USAID

OFFICE OF INSPECTOR GENERAL

Audit of USAID/Egypt's Small and Microenterprise Development Activities

6-263-03-002-P

March 12, 2003

Cairo, Egypt

March 12, 2003

MEMORANDUM

FOR: Anne Aarnes, Acting Director, USAID/Egypt

FROM: David H. Pritchard, Acting RIG/Cairo /s/

SUBJECT: Audit of USAID/Egypt's Small and Microenterprise Development Activities (Report No. 6-263-03-002-P)

This is our final report on the subject audit. We reviewed your comments to our draft report and included them as Appendix II to this report.

The report contains one recommendation for USAID/Egypt to not include in its Annual Report lending results that have not had data quality assessments. Based on the actions USAID/Egypt took in response to our draft report, the recommendation is closed upon report issuance.

I appreciate the cooperation and courtesy that USAID/Egypt and its contractors extended to my staff during the audit.

Table of Contents

Summary of Results 3

Background 3

Audit Objectives 4

Audit Findings 4

Had USAID/Egypt administered small and microenterprise development activities in accordance with applicable USAID guidance? 4

Had USAID/Egypt's small and microenterprise development activities progressed towards their intended results? 7

USAID/Egypt Underreported Poverty Lending Results In Its 2002 Annual Report 8

Reported Results From Two Banking Institutions Could Not Be Verified 9

Management Comments and Our Evaluation 10

Appendix I – Scope and Methodology 12

Appendix II – Management Comments 14

Summary of Results

Regional Inspector General/Cairo audited USAID/Egypt's small and microenterprise development activities to determine if: (1) the Mission administered its activities in accordance with applicable USAID guidance and (2) the activities had progressed towards their intended results. (See page 4.)

USAID/Egypt administered small and microenterprise development activities in accordance with applicable USAID guidance. (See page 4.)

In regards to intended results, USAID/Egypt's small and microenterprise activities had mixed results for calendar year 2001. One indicator (poverty loans) exceeded its target by more than 90 percent, but another indicator (value of loans disbursed) fell short of its target by 15 percent. Also, the Mission had underreported poverty lending results in its 2002 Annual Report, and results for two banking institutions could not be verified. (See pages 7 through 11.)

To address the results that could not be verified, we recommended that the Mission not report in future Annual Reports lending results reported by two banking institutions until data quality assessments of the results can be performed. (See pages 10 and 11.)

Background

In 1994, USAID launched a "Microenterprise Initiative" in partnership with the Congress. The initiative committed to expanding funding for microenterprise programs and set a goal that one-half of all microenterprise resources would support programs and institutions that provide credit to the poorest, with loans under $300. In October 2000, the President signed the Microenterprise for Self-Reliance and International Anti-Corruption Act of 2000. The purposes of the Act included, among others, making microenterprise development an important element of United States foreign economic policy and assistance, and providing for the continuation and expansion of USAID's 1994 Microenterprise Initiative.

In support of USAID's small and microenterprise program, USAID/Egypt began implementing a $35 million Small Enterprise Credit Project in 1996 and an $85 million Small and Emerging Business Project in 1997. Planned results of the Small Enterprise Credit Project included establishing up to 40 small business service units that would manage the delivery of credit, technical assistance, and training to small entrepreneurs. Planned results of the Small and Emerging Business Project included establishing up to 60 small and emerging business service organizations reaching operational break-even during the life of the project. USAID/Egypt's strategic objective team for economic growth had responsibility for the two projects.

Our audit focused on calendar year 2001. Cumulative expenditures as of December 31, 2001, totaled $19 million for the Small Enterprise Credit Project and $6 million for the Small and Emerging Business Project.

Audit Objectives

As a carryover audit from our fiscal year 2001 audit plan, our audit aimed to answer the following two questions:

- Had USAID/Egypt administered small and microenterprise development activities in accordance with applicable USAID guidance?
- Had USAID/Egypt's small and microenterprise development activities progressed towards their intended results?

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

Audit Findings

Had USAID/Egypt administered small and microenterprise development activities in accordance with applicable USAID guidance?

USAID/Egypt administered small and microenterprise development activities in accordance with applicable USAID guidance.

For example, in accordance with Automated Directives System (ADS) Chapter 219, which provides guidance on microenterprise development, the Mission's small and microenterprise development activities reached poor people and women. Mission-supported microfinance institutions also reached full financial sustainability, and they had annual audits of their financial statements. Some specific accomplishments for calendar year 2001 included the following[1]:

- 48 percent of loans were poverty loans[2] (i.e., loans of $300 or less); hence, the Mission's activities were very close to the 50 percent target established for USAID by the Microenterprise for Self-Reliance and International Anti-Corruption Act of 2000. This Act requires that at least 50 percent of microenterprise funding go to the poor or to directly benefit them. USAID uses a proxy indicator to define the poor as individuals who received a poverty loan.

- 43 percent of loans went to women indicating that the Mission's activities were formally and effectively open to women in accordance with ADS 219. The percentage also indicated that the Mission's activities were targeting and reaching women[3].

[1] Appendix I explains the methodology used to validate these accomplishments.
[2] Included in this percentage are 2,960 poverty loans made by the National Bank for Development and the Banque du Caire that we were unable to verify due to an access to records issue caused by Egypt's bank secrecy laws.
[3] Included in this percentage are 1,528 loans made to women by the Banque du Caire that we were unable to verify due to an access to records issue caused by Egypt's bank secrecy laws.

- 140,000 small or microenterprise loans totaling almost 297 million Egyptian pounds ($65 million) were made[4]. These statistics indicated that the Mission's activities had broad outreach as called for by USAID's Microenterprise Development Policy Paper.

- 3 of 3 microfinance institutions with which the Mission had active agreements in 2001 had reached full financial sustainability. Per ADS 219, microfinance institutions are supposed to be committed to achieving full financial sustainability.

- The Mission had ensured that all required financial audits of its small and microenterprise development activities had, in accordance with ADS Chapter 591, been performed.

Below are two photos of borrowers who benefited from USAID/Egypt's small and microenterprise development activities.

Photograph of a borrower (left), who mixed and sold car paints, and the loan extension officer (right), who arranged for the borrower's loan. (Cairo, Egypt, August 27, 2002)

[4] Includes loans of 43 million Egyptian pounds made by the National Bank for Development and the Banque du Caire that we were unable to verify due to an access to records issue caused by Egypt's bank secrecy laws.

Photograph of a borrower, who operated a juice shop.
(Alexandria, Egypt, September 3, 2002)

Had USAID/Egypt's small and microenterprise development activities progressed towards their intended results?

USAID/Egypt's small and microenterprise development activities had mixed results for calendar year 2001, and the Mission underreported poverty lending results in its 2002 Annual Report[5] and results for two banking institutions could not be verified.

As illustrated in the below chart, USAID/Egypt's small and microenterprise activities surpassed their target for the number of poverty loans made during 2001 by more than 90 percent, but fell short of their target for the value of loans disbursed by 15 percent.

Comparison of Actual Accomplishments to Planned Targets

Performance Indicator	2001 Target	2001 Actual	Difference	Percentage Difference
Number of loans at poverty level (under $300)	35,000	67,402[6]	32,402	+93%
Value of small and microenterprise loans disbursed in Egyptian pounds (in millions)[7]	350	297[8]	53	-15%

Mission officials said that the number of poverty loans greatly surpassed their expectations because several branch lending offices began group/poverty lending programs during 2001, and the scale of their lending was much greater than the Mission had anticipated.

In regards to the value of loans disbursed, Mission officials said that their target for 2001 was primarily not met due to a change in the lending policies of the National Bank for Development. The officials explained that the bank reduced the amount of a microenterprise loan from LE[9] 10,000 to LE 3,000, which in turn caused the annual volume of the bank's loans to decrease from LE 70 million to LE 25 million—a LE 45 million decrease.

[5] The 2002 Annual Report discussed results achieved during fiscal year 2001. USAID refers to these reports according the year submitted, not the year of the reported results.
[6] Includes 2,960 poverty loans made by the National Bank for Development and the Banque du Caire that we were unable to verify due to Egypt's bank secrecy laws.
[7] For conversion purposes, one U.S. dollar equaled 4.6 Egyptian pounds on December 31, 2001.
[8] Includes 43 million in loans made by the National Bank for Development and the Banque du Caire that we were unable to verify due to Egypt's bank secrecy laws.
[9] Egyptian Pounds.

Based on the results achieved during 2001, activity managers for the Mission's microenterprise development activities adjusted their planned targets for calendar year 2002. For example, they increased the planned number of poverty loans from 40,000 to 70,000 loans and decreased the planned amount of loans disbursed from LE 400 million to LE 360 million.

Based on the Mission's explanations for having either surpassed or missed their 2001 targets and the subsequent revision of its targets for calendar year 2002, we did not have any recommendations for the Mission's small and microenterprise activities. However, the Mission underreported poverty lending results in its 2002 Annual Report, and the results reported by two banking institutions could not be verified. These two issues are discussed below.

USAID/Egypt Underreported Poverty
Lending Results In Its 2002 Annual Report

In its 2002 Annual Report, USAID/Egypt underreported an increase in the number of poverty loans. Mission officials could not locate the worksheet calculations used to estimate the Mission's reported number of poverty loans. Accordingly, we could neither review how the officials calculated the number of poverty loans nor determine why the number of poverty loans were significantly underreported. USAID/Egypt's draft Mission Order titled "Monitoring and Evaluation Policies and Procedures" required strategic objective teams to manage their performance data and to ensure that paper documentation is organized and accessible.

In its 2002 Annual Report, USAID/Egypt said, "Last year alone, the number of poverty loans under $300 more than doubled from 16,000 to 34,000 loans, an increase of almost $10 million in poverty lending." However, the number of poverty loans had more than quadrupled in the year 2001 to 67,402 loans.

The Mission's statement that there had been "an increase of almost $10 million in poverty lending" was also inaccurate. The maximum amount for a poverty loan ($300) multiplied by an 18,000 increase in loans issued from 16,000 loans in calendar year 2000 to 34,000 loans in calendar year 2001 would have equaled $5.4 million in additional total poverty lending.

Comparison of Reported and Actual Results

Indicator	Result Reported	Result Per Audit	Difference
No. of Poverty Loans	34,000	67,402[10]	33,402

[10] Includes 2,960 poverty loans made by the National Bank for Development and the Banque du Caire that we were unable to verify due to Egypt's bank secrecy laws.

USAID/Egypt officials said that at the time they had to provide the Mission's program office with poverty lending results for 2001, they did not yet have specific results for the entire year. Hence, they said that they estimated the number of poverty loans for the last half of the year, but they could not locate the worksheet calculations used to estimate the Mission's reported number of poverty loans. Accordingly, we could neither review how the officials calculated the number of poverty loans nor determine why the number of poverty loans were significantly underreported.

USAID/Egypt's draft Mission Order titled "Monitoring and Evaluation Policies and Procedures" included procedures requiring strategic objective teams to manage their performance data and to ensure that paper documentation is organized and accessible. Since the Mission was in the process of adopting procedures requiring strategic objective teams to retain support for performance data, we did not make a recommendation for the Mission to adopt such procedures.

In regards to the statement that there had been an increase of almost $10 million in poverty lending, a Mission official said that the $10 million increase was meant to refer to the amount of poverty lending during 2001. That is, the official said that the total amount of poverty loans (i.e., 34,000) multiplied by $300 (i.e., the maximum amount for a poverty loan) equaled approximately $10 million.

Although the official said that the $10 million was meant to refer to the amount of poverty lending in 2001, because the sentence in question discussed the more than doubling of loans from 2000 to 2001, the statement "an increase of almost $10 million" implied an increase in poverty lending between the years 2000 and 2001, which was not accurate. Mission officials concluded that the reporting error was a mistake and as such, we did not make a recommendation to address it.

Reported Results From Two Banking Institutions Could Not Be Verified

ADS Chapter 203.3.6.6 requires data quality assessments to be performed at least once every three years on results reported for each indicator included in the Mission's Results Report and Resource Request Report[11]. Contrary to the above ADS requirement, USAID/Egypt officials had reported poverty lending results from two banks, whose data quality the Mission could not assess due to Egypt's bank secrecy laws. As a result, poverty lending information included in the 2002 Annual Report may not have been sufficiently complete or accurate.

ADS Chapter 203.3.6.6 titled "Assessing the Quality of Performance Data" says that for each indicator reported in the Results Report and Resource Request Report, data quality must be reassessed as needed, but no less than once every three years. The chapter adds that data quality assessments include verifying and

[11] The Results Report and Resource Request or R4 Report was replaced in fiscal year 2001 by an "Annual Report".

validating performance information and reviewing data collection, maintenance, and processing procedures. Further, it says that the assessments are intended to ensure that performance information is sufficiently complete, accurate, and consistent.

Complimenting the above ADS requirement, USAID's fiscal year 2002 Annual Report Guidance dated December 3, 2001 said the following:

> All indicators reported in the Annual Report *must* have had a data quality assessment done within the past three years, as described in ADS 203. Moreover, if no data quality assessment has been done on a particular indicator then Operating Units ***must not*** report it.

Contrary to the above ADS and Annual Report requirements, Mission officials had not performed a data quality assessment of small and microenterprise lending results reported by the National Bank for Development and the Banque du Caire. Hence, the Mission had not ensured that reported poverty lending information, which totaled almost 3,000 loans for these two banking institutions, was sufficiently complete and accurate.

Mission officials said that they were unable to perform data quality assessments of the results reported by both the National Bank for Development and the Banque du Caire because Egypt's bank secrecy laws prevented them from having access to source documents, such as loan applications, which they would need to verify reported results.

Because USAID/Egypt could not assess the quality of data reported by the National Bank for Development and the Banque du Caire, the Mission had not ensured that reported poverty lending information for these two banking institutions was sufficiently complete and accurate. Accordingly, we recommend the following:

> **Recommendation No. 1: We recommend that the Director, USAID/Egypt not report in future Annual Reports lending results reported by the National Bank for Development and the Banque du Caire until data quality assessments of their respective results can be performed.**

Management Comments and Our Evaluation

Our draft report contained two recommendations. In response to the report, USAID/Egypt said that it agreed with our audit recommendations and explained the actions it had taken to resolve the recommendations.

In regards to Recommendation No. 1, USAID/Egypt said that it had reached agreements with both Banque du Caire and the National Bank for Development to conduct periodic data quality assessments of their respective reported results to

satisfy the data quality standards specified in ADS 203. The Mission also said (and provided evidence supporting) that Mission staff had visited a sample of borrowers at each bank to verify that loans were being made to actual borrowers. Further, USAID/Egypt said that it had verified the number of poverty loans issued by the Banque du Caire and the National Bank for Development and reported them in its fiscal year 2003 annual report. Based on the Mission's comments and the evidence it submitted, the Mission has assessed the quality of data reported by the Banque du Caire and the National Bank for Development and properly included those results in its fiscal year 2003 annual report. Accordingly, final action has been taken on Recommendation No. 1.

In regards to Recommendation No. 2, which was included in our draft report, USAID/Egypt said that since the Mission will conduct data quality assessments of all the results reported by the participating small and micro enterprise institutions, including the Banque du Caire and the National Bank for Development, it believed that its performance monitoring plans should remain unchanged. Based on the Mission's comments and its agreements with the Banque du Caire and the National Bank for Development, which allow it to perform data quality assessments, there is no longer a need for the Mission to revise its performance monitoring plans to state that data quality assessment can not be performed of these banks' results. Accordingly, we have revised our report and removed Recommendation No. 2.

Scope and Methodology

Scope

We performed our audit in accordance with generally accepted government auditing standards and assessed USAID/Egypt's compliance with Automated Directives System Chapter 219 titled "Microenterprise Development" and USAID's Microenterprise Development Policy Paper. The audit also assessed whether USAID/Egypt's small and microenterprise development activities had progressed towards their intended results for calendar year 2001.

We performed our fieldwork at USAID/Egypt's office in Cairo, Egypt and at six microfinance foundations located in Alexandria, Assiut, Cairo, Dakahlia, Port Said, and Sharkeya, Egypt. Fieldwork was performed from May 8 to June 16, 2002, and from August 25 to October 28, 2002.

The audit scope included:

- Controls over the issuance of loans made by two microfinance organizations;
- A universe of 140,357 small or microenterprise loans totaling $65 million in disbursements made during calendar year 2001, but we could not audit 17,058 of these loans due to Egypt's bank secrecy laws. These laws prevented us from having access to borrowers' loan applications and reduced the number of loans in our universe to 123,299 and $55 million in disbursements;
- Testing 83 loans with disbursements totaling $135,108;
- Supporting documentation for 83 small or microenterprise loans;
- Interviews with 83 borrowers; and
- Three cooperative agreements and one financing agreement that were being implemented in calendar year 2001.

We communicated an insignificant, non-compliance issue with a control procedure for microenterprise reporting to Mission officials during our exit conference on October 28, 2002. The control procedure is described in Automated Directives System Chapter 291.3.6.

Methodology

To determine the accuracy of USAID/Egypt's database of 123,299 loans, we chose a 90 percent confidence level and assumed an error rate of 5 percent. We then randomly selected 83 loans to test. To assist us with our testing, we hired an Independent Public Accounting firm.

Our tests included reviewing 83 loan applications to determine whether they had been signed by the borrower and a loan officer and approved by someone other than the loan officer. Our tests also compared information listed on the borrower's loan application, such as the borrower's name, gender, and loan amount, to that which was

recorded in the microfinance organization's loan database. Further, we interviewed the 83 borrowers in our sample to determine whether (a) the amount of their loan matched the amount recorded in the microfinance organization's loan database, (b) they used their loan for a valid purpose, and (c) they had 15 or fewer employees, which would qualify them for a small or microenterprise business loan.

Our tests revealed that 3 of the 83 sampled loans (3.6 percent) were invalid because the borrower either had more than 15 employees or had used the loan for an invalid purpose (e.g., raising livestock). Given that the error rate in our statistical sample was less than five percent, we concluded with a 90 percent confidence level that the error rate in the database of 123,299 loans was also less than five percent.

Since this error rate fell below our five percent materiality level, we also concluded that we could generate reliable small and microenterprise lending statistics from the loan database. We then compared these statistics to USAID/Egypt's planned targets for 2001 to determine whether its small and microenterprise development activities had progressed towards their intended 2001 targets. If a planned target was missed by more or less than 10 percent, we interviewed Mission officials to determine the cause. We also used the statistics to determine the extent to which USAID/Egypt's small and microenterprise activities were benefiting women and the poor.

Management Comments

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

MEMORANDUM

To: David Pritchard, A/RIG/Cairo

From: Anne Aarnes, D/DIR //Signed//

Date: January 30, 2003

Subject: Recommendation Closure Request - Audit of USAID/Egypt's Small and Microenterprise Development Activities (Report No. 6-263-03-XXX-P)

Attached please find a copy of the subject report dated December 17, 2002, (Attachment A).

The report contains two recommendations for USAID/Egypt (1) that the Director, USAID Egypt not report in future Annual Reports lending results reported by the National Bank for Development and Banque du Caire until data quality assessments of their respective results can be performed; and (2) that the Director, USAID/Egypt, revise the performance monitoring plans for the indicators "number of loans at poverty level" and "value of small and microenterprise loans disbursed" to disclose that data quality assessments for results reported by the National Bank for Development and the Banque du Caire could not be performed due to bank secrecy laws in Egypt.

The Mission agreed with the RIG/Cairo recommendations and explained the actions taken or planned to be taken to resolve the audit recommendations. Following is the Mission final response to the recommendations:

USAID Office Building
Plot 1A off El-Laselki Road
New Maadi, Cairo - Egypt
Postal Code: 11435

Tel: (202) 522 7000
Fax: (202) 516 4628
(202) 516 4659

Recommendation No. 1: We recommend that the Director, USAID/Egypt not report in future Annual Reports lending results reported by the National Bank for Development and the Banque du Caire until data quality assessments of their respective results can be performed.

The Mission reached agreements with both Banque Du Caire (BDC) and the National Bank for Development (NBD) to conduct periodic data quality assessment of their respective reported results to satisfy the data quality standards specified in ADS 203. As required, the periodic data quality assessment will be conducted and documented in accordance with the cited ADS guidance, and will specifically address the validity, integrity, precision, reliability and timeliness of the reported results of the two banks.

With regard to FY 2003 annual report, the Mission reported the number of "Loans at Poverty Level" issued by the participating institutions in the optional indicator table. The numbers reported included the poverty loans issued by BDC and NBD during FY 2002. The Mission's staff verified these numbers in accordance with ADS 203 guidance. Following are the specific actions taken by the Mission in this regard:

Banque du Caire (BDC)

- We are providing a copy of the guarantee agreement signed between BDC and the Credit Guarantee Corporation (CGC) dated June 6, 2002 (Attachment B). Section 5, Article 4, and Section 6, Article 5, authorize CGC to conduct data quality assessments of BDC SME activities supported by USAID.

- The loan-tracking system installed in BDC is the same loan-tracking system installed in the six foundations for which the internal audit conducted full data quality assessments. The system was installed and is being maintained by the USAID technical assistance team. The reports generated by this database software fulfill all required USAID reporting requirements. These reports are submitted to CGC and USAID on a quarterly basis. Separately, the technical assistance team reports directly to USAID on BDC progress towards achieving the planned results. The primary source of reports generated and submitted to USAID by BDC and the TA contractor is the USAID SME loan-tracking system operating in the bank. This arrangement is adequate for USAID to verify and determine the accuracy of the reported results vis-à-vis the loan-tracking system. (a full set of a monthly report by BDC is provided as Attachment C)

- Despite the bank secrecy laws in Egypt that disallow access to the actual database, Mission staff were able to visit a random sample of borrowers to verify their existence because the borrowers have waived the secrecy provision and have granted access to their files for the purpose of data quality assessment. For the BDC results included in the Mission's 2003 Annual Report, the USAID technical assistance team visited large numbers of reported BDC borrowers as part of the field training carried out in every branch office during the entire year. These visits are documented in the TA quarterly reports submitted to USAID throughout FY 2002. Because of these site visits, it is reasonable to conclude that loans are, indeed, being made to actual borrowers.

National Bank for Development (NBD)

- We are providing the NBD written approval that allows the Mission to conduct periodic data quality assessment of their respective reported results to satisfy the data quality standards included in ADS 203 (Attachment D).

- As with BDC, the bank secrecy laws of Egypt disallow independent inspection of the NBD SME loan database. With regard to the Mission's ability to visit a random sample of borrowers to verify their existence, the data quality assessment will be done according to ADS 203 guidance. Attached please find the monthly reporting of NBD results, as prepared by the bank (Attachment E).

- For the Mission's FY 2003 annual report, please find a site visit report conducted by Mr. Rizkalla Zayat, Mission's Project Officer, that covers a meeting with NBD management, including reporting on visits to 6 NBD SME borrowers (Attachment F).

Based on the above, USAID/Egypt requests the closure of Recommendation No. 1.

Recommendation No. 2: We recommend that the Director, USAID/Egypt, revise the performance monitoring plans for the indicators "number of loans at poverty level" and "value of small and microenterprise loans disbursed" to disclose that data quality assessments for results reported by the National Bank for Development and the Banque du Caire could not be performed due to bank secrecy laws in Egypt.

Since the Mission will conduct data quality assessments, in accordance with ADS 203 guidance, of all the results reported by the participating SME institutions, including BDC and NBD, we believe that the indicators should remain unchanged. However, based on our understanding of Recommendation No. 2, should data quality assessments not be performed in compliance with ADS 203 due to bank secrecy laws in Egypt, the Mission will disclose that data quality assessments for results reported by any of the participating institutions, including BDC and NBD, could not be performed.

Based on the above, USAID/Egypt requests the closure of Recommendation No. 2.