USAID

OFFICE OF INSPECTOR GENERAL

Audit of USAID/Egypt's Recipient Audit Universe

Audit Report No. 6-263-02-002-P

December 26, 2001

U.S. Agency for International Development
Cairo, Egypt

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

RIG/Cairo

December 26, 2001

MEMORANDUM

FOR: **Acting USAID/Egypt Director, Anne Aarnes**

FROM: **RIG/Cairo, Darryl T. Burris**

SUBJECT: **Audit of USAID/Egypt's Recipient Audit Universe (Report No. 6-263-02-002-P)**

This memorandum is our report on the subject audit. In finalizing the report, we considered your comments on the draft report. These comments are summarized on page 8 of the report and in their entirety in Appendix II.

Base on your comments, we consider that final action has been completed on Recommendation No. 1 of the report.

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

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Summary of Results

The Regional Inspector General/Cairo performed this audit to determine whether USAID/Egypt's audit universe is complete and accurate and if required audits were done in a timely manner.

We verified that USAID/Egypt developed an accurate recipient audit universe (page 4). However, the funds disbursed to establish collateral funds for small and micro finance lending activities were not included in the scope of annual audits, except for closeout audits; and one agreement establishing a collateral fund did not include standard audit provisions (page 6). We recommended that the Mission obtain an opinion from the Regional Legal Advisor on whether the Mission's collateral funds are subject to audit and, if so, how frequently and to what extent (page 7). Finally, financial audits contracted by recipients in fiscal years 2000 and 2001 were not submitted within the timeframes specified in USAID's Automated Directives System (ADS) guidance (page 7). However, this condition was due to unusual circumstances and, therefore, does not require corrective action.

Background

Financial audits of contracts and grants are a primary basis for effective management and control of USAID's program expenditures. These audits are designed to provide Agency management reasonable assurance that transactions are properly recorded and accounted for; laws, regulations and provisions of contract or grant agreements are complied with; and USAID-financed funds, property and other assets are safeguarded against unauthorized use or disposition.

In response to congressional concerns, USAID has taken an active role in recent years using audits as a management tool to improve financial accountability of programs. During 1991 and 1992, USAID revised its standard provisions for contracts and grants, requiring annual audits of non-U.S. organizations disbursing USAID funds of $25,000 or more. The threshold was increased to $100,000 in May 1994 and to $300,000 in July 1998.

Furthermore, in April 1992, USAID issued a General Notice defining the role of USAID missions in obtaining audits of contracts, grants and cooperative agreements with non-U.S. organizations. In May 1996, these requirements were incorporated into Chapter 591 of the ADS, which, among other things, requires USAID missions to (1) establish an audit management program; (2) maintain an audit inventory database; and (3) have audits done for non-U.S. grants, contracts and cooperative agreements that meet the audit threshold.

These initiatives help to prevent misuse of development funds and facilitates timely corrective actions by USAID. Lack of adequate audit coverage constitutes a high risk because, without such a control mechanism, financial accountability of program expenditures cannot be reasonably assured.

In March 1995, the Office of Inspector General (OIG) issued Audit Report No. 03-95-009 on USAID's implementation of its 1992 initiative to improve the financial

management of programs. The report concluded that most missions had implemented the general requirements of the financial audit management program and established audit inventory databases. However, complete coverage was impaired as a result of obstacles arising from host government restrictions and local audit firm capabilities.

In March 1998, the OIG issued Audit Report No. 9-000-98-002-F on USAID missions' roles in obtaining audits of contracts, grants and cooperative agreements. The report concluded that 11 of the 14 USAID missions selected agency-wide generally obtained audits of contracts, grants and cooperative agreements as required by ADS chapter 591. However, a significant number of required audits were not completed at 10 of the audited 14 USAID missions.

In May 1999, OIG management decided to verify the accuracy of USAID missions' recipient audit universes agency-wide over a period of three years because the lack of audit coverage was perceived as a high-risk area.

Audit Objective

As part of its fiscal year 2001 audit plan, RIG/Cairo performed this audit to answer the following question:

Is USAID/Egypt's audit universe accurate and were required audits conducted in a timely manner?

The audit scope and methodology is in Appendix I.

Audit Findings

Is USAID/Egypt's audit universe accurate and were required audits conducted in a timely manner?

USAID/Egypt's audit universe was accurate, although some confusion existed about the appropriate audit coverage for collateral funds. Further, fiscal year 2000 and 2001 recipient-contracted audits were not conducted in a timely manner. Details of the audit findings are discussed below.

Identification of the Audit Universe

USAID/Egypt developed an accurate audit universe from its database. The audit universe indicated that as of June 30, 2000, on a cumulative basis within its search criteria,[1] the Mission had disbursed approximately $1.75 billion to 109 U.S. or

[1] USAID/Egypt's search criteria were all commitments with a commitment end date 6/30/97 or more recent but excluding the following: (a) indefinite quantity contracts with accounting firms, (b) U.S. and Foreign National personal services contracts, (c) bank letters of commitment, (d) letters of commitment with suppliers of goods, (e) small purchases, (f) low dollar value disbursements, (g) fully audited disbursements, (h) fixed amount reimbursement agreements, and (i) collateral funds. The value of the exclusions was $1.05 billion.

international organizations, and $706 million to 15 Egyptian organizations.[2] The table below provides a breakdown of these disbursements by type of agreement and by number and type of recipient:

	U.S.& International		Egyptian		Total	
Type of Agreement	Disbursements and No. of Recipients		Disbursements and No. of Recipients		Disbursements and No. of Recipients[3]	
Contracts	$1,511,535,222	79	-	-	$1,511,535,222	79
Grants	156,027,338	18	$683,900,190	12[4]	839,927,528	30
Cooperative Agreements	79,579,627	12	22,330,873	3	101,910,500	15
Totals[5]	$1,747,142,187	109	$706,231,063	15	$2,453,373,250	124

Our audit focused on the Mission's development and management of an audit universe for the entities that fall within the Mission's responsibility. The audit universe for U.S. and international organizations is managed by USAID/Washington. ADS Chapter 591 requires audits on non-U.S. recipient organizations if their USAID-funded expenditures exceed $300,000 during the recipient's fiscal year.

USAID/Egypt builds its annual audit plan by analyzing downloaded Mission Accounting and Control System (MACS) information and past audit coverage of the entities involved to determine whether there are unaudited disbursements exceeding, or projected to exceed, $300,000 by the entity's fiscal year end. Government of Egypt entities generally have a June 30 fiscal year end while non-governmental entities normally have a December 31 fiscal year end.

We considered the Mission's approach for developing its audit universe to be reasonable unless entities or funds were improperly excluded from the analysis or continuing audit requirements existed for an entity more than three years beyond its agreement's commitment end date as might be the case for an endowment.

[2] As discussed further in Appendix I, the disbursements presented in this report have not been audited.

[3] The database may include the same recipient with slightly different name spellings and, as well, recipients might have more than one type of agreement. Therefore, the count of the number of recipients may be slightly inflated.

[4] Includes six cash transfer agreements with Government of Egypt ministries amounting to $641 million. For purposes of this audit we counted these agreements as being with one recipient, i.e., the Government of Egypt, since the cash transfer agreements are audited as a group.

[5] Some of the Mission's agreements are funded using a combination of U.S. dollars and Host Country Owned Local Currency. For purposes of this table, the Host Country Owned Local Currency amounts have been converted to their dollar equivalent and combined with the U.S. dollar funding.

Audit Coverage
for Collateral Funds

For small and micro-finance activities, USAID/Egypt has disbursed funds to some recipients to establish collateral funds. The Mission explained that these collateral funds remain in a recipient's bank account drawing interest backing up overdraft (line of credit) accounts from which the recipient conducts its lending activities. Some agreements allowed the recipient to use the interest earned from the collateral funds for its administrative costs to run the agreed upon program. Other agreements allowed the interest to be added to the collateral fund to make a larger collateral fund. In both cases, the interest was considered to be program income. The Mission does not count collateral funds when assessing whether the $300,000 per year expenditure threshold for audit has been met because the recipients never spend the initial collateral funds given to them.

The Mission does schedule audits of USAID funds provided to these entities for their operating expenses, assuming the $300,000 per year audit threshold is met. Additionally, for close-out audits of these entities, the Mission has included a specific step in financial audit statements of work to assess whether the collateral funds have been used in accordance with the agreement.

After the agreement ends, audit coverage ends although the collateral funds remain with the recipient. Although Mission personnel said that they understood that the collateral funds will continue to be used after the agreement ends for the same purposes as during the agreement period, only one of four agreements that we reviewed had specific provisions to this effect.

OMB Circular A-133 indicates that for certain types of awards, e.g., loan guarantees and endowments, for which the Federal Government imposes continuing compliance requirements, the cumulative balance of federal awards in the hands of a recipient are considered to be award amounts for purposes of assessing whether the dollar threshold for audit is exceeded in a given year. Since the collateral funds given by the Mission are of the nature of either a loan guarantee fund or an endowment fund[6] restricted to specified uses, it would appear that under the OMB criteria collateral funds should be audited each year, at least until the agreement end date or a later date if called for in the agreement.

In 1999, USAID/Egypt and a local for-profit entity, Credit Guarantee Company for Small Scale Enterprises (CGC), entered into a financing agreement to capitalize a Guarantee Facility Trust Fund. USAID's total estimated contribution to this Financing Agreement was $8.4 million. These funds are to be used solely as collateral against CGC's guarantees of loans and/or lines of credit from various sources to support small and emerging businesses in Egypt. Although

[6] USAID's policy Determination (PD) No. 21, dated July 18, 1994, Guidelines: Endowments Financed With Appropriated Funds, states that for purposes of PD 21 an endowment is considered to be the capitalization of a fund, independent from USAID, the objective of which to generate income to maintain activities of a private, non-profit institution that are consistent with proposes of the Agency's authorizing legislation.

management details are still being worked out, the CGC project is planned to ultimately involve about $60 million and approximately 60 sub-recipients. We noted that this collateral fund agreement does not include USAID's standard provisions for audits. A one-time audit is called for, but there is no mention of the audit standards to follow or provisions for quality control by the OIG. Hence, we believe that audit requirements applicable to the Mission's collateral funds remained an area of confusion. Consequently, we make the following recommendation.

> **Recommendation No. 1: We recommend that USAID/Egypt obtain an opinion from the Regional Legal Advisor on whether the Mission's collateral funds are subject to audit and, if so, what the extent and timing of such audits should be.**

Recipient-Contracted Audit Report Timeliness

ADS E591.5.4 requires that recipient-contracted audits be submitted to the cognizant OIG office within nine months of the audited period. We reviewed the timeliness of such audits submitted under the Mission's fiscal year 2000 and 2001 audit plans and found that the audits were not submitted timely. In the case of the fiscal year 2000 plan, 11 of 17 recipients submitted their reports beyond nine months of the audited period. For the fiscal year 2001 audit plan, none of the 8 audits that were due by the end of March had been submitted, although 4 of the 8 were submitted within two months after the required date.

Regarding the fiscal year 2000 audit plan, the Mission did not send out its first audit notification letters to recipients until January 2000. Considering that the audits of the Egyptian government entities (with a June 30 fiscal year end) were due by the end of March 2000, only two months remained for the recipients to contract for the audits and get them submitted on time. For its fiscal year 2001 audit plan, the Mission sent out its initial audit notification letters in December, a month earlier than the previous year. The Mission expects that by next year it should get back to its old timetable which was to send out the audit notification letters in October.

We attribute the delays in sending audit notification letters to the following reasons:

- Fiscal year 2000 was the first year that the Mission had Egyptian government recipients contract for their audits. Previously, these audits had been Mission-contracted. In implementing the first cycle of such audits, the Mission had to do a lot of convincing of the entities to take on this new responsibility. Further, some entities had to learn how to contract for these audits.
- The Mission and RIG/Cairo took considerable time to determine the language to be included in the notification letter.
- Notification letters were held up until RIG/Cairo and the Mission's legal, contracting, and financial management offices made a determination on certain

legal issues regarding the eligibility of certain audit firms to compete for the audit work.

- The Mission did not want to send out current year notification letters until the prior year's audits were complete.

As indicated above, fiscal year 2000 and 2001 recipient-contracted audit delays were due to unusual circumstances, and the Mission expects to be back on schedule in fiscal year 2002. Accordingly, we are not making a recommendation. However, we suggest that if in executing the fiscal year 2002 audit plan the Mission sends out its audit notification letters in October and still finds that the Egyptian government entities are unable to meet their March 30 deadline for submitting their audit reports, then the Mission should consider sending its audit notification letters earlier.

Management Comments and Our Evaluation

USAID/Egypt obtained an opinion from its Regional Legal Advisor on whether the Mission's collateral funds are subject to audit, and the extent and timing of such audits. The Regional Legal Advisor's opinion stated in part that, "funds disbursed under any USAID agreement are subject to audit in accordance with standard USAID audit provisions included in such agreements. …For any USAID/Egypt agreements establishing collateral funds that inadvertently do not contain appropriate audit clauses, such as the Credit Guarantee Company (CGC) Financing Agreement mentioned in the report, the Mission intends to amend such agreements to include standard audit provisions. …The standard provisions require an annual audit of the financial statements of the organization during the oversight and post-oversight periods." The Mission stated it had revised its audit plan accordingly.

Based on the Mission's response and action, Recommendation No. 1 is closed upon report issuance.

Scope and Methodology

Scope

We performed the audit in accordance with generally accepted government auditing standards and assessed whether (1) USAID/Egypt's audit universe was complete and accurate, and (2) required audits were done in a timely manner.

We carried out fieldwork at USAID/Egypt in Cairo from October 30 through December 30, 2000, with some follow up work in April and May 2001. The audit covered approximately $2.45 billion of USAID disbursements to various organizations. The audit scope included:

- Reviewing the Mission's audit management program and related documents.
- Interviewing cognizant Mission officials.
- Reviewing the Mission's automated database of contracts, grants and cooperative agreements and identifying those that require audits.

In addition, we obtained information on (1) total disbursements for all grants, contracts and cooperative agreements as of June 30, 2000; and (2) the number and amount of grants, contracts and cooperative agreements falling below the audit threshold of $300,000.

The audit criteria were principally comprised of Chapter 591 of USAID's Automated Directives System (ADS) and the OIG *Guidelines for Financial Audits Contracted by Foreign Recipients*, revised in July 1998.

Methodology

We reviewed the Mission's audit inventory database to determine if it contained the information needed to monitor and track required audits. We also examined documentation and conducted interviews with cognizant officials to determine whether USAID/Egypt had met its responsibilities established by ADS Chapter 591 and the OIG Guidelines.

To answer our audit objective, we obtained the universe of USAID/Egypt's grants, contracts and cooperative agreements and determined the number and dollar amounts of all agreements with Egyptian organizations subject to audit coverage at June 30, 2000. We obtained the information from USAID/Egypt's contract files and the Mission Accounting and Control System (MACS). We then ascertained whether (1) these agreements were included in the Mission's audit inventory, (2) required audits were completed on time, (3) audit reports were prepared in accordance with USAID guidelines and sent to RIG/Cairo for review, and (4) the agreements contained required audit clauses.

To achieve the audit's objective, we relied on computer-processed data contained in USAID/Egypt's MACS database. We did not establish the reliability of this

data because of time and staff constraints.

Because of the small size of the audit universe within the Mission's management responsibility, we considered even one exception as significant for reporting purposes.

MANAGEMENT COMMENTS

USAID

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT 6 DEC 2001

MEMORANDUM

TO: RIG/A, Darryl T. Burris

FROM: Division Chief, Elizabeth Palmer, FM/FA

SUBJECT: Response to the Audit of USAID/Egypt's Recipient Audit Universe Audit Draft Report No. 6-263-01-00X-P

Following is the Mission's response to Recommendation No. 1.

Recommendation No. 1:

We recommend that USAID/Egypt obtain an opinion from the Regional Legal Advisor on whether the Mission's collateral funds are subject to audit and, if so, what the extent and timing of such audits should be.

The attached legal opinion states that an annual audit of the financial statements of the organization is required during the oversight and post-oversight periods. We have revised our FY '02 audit plan accordingly. During the oversight period, these reports will be sent to RIG/Cairo for review under the provisions of the USAID Recipient Contracted Audit Program. The USAID/Cairo Mission has taken final action, therefore, please close Recommendation No. 1 upon issuance of the final report.

Thank you for your cooperation.

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MEMORANDUM

TO: OD/FM, Homi Jamshed

FROM: LEG, Monica Smith

CC: OD/LEG, Paul Weisenfeld
FM/FA/OD, Elizabeth Palmer
FM/FA, Khaled Farag

DATE: October 31, 2001

RE: Audit of USAID/Egypt's Recipient Audit Universe:
Audit Report No. 6-263-02-00X-P

Recommendation No. 1 in the subject audit report recommends that USAID/Egypt obtain an opinion from the Regional Legal Advisor on whether the Mission's collateral funds are subject to audit and, if so, what the extent and timing of such audits should be.[1] The audit report indicates that there is some disagreement regarding whether such funds are subject to audit. The Legal Office believes that it is well sealed that funds disbursed under any USAID agreement are subject to audit in accordance with standard USAID audit provisions included in such agreements. Audit provisions are routinely included in order to verify that the funds are being used for the purposes set forth in the agreement.

For any USAID/Egypt agreements establishing collateral funds that inadvertently do not contain appropriate audit clauses, such as the Credit Guarantee Company (CGC) Financing Agreement mentioned in the report, the Mission intends to amend such agreements to include standard audit provisions. Such audit provisions will be similar to those used for endowments, since for audit purposes, agreements providing collateral funds as described in the audit report most closely resemble endowments (rather than grants). The standard provisions require an annual audit of the financial statements of the organization during the oversight and post-oversight periods. The scope of work for the annual audit shall include determination of whether the recipient has used its funds in accordance with the agreement, as well as verification of compliance with the conflict of interest policies of the recipient.

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[1]Collateral funds refer to funds granted to a recipient for the purpose of serving as collateral against the recipient's issuance of guarantees of loans or lines of credit from various sources to eligible small and emerging business service units. The collateral funds may be incrementally depleted only upon default of any of such loans.