by the secondary market as reported by Reuters Financial News Service for the last business day which immediately precedes the opening date of the letter of credit.

By instituting this rate the Program will be using a publically reported rate which is understood by importers, bankers and government. Since it is a reported rate, it will also provide the degree of control and accountability which is needed to ensure that deposits into the Special Account are accurate.

SK

Page 2, PII, No. 33

The second modification pertains to term credit lending offered to importers by participating banks. Currently banks are permitted under the terms of the Operating Circular to extend credit facilities to importers beyond specified interest-free grace periods. This credit period varies between six months and eight years, depending upon the type of import. Banks charge interest on any outstanding credit balance remaining after the grace period in accordance with the prevailing interest rate structure specified by the Central Bank.

Most banks currently deposit the importer's 20 percent downpayment in the Central Bank when a letter of credit is issued and deposit the remaining 80 percent at the end of the grace period. After completing the deposit requirement with the Central Bank, banks have no further obligations to the program. If a bank desires to lend the client the 80 percent portion, the bank extends the client a standard commercial loan. Banks which choose not to complete the 80 percent payment to the Central Bank at the end of the grace period carry the outstanding amount on their records as a contingent liability and deposit the importer's payments of principal and interest into the Central Bank as they are collected. Under the standard terms of the Circular banks are required to deposit all interest collected into the Central Bank without retaining any portion.

Under Annex I of the Operating Circular, which offers eight year project financing, banks are permitted to retain 2 percent of the interest collected following an 18 month grace period. This implementation letter requests that banks also be permitted to charge clients the 2% during the 18 month grace period and to retain this amount to cover the banks' risk and financial exposure during this relatively long period. This will permit banks to utilize additional funds for project lending without being fully exposed for their risk.

Under current policy the amount of interest which the bank must charge a client, and in turn deposit into the Central Bank, is specified and regulated by the Central Bank. However, once policy reforms are implemented banks will be free to establish their own interest rates. Since CIP funds cost the banks nothing, banks could presumably charge preferred clients little or no interest. If, on the other hand, a special "CIP interest rate" were to be established our program might be detrimental to the aims of the policy reform which has as its objective the establishment of a free money market.

SS

Page 3, PIL no. 33

For these reasons USAID proposes that credit facilities beyond the end of the grace period be temporarily suspended until such time as the policy reforms have been implemented and the banking and commercial sectors have had time to adjust to the impacts of the reforms.

If you are in agreement with these modifications, please sign this implementation letter and return a copy to this office. Upon receiving your signature USAID will promptly notify banks that credit facilities will be suspended until further notice and advise banks regarding the applicable exchange rate to be applied to PRCIP transactions.

Sincerely,

Lyn Dunn
Project Officer
Commodity Management
and Trade

Dr. Hassan Selim

DOC.8867I

Drafter: TI/CMT:LDunn: 

Clearance:

TI/AD:GFHuger: draft
TI/CMT/OD:AJLaemmerzahl: draft
ECON/AD:SSkogstad: draft
DC/FM/FA:NWijesooriya: draft
FM/FA:MGMatta: draft
PDS/PS:MJune: draft
TI/FI:MGad: draft
LEG:PSullivan: _____

Info: CMT/ALEX:JShane

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UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

Office of Financial Management
 USAID - American Embassy
 Kamel El Din Street
 Garden City, Cairo

June 12, 1991

Dr. Hassan Selim
 Administrator
 Department of Economic Cooperation
 with USA
 Ministry of International Cooperation
 8, Adly Street
 Cairo, Egypt

Dear Mr. Selim,

Thank you for your letter dated April 9, 1991 regarding Special Account deposits in local currency generated from the CIP private sector imports.

USAID concurs with MIC and MOF decision to have local banks implement item number 21 and 23 of the general circular no. 1 dated March 14, 1989. USAID also agrees to provide MOF with a monthly status report identifying new transactions approved by USAID, to assist MOF verifying the adequacy of reports submitted and payments made by local banks. (Reports for April & May 1991 attached.)

MOF should send copies of such reports to the Central Bank of Egypt (CBE) and should both coordinate the tracking and monitoring of local currency deposits to insure that they are adequately accounted for. Further USAID recommends that inspectors from the CBE should visit each of the participating banks at least twice every year to verify compliance with the CIP general circular.

Thank you for your cooperation.

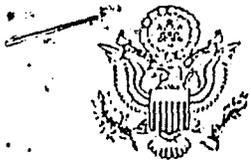
Sincerely,

Nimalka Wijessoriya
 Nimalka Wijessoriya
 Acting Associate Director
 for Financial Management

Attachments: a/s above

cc: Mr. Mohamed Nabil Mokhtar (with attachments)
 Administrator
 Finance and Loans Department
 Ministry of Finance

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CAIRO, EGYPT

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

Office of Financial Management
USAID - American Embassy
Kamel El Din Salah Street
Garden City, Cairo

March 20, 1991

Dr. Hassan Selim
Administrator
Department for Economic Cooperation
with USA
Ministry of International Cooperation
8, Adly Street
Cairo, Egypt

Dear Dr. Selim:

This is in regard to the Special Account deposits in local currency generated from the CIP private sector imports and our mutual concern to achieve an adequate internal control and monitoring procedures of such funds.

The general circular No. 1 issued on March 14, 1989 sets forth the rules and procedures for utilization of funds for the private enterprise credit project, Agreement No. 201.1. Under item 21 of such circular, participating banks shall authorize the Central Bank to draw down their account by the amount of interest and principal due on the funds advanced under the program and to furnish the Ministry of Finance, Central Administration for financing and Loans with a copy of the required authorization.

In a recent review of Special Account deposits by local banks and upon reviewing Central Bank of Egypt (CBE) and Ministry of Finance (MOF) monitoring procedures, we noticed that both MOF and CBE relies only on local banks to provide information on CIP transactions. This information is provided by local banks when they submit the authorization as indicated in the circular. If both MOF and CBE do not receive such authorization they would not be able to track deposits for transactions approved by USAID.

USAID believes that MOF as an owner of The Special Account and CBE as the bank holding such account should be fully aware of all approved transactions as they occur.

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Since it is the GOE's responsibility to ensure that local currency deposits to the Special Account are adequately accounted for, the GOE system currently maintained should enable MOF and CBE to early identify new transactions in order to achieve an adequate internal accounting control.

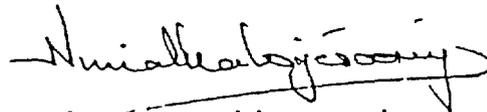
USAID would appreciate your discussing this matter with MOF and inform us with your suggestions to resolve this problem.

In our view the attached monthly report prepared by USAID could assist in resolving this issue if provided and used by MOF and CBE.

If you need more information or assistance please let me know.

Best regards.

Sincerely yours,



Nimalka Wijesooriya
Acting Associate Director
for Financial Management

Attachments: a/s above

cc: Mr. Mohamed Nabil Mokhtar
Administrator
Finance and Loans Department
Ministry of Finance
Magles El Shaab Street
Cairo, Egypt

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ARAB REPUBLIC OF EGYPT
MINISTRY OF INTERNATIONAL COOPERATION
DEPARTMENT FOR ECONOMIC COOPERATION
WITH U. S. A

00306

Matter

April, 9, 1991

Mr. Nimalaka Wijessooriya
Acting Associate Director
For Financial Management
USAID/C.

ROUTED BY	<i>FY</i>	<i>TI</i>
APPROVED BY	<i>[Signature]</i>	<i>PDS</i>
DATE	<i>4/22</i>	
INITIALS	<i>[Signature]</i>	

* *letter dated*
6/12/1991

Subject: Special Account deposits in local
currency generated from the CIP
Private Sector imports.

Dear Mr. Wigessooriya,

This is in response to your letter dated March 20, 1991 regarding
the subject matter.

Please be informed that MIC after consultation with MOF, advised
all participating banks in the CIP Private Sector of the neces-
sity to implement item (21) in the General Circular.

Meanwhile, all participating banks were also advised to provide
MOF and CBE, on a timely basis, with information stated in item
(23) in the same Circular (starting from April 1st, 1991.) as it
is provided to AID, given that any bank that fails to meet these
requirements may be suspended or terminated from the program.

In addition, it is required from AID to present to MOF and CBE
a monthly status report like the one presented to MIC (article
22), to enable them double check the data received from AID and
participating banks.

Best regards.

Sincerely yours,

[Signature]

Dr. Hassan Selim
Administrator.

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UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

Office of Financial Management
USAID - American Embassy
Kamel El Din Street
Garden City, Cairo

June 12, 1991

Dr. Hassan Selim
Administrator
Department of Economic Cooperation
with USA
Ministry of International Cooperation
8, Adly Street
Cairo, Egypt

Dear Mr. Selim,

Thank you for your letter dated April 9, 1991 regarding Special Account deposits in local currency generated from the CIP private sector imports.

USAID concurs with MIC and MOF decision to have local banks implement item number 21 and 23 of the general circular no. 1 dated March 14, 1989. USAID also agrees to provide MOF with a monthly status report identifying new transactions approved by USAID, to assist MOF verifying the adequacy of reports submitted and payments made by local banks. (Reports for April & May 1991 attached.)

MOF should send copies of such reports to the Central Bank of Egypt (CBE) and should both coordinate the tracking and monitoring of local currency deposits to insure that they are adequately accounted for. Further USAID recommends that inspectors from the CBE should visit each of the participating banks at least twice every year to verify compliance with the CIP general circular.

Thank you for your cooperation.

Sincerely,

Nimalka Wijessoriya
Acting Associate Director
for Financial Management

Attachments: a/s above

cc: Mr. Mohamed Nabil Mokhtar (with attachments)
Administrator
Finance and Loans Department
Ministry of Finance
Madaa El Shab

July 3, 1991

Mr. Abdel Monem Mahfouz
General Manager
Foreign Resources Department
Development Industrial Bank
110, Galaa Street
Cairo

Dear Mr. Mahfouz:

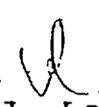
As of October 1, 1991, your bank will no longer have a bank letter of commitment under the Private Sector Commodity Import Program.

From that date, CIP transactions for clients of your bank must be submitted in cooperation with another bank which holds a letter of commitment. Section 8 of General Circular Number One of March, 1989 provides for this arrangement.

We appreciate the past interest in the program on the part of your bank and your clients.

Sincerely,

draft: J. Van Meter: SUSPENSI


Arthur J. Laemmerzahl
Office Director
Commodity Management & Trade

APPENDIX III

Report Distribution

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