Regional Inspector General for Audit
Cairo, Egypt

PD-ABM-321

Audit of the Gaza Housing Project

Report No. 6-294-96-001
November 21, 1995

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID

CAIRO, EGYPT

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

November 21, 1995

MEMORANDUM

TO : Director USAID West Bank/Gaza, Christopher D. Crowley

FROM : RIG/A/Cairo, Lou Mundy Lou Mundy

SUBJECT: Audit of the Gaza Housing Project

This memorandum is our report on the subject audit. Overall, the audit found that USAID West Bank/Gaza properly monitored the Gaza Housing Project. Further, the Mission took appropriate action, in coordination with the construction manger, to address concerns about the availability of utility services to the apartment units provided under the Project. However, the Mission needs to clarify who the intended beneficiaries of this assistance are and to develop a maintenance plan to help ensure that continuing maintenance services are provided for the completed apartment units.

The report contains two recommendations for your action, both of which are resolved and may be closed once planned actions have been taken. Your response (Appendix II) indicates that closure of both recommendations is expected by March 31, 1996. As appropriate, please advise this office of the Mission's progress in closing these recommendations.

Thank you for the cooperation and assistance extended to the audit staff on this engagement and your continued support of the audit program in the West Bank and Gaza.

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Background

After the September 1993 Declaration of Principles between the Palestine Liberation Organization and Israel extended autonomy to the Gaza Strip and the West Bank, Palestinian officials urgently requested housing assistance. To demonstrate an early commitment towards helping the Palestinians and the Middle East peace process, the U.S. proposed the Gaza Housing Project (Project) as a quick-start activity under its expanded program in the West Bank and Gaza. In order to respond quickly to the perceived need for emergency housing, USAID adopted an existing design for the apartment units constructed under this Project. Further, Mission officials informed the auditors that most of the Project's design was done in Washington, D.C., as USAID West Bank/Gaza had not yet been established as a formal USAID mission. Construction activities began in July 1994, ten months after the September 1993 Declaration of Principles.

The Project, which was designed to improve housing conditions in the Gaza Strip and West Bank, was funded at $25.5 million, of which about $12.4 million was obligated and about $3.1 million expended as of March 31, 1995. The project assistance completion date is September 30, 1997. The Project includes four components:

- construction of 192 apartments in six high-rise buildings in Gaza (Al Karama apartments),

- construction of new apartments for 58 employees of the Gaza Community Mental Health Program (private housing component),

- improvement of private homes in Gaza (home improvement component), and

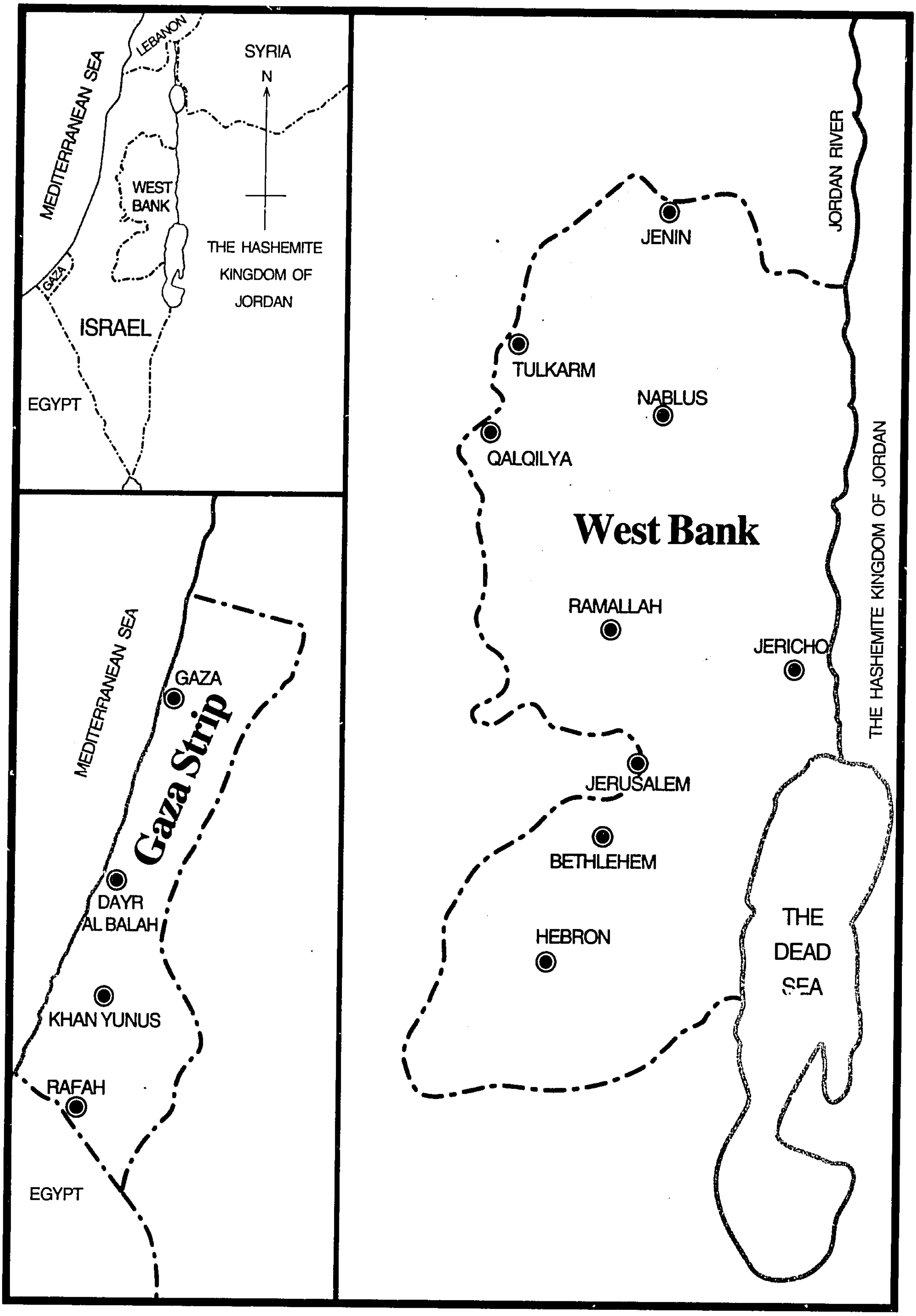
- upgrade of neighborhoods in low and moderate income municipalities of Gaza.

USAID West Bank/Gaza is responsible for monitoring the Project. The Palestinian Housing Council, located in Gaza, is responsible for overall Project implementation.

Most Project activity has focused on the construction of the Al Karama apartment component. Other Project components have not yet progressed far in that (1) the private housing component has been postponed pending a review of the overall Mission strategy, (2) the home improvement component just began in April 1995, and (3) the component to upgrade neighborhoods has not yet begun as the Mission was still deciding on implementing details. Because activities on these components were limited, the audit focused on the Al Karama apartment component.

The 192 Al Karama apartments, financed by USAID, are part of a much larger, multi-donor housing program. The overall program consists of 1,116 apartment units being built with donor assistance at three locations. The European Union is financing the 924 units not financed by USAID.

West Bank and Gaza



As of July 31, 1995, the Al Karama apartments were progressing well toward the estimated completion date of January 1996. USAID West Bank/Gaza officials stated that they have worked closely with both the Palestinian Housing Council and European Union in monitoring construction activities and working out details on policy considerations.

Al Karama Apartments Under Construction in Gaza (May 22, 1995)

Audit Objective

In accordance with the Fiscal Year 1995 Audit Plan, the Office of the Inspector General for Audit/Cairo audited this Project to answer the following objective:

Did USAID West Bank/Gaza monitor the Gaza Housing Project to ensure that desired results were achieved?

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

Audit Findings

Our answer to the following audit objective is qualified to the extent of the effect, if any, of not having received appropriate written representations for the audit from USAID West Bank/Gaza officials. Appendix I includes a discussion of this qualification.

Did USAID West Bank/Gaza monitor the Gaza Housing Project to ensure that desired results were achieved?

We found that USAID West Bank/Gaza had properly monitored Project activities; however, some desired results remained uncertain. Construction of the 192 Al Karama apartment units, scheduled for completion by the end of January 1996, was generally proceeding on time and in accordance with plans. Further, the Mission had worked effectively with the Palestinian Housing Council, the construction manager, and Gaza municipalities to attempt to overcome potentially serious problems concerning the availability of utility services for the Al Karama apartments. As discussed previously, the other three Project components were just beginning and were therefore excluded from audit coverage.

The audit found that the Mission had closely monitored construction of the Al Karama apartments. In doing so, the Mission (1) worked with the construction manager (Louis Berger International, Inc.) in overseeing construction progress; (2) conducted frequent visits to the construction site, in spite of many access problems to Gaza due to border closures; and (3) held meetings with the Palestinian Housing Council and the construction manager. These efforts undoubtedly contributed significantly toward the 192 units progressing on a timely basis.

These efforts, however, were not totally successful in ensuring that desired results would be achieved, in that:

- The Project's intended beneficiaries-lower-income residents of Gaza-may not benefit from the Project.

- There is no plan to specifically address ongoing maintenance of the apartments after units are occupied.

- Despite the Mission's efforts, the Al Karama apartment units may remain unusable after completion pending the local municipalities' provision of water, sewerage and electricity services.

This latter issue—the provision of utilities—is a potentially serious problem as the units will remain unused pending the provision of these services.

USAID West Bank/Gaza learned after the Project was initiated in 1994 that adequate provision had not been made for utility services to the apartments. With the expertise of its construction manager, Mission officials began meeting with the Palestinian Housing Council and municipalities to explore how adequate water, sewerage, and electricity services could be provided. Unfortunately, this has not been an easy task as the Mission learned that there was not always an adequate and ready source for needed utility services.

Significant progress had been made as of July 31, 1995 toward resolving these difficulties, however, the provision of utility services remains problematic. Although it appeared that a new well would be dug soon, availability of water remained uncertain as the only water now available comes from a well that has little reserve capacity and which is expected to become saline within two years. Sewerage services were to be provided by the Gaza Municipality through a hookup that could be available as early as August 1995, but a formal agreement to provide sewage service was still pending. Finally, electricity for the Al Karama apartments appeared to be available by tapping into an existing line that ran near the site, but the line did not have sufficient capacity for both the USAID-funded apartments and apartments funded by the European Union that were scheduled to come on-line later. Therefore, a long-range solution for electrical service was still pending as of July 31, 1995.

The audit found, however, that the Mission was continuing to do what it could to remedy this problem and that significant progress has been made toward the provision of utility services. Therefore, we are not making any recommendations concerning this issue.

We do believe, however, that USAID West Bank/Gaza needs to take action at this time to help ensure that intended beneficiaries occupy the apartments and maintenance services are provided. These two issues are discussed in detail below.

Need to Ensure That Apartments Are
Occupied by Lower-Income Beneficiaries

It is the intent of the Congress that U.S. assistance be used to help the poor majority of people in developing countries. The use of USAID funds for the Project, and specifically for the Al Karama apartments component, was justified by USAID on the basis that it would benefit lower-income Palestinians in Gaza. The Memorandum of Understanding between USAID and the Palestinian Housing Council sets out the requirement that the beneficiaries represent the lower-income group and requires the Housing Council to obtain USAID's agreement on both the criteria used to select beneficiaries and the terms of sale. Our audit found, however, that the Palestinian Housing Council was considering selling the housing units to higher-income Palestinians in order to maximize sales revenue to recover higher than expected construction costs. This poses a serious issue for resolution with the Housing Council if USAID funds are to be used as intended.

<u>Recommendation No. 1</u> We recommend that the Director, USAID West Bank/Gaza, through collaboration with the Palestinian Housing Council, consider the options available that will ensure that USAID resources invested under the Gaza Housing Project benefit the lower-income target group identified in the Project's Memorandum of Understanding.

USAID policy as reflected in the Foreign Assistance Act of 1961, as amended, states that "The Congress declares that the principal purpose of United States bilateral development assistance is to help the poor majority of people in developing countries to participate in a process of equitable growth..." In accordance with this policy, when USAID authorized the Project, it specified that the Al Karama apartments would be sold to residents of Gaza who are in the lower-income range, defined as households with income less than $700 per month. The Memorandum of Understanding between USAID and the Palestinian Housing Council also clearly states that the Project was to benefit lower-income Palestinians, again specifically stated to consist of households with incomes of less than $700 per month (expressed in 1993 dollars). The Memorandum of Understanding also requires the Housing Council to obtain USAID's agreement on both the criteria used to select beneficiaries and the terms of sale.

A potentially conflicting goal was that the Al Karama apartment component was also supposed to generate a reflow of funds, through the sale of the apartments, that the Palestinian Housing Council could use for housing-related projects. The Project authorization stated that Project beneficiaries were to pay market interest rates for the maximum cost recovery, with a limited subsidy for capital costs, in order to make the units affordable to families in the lower-income range.

In reality, the two conflicting goals may be very difficult to achieve. The apartment units cost more than expected, forcing the Palestinian Housing Council to either sell the apartments to higher-income residents or to recover much less than cost. In order to evaluate this matter fully, USAID West Bank/Gaza had a study performed to determine the financial impact of selling the apartments to lower-income residents. The study concluded that the Al Karama apartments, if priced at full-cost recovery, would not be affordable to most applicants, and that a subsidy of about 39 percent of the total Project cost would be needed if the units were sold to the planned low-income beneficiaries.

With construction nearing completion, we found that the Palestinian Housing Council remained uncertain as to how to market the Al Karama apartment units. The apartments were costing far more than could reasonably be recovered, so the Housing Council had not yet decided on a pricing structure for the USAID-financed units.

This situation occurred because USAID did not clearly confront this issue when designing the Project. According to a Mission official and the construction manager, the 192 apartments were over-designed for a low-income population resulting in costs significantly higher than initially projected. In addition, the study justifying the Project assumed that purchasers would pay a five-percent interest rate, whereas USAID West Bank/Gaza officials believe that purchasers should pay market interest rates. By comparison, the Palestinian Housing Council remains uncertain as to what interest rate to use.

Mission officials have concluded, however, that the Al Karama apartments are not affordable to lower-income Palestinians earning less that $700 monthly, especially if market interest rates are to be charged to purchasers, which the Mission firmly believes should be required.

In March 1995, a USAID West Bank/Gaza discussion paper identified three alternatives available to the Palestinian Housing Council:

- sell the units to eligible low-income beneficiaries, thereby requiring a large subsidy;
- sell the apartments at auction intending to recover full costs for each unit; or
- market some units at full commercial value and use the proceeds to subsidize the sales of other units to lower-income groups.

The discussion paper suggested that interested parties—Palestinians, the European Union, USAID and others—meet to discuss how the Palestinians might use available housing funds to benefit the greatest number of people.

Mission officials were uncertain as to what action to take concerning the Palestinian Housing Council's marketing plans for the 192 units. They said they were waiting for the Housing Council to define its sales strategy. However, while the Housing Council and the European Union may have options on who to sell the units to, we do not believe this to be the case with USAID. As stated above, the justification for USAID funding for the Al Karama apartment units is to benefit lower-income Palestinians—a purpose in line with the Foreign Assistance Act. Because of the possibility that the Housing Council may wish to sell such units to other than lower-income beneficiaries, which would be contrary to the intent of the Congress, we believe that USAID West Bank/Gaza should clearly communicate USAID's commitment to use Project funds to benefit only lower-income Palestinians.

USAID West Bank/Gaza officials stated that they were not necessarily opposed to the recommendation to communicate USAID's commitment to use Project funds to benefit only lower-income Palestinians. However, they stated that the situation was quite complex as USAID was funding only about one-sixth (192 of 1,116 units) of the apartments. Palestinian Housing Council officials also stated that its marketing decisions were complex in that the 1,116 apartments cost different amounts, depending on variations in location, donor requirements, and other matters.

We acknowledge that these factors complicate the situation, but believe that the requirement that USAID funds be used to fund housing low-income people receive priority.

Maintenance Plan Needed to Help Ensure
<u>Completed Apartments Are Properly Maintained</u>

In order to protect its investment, USAID must ensure that adequate provisions for maintenance have been made after the Project facilities are placed in operation. In the case of the Al Karama apartments, however, USAID did not ensure that ongoing maintenance would be available, as no provision was made for the development of a maintenance plan for management to follow after construction was complete and the units turned over to the Palestinian Housing Council. As a result, the 192 apartments and the buildings site may not be adequately maintained after they are occupied.

> **<u>Recommendation No. 2:</u> We recommend that the Director, USAID West Bank/Gaza develop a maintenance plan to help ensure that ongoing maintenance is provided to the Al Karama apartments after completion.**

USAID attempts to protect its investments by ensuring that constructed facilities are maintained once complete. It is common practice to provide the owner of financed facilities with a maintenance plan to help ensure that ongoing maintenance of the building and site is provided. A maintenance plan usually takes the form of a schedule of maintenance activities to be conducted periodically on the buildings and site. The plan should address what is to be maintained, how it is to be maintained, who will conduct the maintenance, when it will be performed, and who will pay for it.

While the Al Karama apartment units are close to completion, there is neither a maintenance plan nor a provision for the construction manager or contractor to develop one. The construction manager said while he has provided limited training on operation and maintenance of the units, he has not been tasked with development of a maintenance plan. Nevertheless, he stated that he would provide a plan, even though it was not contractually required.

Without a maintenance plan specifying scheduled maintenance for different aspects of the buildings and site, there is no assurance that the apartment buildings and site will be maintained and USAID's investment protected. Consequently with limited time remaining before construction is complete and apartments are occupied, we believe that USAID West Bank/Gaza should develop and provide the owner with a maintenance plan to help ensure that adequate maintenance services are available.

Management Comments and Our Evaluation

In its written response to the draft report (Appendix II), USAID West Bank/Gaza agreed with our audit recommendations and cited action that it had taken to resolve them. Accordingly, USAID West Bank/Gaza requested that both recommendations be resolved upon issuance of the final report.

For Recommendation No. 1, the Mission agreed that priority be given to meeting the requirement that USAID funds not be used to finance apartments for more affluent Palestinians. The Mission advised that it reiterated, in an October 5, 1995 letter to the Palestinian Housing Council, that beneficiaries must be within the previously established target groups and that USAID must review the criteria for beneficiary selection and the sales and financing terms to be applied to USAID-funded units. The Mission stated that over the next few months it would work with the Palestinian Housing Council to examine options identified by a study that it had commissioned which, in fact, did identify some potential options that would make the units affordable for lower-income Palestinians. USAID West Bank/Gaza concluded by stating that an acceptable agreement on beneficiary selection and financing terms should be possible by March 31, 1996.

Based on the actions initiated by the Mission outlined above, Recommendation No. 1 is resolved.

Management also agreed with Recommendation No. 2. The Mission stated that the Palestinian Housing Council was in the process of developing an overall plan for maintenance. As understood by the Mission, the maintenance plan would distinguish between the responsibilities of the Palestinian Housing Council, of cooperative associations formed by the owners, and the individuals owners themselves. The plan was to include the establishment of appropriate maintenance fees and a plan to educate residents about maintenance requirements. The Mission stated that the Housing Council anticipated having this plan in place prior to occupancy and that it would work with the Housing Council to develop a plan specific to Al Karama. The Mission believed that a plan would be completed no later than March 31, 1996.

Based on the actions outlined above, Recommendation No. 2 is resolved.

In its response, management also stated that it found certain aspects of the draft audit report to be misleading and/or incorrect. In an attachment to its response Management cited statements that it considered misleading/inaccurate and suggested alternative language for the final report. We reviewed the alternative language and have incorporated the Mission's suggested changes in all but one instance. The Mission's response in its entirety, including the attachment, is presented as Appendix II .

SCOPE AND METHODOLOGY

Scope

We audited the Project (USAID West Bank/Gaza Project No. 294-0006) in accordance with generally accepted government auditing standards. These standards require auditors to obtain written representations from management when they deem them useful. The Office of Inspector General considers such representations necessary to support potentially positive findings. USAID West Bank/Gaza's Director provided us a management representation letter for the audit that contained some essential assertions about the activities we audited. However, the Director did not provide some essential assertions, as follows:

- A statement that the Mission is responsible for the internal control system, compliance with applicable laws and regulations, and the fairness and accuracy of the accounting and management information.

- That there have been no irregularities involving management or employees or other organizations, or communications from other organizations concerning noncompliance with or deficiencies in the Gaza Housing Project.

- That there are no material instances where financial or management information have not been properly and accurately recorded and reported.

The representation letter was also deficient in that (1) it stated that the Mission *reported to us* all contractual agreements rather than stating that the Mission had *complied with* all aspects of contractual agreements, and (2) the representation letter was signed by the Director USAID West Bank/Gaza but not by the Controller and the official directly responsible for the activities associated with the Gaza Housing Project.

Due to the above limitations in the representation letter provided by the Mission, our answers to the audit objectives are qualified to the extent of the effect, if any, of not having representations considered essential.

The audit was performed to determine whether USAID West Bank/Gaza monitored the Project to ensure that desired results were achieved. The Project was funded at $25.5 million, of which about $12.4 million was obligated and about $3.1 million expended as of March 31, 1995. We conducted audit fieldwork from May 2, 1995 through August 2, 1995. In addition to USAID West Bank/Gaza, we visited offices of the construction manager (Louis Berger International, Inc.) in Gaza, and the Palestinian Housing Council in Gaza and Jerusalem.

Methodology

To accomplish the audit objective, we interviewed USAID officials in USAID West Bank/Gaza to assess their monitoring of the Project. We interviewed officials of the recipient organization — the Palestinian Housing Council — and the construction manager (Louis Berger International, Inc.) in Gaza and Jerusalem to discuss how they managed construction and resolved difficulties associated with construction and providing utilities and maintenance services for the housing units. We also reviewed contracts, reports of site visits, periodic implementation reports, memoranda, letters and cables to assess how well USAID West Bank/Gaza was monitoring the Project.

We also visited recipients' and construction manager offices in Gaza and Jerusalem, as reflected in the above scope section, and the Project site in Gaza.

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RECEIVED
22 NOV 1995

TO: Lou Mundy, RIG/A/C

FROM: Christopher Crowley, Director CDC

SUBJECT: Audit of the Gaza Housing Project, No. 294-0006

DATE: November 1, 1995

We have reviewed the draft audit report and are pleased to provide the following response, which we believe will justify resolution of the two recommendations at this time. However, we have some additional comments regarding aspects of the draft report which we find to be misleading and/or incorrect. Attachment A to this memorandum provides these comments, along with our suggested changes in the audit report text. In the event RIG/A does not accept the changes we propose, we request that Attachment A be included in full in the final audit report as part of the Mission's response.

> Recommendation No. 1: **We recommend that the Director, USAID/West Bank and Gaza, through collaboration with the Palestinian Housing Council, study the options available which will assure that USAID resources invested under the Gaza Housing Project benefit the lower income target group identified in the Project's purpose.**

We accept the recommendation. We agree with the auditors' statement that priority be given to meeting the requirement that USAID funds not be used to finance apartments for more affluent Palestinians. In this letter, we provide an update on the position of the Palestinian Housing Council (PHC), and describe the steps USAID has taken to resolve Recommendation No. 1 as well as the process we plan to follow to ensure its prompt closure.

In accord with the audit recommendation, USAID requested a review by a housing finance expert of the options available to meet the requirement, as set forth in the Project Paper and in the Memorandum of Understanding (MOU) with the PHC, that beneficiaries of USAID-funded units be families with an approximate income of $700 per month or less (in 1993 dollars). This review, completed in October 1995, shows that suitable options may be more easily within reach than previously thought, in large part as a result of greater flexibility in possible financing arrangements available to the PHC than was previously assumed.

The earlier USAID-funded study cited in the audit report had indicated that pricing the units for full cost recovery would preclude affordability for most applicants, and that a subsidy of 39 percent would be needed if the units were to be sold to the planned target group. Given the information available at the time, this was a reasonable finding. USAID's consultant for the October 1995 review noted that the earlier study was based on the assumption that certain regulations would apply to the sale of the units, particularly the application of an Islamic law (often applied in Gaza) which would have limited the accumulated interest over the life of each loan to no more than 100 percent of the original loan value. This would have greatly constrained the options available to develop market-based financing terms suitable for lower income clients.

Recently, the PHC has, with help from its legal advisors and from an EU-funded housing expert, proposed an alternate financing mechanism involving a "lease with option to buy" rather than a traditional property sale. The clear advantage of this mechanism is that the interest limitations cited above would not apply. USAID's consultant for the October 1995 review noted that this type of transfer mechanism would be an appropriate way to enable monthly payments to be within the range affordable to those within the target group, at least those at the higher end of the group. Financing schemes under this mechanism would involve a 9 percent effective interest rate with graduated monthly payment schedules. While this progress has been made in identifying options for providing lower-income Palestinians access to housing units, it is worth noting that the income level for the target group was established somewhat arbitrarily at the time of the original design. In fact, even at present no precise data clearly delineating income distribution in the West Bank and Gaza exist.

The October review provides several options for market-based financing, with and without modest capital subsidies. A capital subsidy would, of course, broaden affordability through a write-down of the sales price, thus reaching lower into the target group's income range. The review notes that any subsidy would most likely be between 10 and 20 percent. (The Project Authorization Action Memorandum noted that "limited capital subsidies" would be allowed in order to make the units affordable to families in the lower income range.) A number of considerations will bear on our decision to recommend a particular option, among them: minimizing the subsidy, if possible; minimizing market distortions; and encouraging, where possible, a coordinated approach to pricing and financing with the EU. We are also concerned about how the current housing market might affect demand and occupancy, given evidence which suggests that the market for apartments in Gaza is currently depressed. An additional factor which we are considering is that the beneficiary group could arguably be broadened by the application of a modest inflator on the 1993 dollar income estimate, thus bringing the top of the range to $764.

As noted in the October review, the position of the Palestinian Housing Council (PHC) on disposition of the apartments has evolved over the past several months as it attempts to deal with much the same issue that faces USAID: how to make relatively expensive units affordable to the lower income people who are their clients. Verbally, the PHC has reassured Mission representatives that they share our concern that the units under their responsibility benefit lower income families. Moreover, they recognize the need to address this issue not only for the USAID units, but also for the EU-funded units of similar design at Al Karama and the larger pool of about 1200 EU-funded apartment units. The PHC is also, understandably, interested in maximizing revenues to enable them to provide additional housing in the future.

In an October 5, 1995 letter to the PHC, the Mission, referring to the MOU, reiterated that beneficiaries must be within the previously established target group and that USAID must review the criteria for beneficiary selection and the sales and financing terms to be applied to USAID-funded units. Over the next 3-6 month period USAID will work with the PHC to examine the options proposed in the October review, and any other options the PHC may offer, and agree on beneficiary selection and financing terms which are in accord with USAID's MOU. This will form the basis for prompt closure of the recommendation. Since delays in construction will most likely have a bearing on the timing of these decisions, we feel that March 31, 1996 is a reasonable target date for closure of this recommendation.

> <u>Recommendation No. 2</u>: **We recommend that the Director, USAID/West Bank and Gaza develop a maintenance plan to help ensure that ongoing maintenance is provided to the Al Karama apartments after completion.**

We accept Recommendation No. 2. In our recent discussions with the PHC, they have indicated that they are in the process of developing an overall plan for maintenance. In their view, the plan should distinguish between the responsibilities of the PHC, of cooperative associations formed by unit owners, and of individual owners. It should include the establishment of appropriate fees to be included in owners' monthly payments as owner contributions to maintenance. There will also be a plan to educate residents about maintenance requirements. The PHC anticipates having this plan in place prior to occupancy. USAID will, seeking input from the construction manager and with the assistance of an appropriate expert, work with the PHC to develop a plan specific to Al Karama. We anticipate that the plan will be completed no later than March 31, 1996, at which time we will request closure of this recommendation.

ATTACHMENT A: COMMENTS ON DRAFT AUDIT REPORT TEXT
USAID/WEST BANK AND GAZA
Audit of Gaza Housing Project (294-0006)

USAID/West Bank and Gaza would like to point out several instances where the draft report includes either misleading or incorrect information and request specific wording changes, as follows:

Recommendation No. 1: Introductory Paragraph on Page 6 (p. 6, final paragraph). The paragraph notes that, at the time of the audit, the Palestinian Housing Council (PHC) was considering selling the apartment units to higher income Palestinians to maximize sales revenue. It goes on to state: "As a result, USAID funds for this project may not be used as intended." This is misleading in that it overlooks USAID's role in project management. USAID has, since the project design stage, recognized that the selection of beneficiaries would potentially pose an issue with the PHC, and had earlier realized that certain controls would be required in order to ensure that its beneficiary group will be reached. Accordingly, USAID included in draft form in the Project Paper and later signed a Memorandum of Understanding (MOU) with the PHC which requires USAID review and approval of critical aspects of disposal of the units. The relevant parts of the MOU state:

> "...the PHC shall, at no cost to USAID, or to any USAID-financed contractor, and except as the Parties shall otherwise agree in writing:
>
> > ...(g) identify and designate those beneficiaries, based on PHC eligibility criteria to be agreed upon with USAID, who are to receive housing units;...and provide USAID, on a timely basis, a list of approved beneficiaries describing how each meets the eligibility criteria;
> >
> > (h)...sell these units to deserving beneficiaries on a schedule and pursuant to terms to be generally agreed upon between USAID and the PHC which shall include full financing terms in order to obtain maximum full cost recovery and limitation of capital subsidies to low income groups or their equivalent...

Additionally, the MOU specifically notes the requirement that

> "household income of eligible applicants shall be in the lower-income range, defined for this purpose as being less than $700 per month, expressed in 1993 dollars."

Differences of opinion between USAID and the PHC on these matters, if and when they occur, are to be addressed in the context of the MOU. USAID's role in agreeing upon criteria and financing terms is not mentioned in this paragraph nor elsewhere in the audit report.

The paragraph's concluding sentence states: "As a result, USAID funds for this project may not be used as intended." We believe this sentence to be misleading because it does not recognize USAID's role in these critical elements of the project as set forth in the MOU. We suggest that changes be made in this paragraph to specifically recognize the role of the MOU as part of USAID's system of internal controls. We would suggest that the last sentence of the paragraph be deleted, and that the paragraph read as follows [additions noted in bold]:

> It is the intent of the Congress that U.S. assistance be used to help the poor majority of people in developing countries. The use of USAID funds for the Gaza Housing Project, and specifically for the Al Karama apartments component, was justified by USAID on the basis that it would benefit lower-income Palestinians in Gaza. **The Memorandum of Understanding between USAID and the Palestinian Housing Council sets out the requirement that the beneficiaries represent the lower income group and requires the PHC to obtain USAID agreement on both the criteria used to select beneficiaries and the terms of sale.** Our audit found, however, that the Palestinian Housing Council was seriously considering selling the housing units to higher-income Palestinians in order to maximize sales revenue to recover higher than expected construction costs. **This poses a serious issue for resolution with the PHC if USAID funds are to be used as intended.**

Two related wording changes in the discussion following the recommendation are also relevant, given the MOU in place with the PHC. First, Paragraph 3 of the discussion states that "in reality the two conflicting goals may not be achieved" because units cost more than expected, "forcing the PHC to either sell the apartments to higher income residents or to recover much less than cost." We would suggest that the first sentence of this paragraph be revised to read: "**In reality, the two conflicting goals may be very difficult to achieve.**" Second, Paragraph 8, Line 7 of the discussion states that: "Because of the possibility that such units might be sold to other than lower-income beneficiaries...." be replaced with: "**Because of the possibility that the PHC may wish to sell such units to other than lower-income beneficiaries...**"

2. Recommendation No. 1: Reference to Project Purpose.

The recommendation refers to "the lower-income target group identified in the Project's purpose." We would like to note that, while the Project Authorization referred to "low and moderate income Palestinians," there is no mention of any target group in the Project Purpose statement, which is "to improve shelter conditions in the Gaza Strip and West Bank." The target group is defined in the Project Paper. Therefore, we request that the reference in Recommendation No. 1 to the "project purpose" be changed to "Project Paper."

USAID

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November 1, 1995

Mr. Lou Mundy
Regional Inspector General
For Audits
Cairo, Egypt

Re: Audit of the Gaza Housing Project (294-0006)

Dear Mr. Mundy:

This representation letter is being issued in accordance with USAID guidance in response to your audit of the Gaza Housing Project.

Based on discussions with and verbal representations to me by the USAID/West Bank and Gaza staff, and taking into account identified staff constraints and vulnerabilities as expressed in mission ICAs, I represent to the best of my knowledge and belief, as a layman and not as a lawyer, that:

(A) The Mission has made available to you or otherwise provided to you at your request all financial and management information in the possession and under the control of the Mission relating to the fun:tion being audited.

(B) The Mission has reported to you all known instances pertaining to the function being audited which, in the Mission's judgment, would evidence material irregularities or noncompliance by USAID with USAID policies, or material violations by USAID of U.S. laws and regulations.

(C) The Mission has reported to you all contractual agreements, to the extent there are such agreements which could have any material effect on the function being audited.

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

All representations made herein by me are made as of the date of this letter and in light of my experience since my arrival at post on September 18, 1994.

Sincerely yours,

Christopher D. Crowley

Christopher D. Crowley
Director