



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

CAIRO, EC YPT

Report No. 6-263-98-001-P
June 10, 1998

MEMORANDUM FOR DIRECTOR, USAID/Egypt, John R. Westley

FROM: RIG/A/Cairo, Lou Mundy

SUBJECT: Audit of the Source and Origin of Project Commodities at
USAID/Egypt

This memorandum is our report on the subject audit. Overall, the audit found that USAID/Egypt complied with USAID policies and procedures and contract and agreement requirements concerning the source and origin of project commodities.

We considered the Mission's comments on the draft report, which are included in Appendix II. This report does not contain any recommendations; therefore, no response to the report is required by USAID/Egypt management. We appreciate the cooperation and assistance provided to the auditors on this assignment.

Background

USAID/Egypt's program is among the largest USAID-funded programs in the world, and project commodities valued in the millions of dollars' are procured through the program each year. In response to Section 604 (a) of the Foreign Assistance Act, USAID has established policies which require that commodities procured with USAID funds have their "source" and "origin" in the U.S. Source means the country from which a commodity is shipped to the host country, or the host country if the commodity is located therein at the time of the purchase. Origin means the country where a commodity is mined, grown or produced.

¹ The exact amount is not known because the Mission does not have an inventory of commodities provided to recipients, nor does its accounting system separately account for commodities.

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In recognition of the fact that the assistance takes place in Egypt, and the fact that local cost financing is envisioned in its projects, Egypt is also often included as an eligible country for source and origin purposes, in accordance with USAID regulations and policies.

Audit Objectives

Pursuant to our fiscal year 1998 audit plan, the Regional Office of the Inspector General for Audit in Cairo performed an audit, the objective of which was to answer the following question:

- **Did USAID/Egypt comply with USAID policies and procedures and contract and agreement requirements concerning the source and origin of project commodities?**

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

Audit Findings

Did USAID/Egypt comply with USAID policies and procedures and contract and agreement requirements concerning the source and origin of project commodities?

For the sampled procurement transactions, USAID/Egypt complied with USAID policies and procedures and contract and agreement requirements concerning the source and origin of project commodities.

Our sample included 43 procurement transactions totalling about \$23.3 million from two contracts (one \$43 million direct contract and one \$75 million host country contract) and from one \$1 million grant. All 43 procurement transactions sampled had their source in areas authorized under the two contracts (generally in the U.S.) and under the grant agreement*. For example, eight wheel loaders costing \$1,175,432 were purchased under the host country contract and were shipped from the U. S . for removing dried sludge from the drying lagoons at a waste treatment plant in Port Said, Egypt (see photo on page 5). Source was verified for all transactions by examining shipping documents (bills of lading and airway bills).

For 39 of the 43 procurement transactions sampled, goods valued at about \$23 million had their origin as required in authorized geographic codes (mostly the U.S.).

² Items valued at the dollar equivalent of \$48,000 of the total grant amount sampled (\$94,868) were procured locally by the grantee and the source was Egypt.

Specifically, items comprising 98.4 percent of the dollar value of the sample complied with origin requirements. For example, three dredges were purchased under the host country contract for \$977,115 from the U.S. as required and are being used to pump sludge from waste treatment lagoons for drying (see photo on page 5). Origin was verified using a variety of techniques: inspecting the equipment to see the manufacturer's nameplate; examining certificates of origin; and reviewing purchase orders and other documentation.

The table below summarizes the audit's findings (for details on items sampled see Appendix III):

**Summary of Compliance with Source and Origin Requirements
for Two Contracts and One Grant**

USAID/Egypt (Fiscal Years 1995-97)

| | Dollar Amount Sampled | Complied With Source Requirements | Complied With Origin Requirements | Did Not Comply With Origin Requirements |
|----------------------------------|----------------------------------|--|--|--|
| Direct Contract | \$6,325,219 | \$6,325,219 | \$5,960,153 | \$365,066 |
| Host Country Contract | \$16,905,783 | \$16,905,783 | \$16,905,783 | 0 |
| Grant | \$ 94,868 | \$94,868 | \$94,868 | 0 |
| Totals | \$23,325,870 | \$23,325,870 | \$22,960,804 | \$365,066 |
| Percentage | 100% | 100% | 98.4% | 1.6% |

As for the 1.6 percent of the dollar value of the sampled transactions which did not comply with origin requirements, we regard the dollar amount as immaterial, and the four compliance exceptions noted as not entirely clear-cut (for details of the four exceptions see Appendix III, page 1 of 3). For example, our audit found \$179,603 of computer equipment and peripherals which, per manufacturers' nameplates, were manufactured in countries other than the U.S.³ However, in the computer industry, with the globalization of the marketplace, it is increasingly difficult to tell where a computer's

³ Note that our determination of the origin of a particular item is based solely on checking the manufacturer's nameplate, and not on an analysis of the value of U.S. versus non-U.S. parts making up that item.

internal parts are actually made--regardless of what the nameplate says. (In a number of cases the nameplates said that the equipment was made in a foreign country--but under the trade name of a U.S. firm.) Also, in two other instances we found that replacement gas sensors costing a total of \$163,035 were made in England--not in the U.S. as required by project documentation. These sensors, however, were for use in U.S.-made gas analyzer equipment--and such sensors (we discovered) are not manufactured in the U.S. at all. In these two instances, the noncompliance issue is therefore somewhat moot in that the replacement sensors, while foreign-made, are essential components of U.S. -manufactured equipment.

In summary, the dollar amounts determined to be not of U.S. origin (\$365,066) are not material to the total amount sampled (about \$23.3 million); nor in our judgment, in at least three of the four exceptions found, was it even totally feasible to have met the U.S. origin requirement (we did not pursue the fourth exception for \$22,428 worth of combustion analyzer units made in Germany). Had the contractor requested and the Mission granted a waiver for these four cases, we would not have classified them as exceptions. Nevertheless, because of immateriality of the amounts observed and apparent infeasibility of totally meeting origin requirements in at least three of the four cases, we will not be making any recommendations in this regard.



One of eight wheel loaders purchased in and shipped from the U.S. Photo taken at Port Saïd, Egypt, in February 1998.



Three dredges purchased from the U.S. and used to pump sludge from waste treatment lagoons. Photo taken at Port Saïd in February 1998.

Management Comments and Our Evaluation

The Mission's response noted that, in spite of the large population audited, no material source and origin violations were reported by the auditors. However, our draft report had noted one instance of noncompliance with U.S. flag carrier regulations, which resulted in a recommendation that USAID/Egypt make a management decision on the questioned costs of \$14,820. Subsequently, the contractor provided the Mission supporting documents which were not available to the auditors at the time of the audit and which provided firm evidence that the shipments in question were made to Paris on U.S. flag carriers and reasonable evidence that the Paris to Cairo shipments, made on Egyptian Airlines, were based on an authorized trans-shipment, in accordance with USAID's Automated Directives System, section 314.5.2c. Based on this additional information, we agreed with the Mission conclusion that the freight costs were allowable and removed the recommendation from the audit report.

SCOPE AND METHODOLOGY

Scope

We conducted our audit of the Source and Origin of Project Commodities at USAID/Egypt in accordance with generally accepted government auditing standards. We performed this audit from December 1997 through April 1998. In conducting this audit, we examined the internal controls related to the audit objective, and considered prior audit findings applicable to the areas under review.

We selected for review the highest dollar value instruments as of September 30, 1997, through which commodities were purchased, from each of three categories: (1) Mission direct contracts, (2) host country contracts, and (3) grants. (The instruments in these categories had total expenditures of \$305 million, \$415 million, and \$7 million, respectively, as of that date.) This resulted in the selection for our audit sample of a \$43 million direct contract, a \$75 million host country contract, and a \$1 million grant.

We performed the audit at USAID/Egypt and in contractor offices in Zamalek, Maadi, and Cairo, Egypt. For the direct contract, we visited three host government-affiliated entities located in Zamalek, Helwan, and Cairo. For the host country contract, we visited the Port Said Waste Treatment Plant in Port Said, and Qantara Pump Station, in Qantara, Egypt. For the grant, we visited grantee offices in Alexandria and Cairo.

Methodology

For the purpose of testing compliance with source and origin requirements, we obtained inventory listings from the contractors and the grantee showing commodity procurement transactions of about \$6.8 million, \$29.6 million, and \$127,000, respectively, for fiscal years 1995 through 1997. For the two contracts, we selected judgmental samples of items costing \$100,000 and over, which resulted in samples of 15 procurement transactions valued at about \$6.3 million for the direct contract and 18 transactions valued at about \$16.9 million for the host country contract. For the grant, we selected

transactions valued at \$2,500 or more, resulting in a sample of 10 commodity procurements valued at the dollar equivalent of about \$95,000.

For all three instruments reviewed, except for the items in our sample, we did not verify the completeness or accuracy of the information on the inventory listings provided by the contractors and the grantee. We limited our conclusions to the items that we actually tested. That is, we did not attempt to project the results of our tests to the universe of all commodities purchased by the contractors and grantee or to the universe of all commodities financed by USAID/Egypt. We did not attempt a statistical sample because the universe of commodities is unknown: the Mission does not have an inventory of commodities provided to recipients, nor does its accounting system separately account for commodities.

For transactions selected, we determined the applicable source and origin requirements by reviewing the relevant grant and contract provisions. Source was verified by examining relevant shipping documents (bills of lading or airway bills). Origin was verified by a number of techniques: inspecting the equipment to see if the manufacturer's nameplate showed where the item was manufactured; examining the relevant certificate of origin; or reviewing documentation such as technical specifications, requests for consent, purchase orders, and suppliers' certificates (also, some bills of lading noted the "point and country of origin of goods"). In a few cases where the procurement transaction consisted of the purchase of numerous items of lesser value, we selected a sample of items from that transaction for review. If the procurement transaction selected for review consisted only of freight costs (as it did in two cases), we examined instead the source and origin of the item related to the freight charge.

We also reviewed contractor compliance with contract provisions for the use of U.S. flag ocean and air carriers for freight shipments.

In planning the audit, we established a materiality threshold of 5 percent of the total dollar amount sampled at which not meeting the performance criteria becomes significant enough to affect the audit's conclusions and thus require disclosure in the audit report.



CAIRO EGYPT

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

Memorandum

June 10, 1998

TO: Lou Mundy, RIG/A/C
FROM: John R. Westley, DIR
SUBJECT: Performance Audit of the Source and Origin of Project Commodities at USAID/Egypt, Draft Report Po. 6-263-98-30X-P, dated May 7, 1998.

Following is the Mission's response to the subject draft report:

As noted in the draft audit report, the auditors reviewed a sample of 43 transactions, valued at 523.3 million, out of \$119 million of USAID Egypt funded instruments. Mission is pleased to note that, in spite of the large universe audited, no material findings related to complying with source and origin requirements were reported by the auditors. The auditors, however, noted one instance of non compliance with U.S. flag carrier regulations, which resulted in questioning \$14,820 under Recommendation No. 1 of the subject report.

Recommendation No. 1

We recommend that USAID/Egypt make a management decision on the questioned costs of \$14,820 related to freight shipment on a non-U.S. flag carrier and recover from the contractor any amounts determined to be unallowable.

Mission Response:

Based on the attached memo from the Procurement office, Mission believes that the questioned amount represents allowable freight costs. The amount was paid to a U.S. shipping agency to make two shipments from San Francisco and Dayton/OHIO to Cairo. Mission has obtained supporting documents which were not available to the auditors at the time of the audit. The documents provided firm evidence that the shipments were made to Paris on U.S. flag carriers. The documents also provided reasonable evidence that the Paris to Cairo shipments, made on Egyptian Airlines, were based on an authorized trans-shipment. in accordance with MS 300, section 314.5.2c (attached are the PROC office determination and the supporting documents).

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- 2 -

Based on the above, Mission determined that the \$14,820 questioned under Recommendation 10.1 is allowable and therefore, requests closure of the recommendation.

Mission management would like to extend its appreciation to the audit team for the extensive efforts exerted, and objective conclusions made by them under this audit.

Please issue the final report.

Att: a/s

**Sample of Procurement Transactions ‘Reviewed
for Compliance with Source and Origin Requirements
USAID/Egypt (Fiscal Years 1995-97)***

| Procurement Transactions Reviewed | Transaction Amounts | Complied with Requirements | | Amounts Not in Compliance | Comments |
|---|---------------------|----------------------------|----------|---------------------------|---|
| | | (Source) | (Origin) | | |
| Direct Contract Items: | | | | | |
| heat recovery units | \$184,311 | yes | yes | -- | |
| crane (freight) | 129,322 | yes | yes | -- | |
| 40 gas burners | 246,056 | yes | yes | -- | |
| regenerative burner system | 298,771 | yes | yes | -- | |
| glass furnace (freight) | 110,092 | yes | yes | -- | |
| CO, recovery system | 687,440 | yes | yes | -- | |
| dual burners | 435,230 | yes | yes | -- | |
| 93 computers & other equipment | 347,497 | yes | no | \$179,603 | monitors, plotters, printers, scanners, and laptops were of non-U.S. origin |
| 16 electric power analyzers | 320,955 | yes | yes | -- | |
| combustion analyzers | 109,656 | yes | no | 22,428 | 12 analyzer units were of non-U.S. origin |
| 12 vapor analyzers | 116,160 | yes | yes | -- | |
| spare sensors and miscellaneous equipment | 125,558 | yes | no | 63,315 | sensors were made in England but for U.S.-made equipment |
| spare parts | 252,277 | yes | no | 99,720 | sensors were made in England but for U.S.-made equipment |
| magnetic crane | 367,596 | yes | yes | -- | |
| glass furnace | 2,594,298 | yes | yes | -- | |
| Direct Contract Totals | \$6,325,219 | | | \$365,066 | |

* All transactions reviewed were for fiscal years 1995 through 1997 except for two direct contract items from fiscal year 1994 which were related to freight payments made in 1995 and 1996. Note that for freight payment transactions, we reviewed the source and origin of the item related to the payments.

**Sample of Procurement Transactions Reviewed
for Compliance with Source and Origin Requirements**
USAID/Egypt (Fiscal Years 1995-97)

| Procurement Transactions Reviewed | Transaction Amounts | Complied with Requirements | | Amounts Not in Compliance | Comments |
|-------------------------------------|---------------------|----------------------------|----------|---------------------------|----------|
| | | (Source) | (Origin) | | |
| Host Country Contract Items: | | | | | |
| 186 slide gates | \$189,646 | yes | yes | -- | |
| 4 screw pumps | 941,250 | yes | yes | -- | |
| 488 steel H-piles | 199,241 | yes | yes | -- | |
| 3 dredges | 977,115 | yes | yes | -- | |
| 205 aerators | 3,993,055 | yes | yes | -- | |
| fencing material | 205,221 | yes | yes | -- | |
| 8 wheel loaders | 1,175,432 | yes | yes | -- | |
| ductile iron pipes | 1,657,315 | yes | yes | -- | |
| 13 miscellaneous vehicles | 476,069 | yes | yes | -- | |
| emergency power system | 692,950 | yes | yes | -- | |
| 99 sun panels | 319,555 | yes | yes | -- | |
| 5 dump trucks | 390,185 | yes | yes | -- | |
| 13 pumps | 998,782 | yes | yes | -- | |
| water screens and control panels | 165,792 | yes | yes | -- | |
| 5 trailer trucks | 498,675 | yes | yes | -- | |
| heating/air conditioning | 474,658 | yes | yes | -- | |
| composting system | 3,089,400 | yes | yes | -- | |
| 2 sludge augers | 461,442 | yes | yes | -- | |
| Host Country Contract Totals | \$16,905,783 | | | \$0 | |

**Sample of Procurement Transactions Reviewed
for Compliance with Source and Origin Requirements**
MAID/Egypt (Fiscal Years 1995-97)

| Procurement Transactions Reviewed | Transaction Amounts | Complied with Requirements | | Amounts Not in Compliance | Comments |
|-----------------------------------|---------------------|----------------------------|----------|---------------------------|----------|
| | | (Source) | (Origin) | | |
| Grant Items: | | | | | |
| 8 desks | \$2,624 | yes | yes | -- | |
| 3 personal computers | 6,600 | yes | yes | -- | |
| 3 personal computers | 6,838 | yes | yes | -- | |
| 1 laptop computer | 2,794 | yes | yes | -- | |
| 3 personal computers | 5,206 | yes | yes | -- | |
| 1 personal computer | 3,460 | yes | yes | -- | |
| 1 photocopier | 5,294 | yes | yes | -- | |
| 1 photocopier | 12,213 | yes | yes | -- | |
| 1 personal computer | 2,971 | yes | yes | -- | |
| 2 vans | 46,868 | yes | yes | -- | |
| Grant Totals | \$94,868 | | | \$0 | |

| | | | | | |
|--|---------------------|--|--|------------------|--|
| Grand Totals for the Two Contracts & Grant Reviewed | \$23,325,870 | | | \$365,066 | |
| Percentages | 100% | | | 1.6% | |

Major Contributors to this Report

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for Audit, Cairo, Egypt

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