

THE ARAB REPUBLIC OF EGYPT
INCLUSIVE HOUSING FINANCE PROGRAM

FIDUCIARY SYSTEMS ASSESSMENT

APRIL 9, 2015



1. The assessment¹ indicates that the fiduciary systems for the Program, with the enhancements proposed in the Program Action Plan, will provide reasonable assurance that the funds will be used as intended per the Bank’s PforR policy. Based on the expenditure program, no contracts in excess of the PforR policy exclusion limits have been identified.

2. As shown in Table 5.1, 98 percent of the Program expenditures relate to housing demand subsidies (97 percent for ownership subsidies). Hence, the Fiduciary Assessment has focused primarily on the systems supporting execution of these expenditures.

Table 5.1: Program Expenditures

Country	Systems, Rules, Procedures and Oversight Mechanisms	Expense Item	US\$ million	Percentage
		SHF overhead	16.0	0.8
		SHF studies, plans, and Capacity Building	10.0	0.5
		Housing data and systems	12.0	0.6
		Housing demand programs – ownership	1,926.6	97.2
		Housing demand programs – rental	17.6	0.9
		Total	1,982.2	100

Source: World Bank estimates based on Ministry’s data (2014).

3. The expenditures to be incurred under the PforR Program will form part of the SHF budget. Even though the SHF is a new entity under development, it will be subject to the Government of Egypt’s Public Financial Management (PFM) arrangements, which have been analysed through various analytical pieces.²

Moreover, country system knowledge has been gathered through the Bank’s provision of technical advisory services in areas of the Government financial controls, public procurement, and external audit. A summary of applicable PFM systems, rules, procedures and oversight mechanisms follows.

4. **Legal framework.** The constitution provides the legal basis for the budget, for appropriating and spending public funds, and for preparing and approving the final accounts of the state budget. The 2014 constitution maintained these provisions and strengthened the independence and transparency of the Central Audit Organization (CAO), the supreme audit institution. A range of laws deal with specific aspects of financial management; in addition, there are specific laws for entities such as economic authorities and special funds. Unifying the PFM legal infrastructure under an integrated law would enable a more consistent and transparent approach. The Bank has recently supported the Government in the review of the draft amendment to the Public Procurement Law, the review of the new draft law of the CAO, and will start working with the Ministry of Finance on budget legislation modernization and harmonization task.

5. **Budget comprehensiveness.** The state budget covers the activities of the central Government, Governorates, and public service authorities. However, a number of special accounts and funds function under separate provisions with limited transparency. They are

¹ This is the complete Fiduciary Systems Assessment.

² ADE. Report on Public Expenditure and Financial Accountability (PEFA), October 2009.

International Monetary Fund (with World Bank contribution). A Roadmap to Advance the Public Financial Management Reform Agenda, January 2012.

World Bank. Country Financial Accountability Assessment (CFAA), April 2008.

World Bank staff reports.

nominally in-budget, as their expenditures are reported within the budget with an equivalent revenue amount, but leaving the remainder of revenues collected unreported.

6. The Government has successfully decreased the aggregate balance of special funds to LE 28 billion in September 2014 down from LE 37 billion in July 2011. This was mainly achieved through measures such as: (i) asking budget entities during budget negotiation stage to use the special funds under their controls to finance portions of their budget expenditures; (ii) issuing a one-off legislation requiring the special funds to transfer 25 percent of their outstanding balances as of June 30, 2012 to the central treasury; and (iii) the annual budget laws for the past two years obliged special funds to transfer a percentage of their annual revenues (20 percent in 2012/2013; 10 percent in 2014/2015) to the central treasury. The Ministry of Finance is currently deliberating on ways to increase the governance and transparency of special funds.

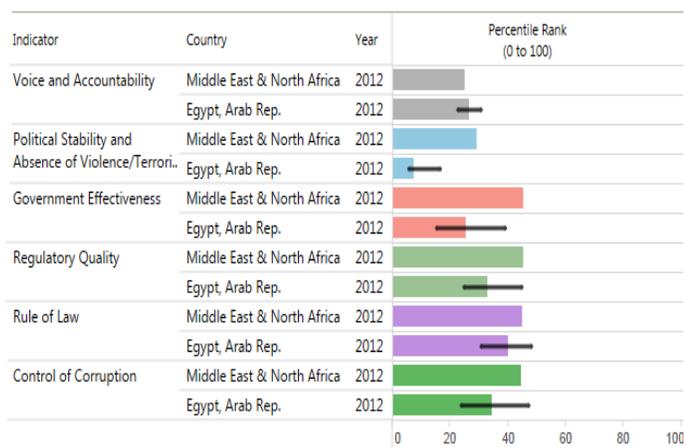
7. **Budget formulation.** The annual budget calendar largely provides for an orderly and timely budget formulation and appropriation process. The establishment of a Macro-Fiscal Unit at the Ministry of Finance has contributed to better budget estimates, but a system of dual budgeting, i.e. the recurrent expenditure chapter managed by the Ministry of Finance and the capital investment chapter managed by Ministry of International Cooperation, persists, with the two ministries collaborating on the overall envelope. In 2012, the Ministry of Finance mandated the preparation of a pre-budget statement to include the general framework for fiscal policy, the estimated aggregates in the draft budget, and the related economic and social priorities. However, the pre-budget statement is not published.

8. **Public procurement.** The Bank has been engaged with the Government on public procurement reform for over two decades. Country Procurement Assessment Reviews (CPARs) identified areas that require attention such as: (i) the need for improvement of procurement practices at the sector and decentralized levels; (ii) although the procurement law and the executive statutes provide important concepts for public procurement and are based on sound principles, they are broad and not always sufficiently clear for consistent application; (iii) there is no independent protest mechanism other than an appeal to the competent authority; and (iv) the need to develop a capacity building strategy and implement it through a systematic training program.

9. The Government, through the Ministry of Administrative Development, implemented a Government procurement portal (<http://etenders.gov.eg>), for mandatory publication of bidding opportunities, bidding documents, bid evaluations and results. While it is considered that this tool will increase transparency and efficiency, stakeholder participation through greater access to information and provide equal opportunities to all in public procurement, enhancing the systems capabilities, such as “e-contract management”, could bring about significant additional benefits.

10. **Governance indicators.** Egypt lags behind Regional neighbors in most dimensions measured by the Worldwide

Figure 5.1: Worldwide Governance Indicators



Source: World Bank (2013).

Governance Indicators (Figure 5.1), including Government effectiveness and control of corruption.

11. The Government has adopted an administrative reform initiative starting from August 2014, aiming to enhance transparency and integrity in public administration.

12. **Budget execution controls.** The ex-ante control system is implemented by Ministry of Finance's financial controllers and includes transaction-based compliance controls over payments (in addition to the line ministries' own due diligence), recording of transactions, and production of accounts at unit level.

13. With technical support from the Bank, the Ministry of Finance recently finalized the Manual of Procedures of the ex-ante Internal Financial Control. The manual has been published and disclosed over the whole financial control network and budget entities (line ministries, agencies, various public institutions). The manual has three objectives: (i) simplifying the control procedures; (ii) standardizing and homogenizing the controls (each procedure is described with one standardized page defining the main components of the control such as laws and regulations to comply with, required documentation, budgetary requirements); and (iii) making the control more predictable by the line ministries. The issuance of the manual will be accompanied by training activities.

14. **Financial inspection** is centralized and is carried out by the Directorate for Financial Inspection in the Accounts and Financial Directorates Department in the Ministry of Finance. Its main activity is to carry out ex-post reviews of compliance by Accounting Units. Inspections can cover all stages of the budget cycle and are normally initiated on the basis of complaints. No risk-based approach is used for formulating the annual work program. A report is submitted to the Head of the Accounts and Financial Directorates Department after each inspection. In addition, an annual report presents all the cases of alleged misuse of funds.

15. There is currently no function in the Ministry of Finance or in the line ministries that carries out independent internal audit. While the financial inspection in Egypt carries out ex-post reviews, it does not perform systematic, risk-based audits of the functioning of the internal control system.

16. **Government Financial Management Information System (GFMIS).** Accounting units across the central Government use the GFMIS to record budget allocations and modifications, and to execute the budget through general ledger transactions. However, the budget execution process chain remains largely manual. A decision was made recently to postpone using the cash management and commitments modules in accounting units. The modules for purchasing, accounts receivables and accounts payables are available but not yet activated. The Government would benefit from articulating a clear direction for the future rollout of the GFMIS and reassessing the underlying business processes.

17. **Cash management and controls.** The Ministry of Finance exercises monitoring of the actual cash transactions and balances of the accounting units included in the state budget through the longstanding arrangements with the Central Bank of Egypt (CBE). The introduction of the treasury single account (TSA) law and the closing of many special accounts and funds in commercial banks further enhanced Ministry of Finance ability and reduced financing costs. However, the TSA implementation was not completed. As stated earlier, many special accounts and funds remain with separate payment and cash management processes. Ministry of Finance still relies on manual cash planning arrangements focusing mainly on revenue forecasting.

18. **Accounting and financial reporting.** Accounting is cash-based for the state budget; hence, no complete information on accounts receivable (e.g. advances) and accounts payable (including expenditure arrears) is available. The published final accounts of 2012/2013 showed only an economic classification of expenses, which is closely aligned to the international standard, and broken down by administrative category (administrative body, Governorates and service authorities). Conversely, the 2014/2015 budget presented a functional classification together with the economic classification -- except for expenditures that are presented as single line item.

19. Monthly budget execution reports detailing expenditures and revenues are produced by budget entities and submitted to the Ministry of Finance's Final Accounts sector within a maximum of ten days after each month-end. They include actual and budget amounts, but not commitments. Annual final accounts are produced and audited within six months after fiscal year-end.³The latest Final Accounts law of 2012/2013 was issued on November 28, 2013. No discussion and analysis accompanies the annual accounts.

20. **Budget transparency.** The enacted budget, in-year budget reports, and year-end budget reports are made public. The production of the citizen budget was discontinued in the last few years, but is expected to be resumed soon. The 2014 Constitution requires making public the annual audit reports by the CAO.

21. **External audit.** The CAO has a comprehensive scope of coverage and is known to issue its report on the annual accounts on a timely basis.

22. The CAO authorities have recently showed willingness to reform, supported by the provisions of the 2014 Constitution which, among others, introduces elements to strengthen its independence and transparency. Its reports will need to be submitted to Parliament, the President of the Republic, and for public opinion. The Bank is providing technical support to expose the CAO to international good practices through this transitional phase.

Capacity and Performance of the Program Implementing Agencies

23. The fiduciary assessment is focused on the arrangements for development of the SHF, a new entity that will implement the Government's social housing program, including the Bank-supported Inclusive Housing Finance Program.

24. **The Social Housing Fund.** The SHF is a legal entity under the tutelage of the Ministry, created by the recent Social Housing Law. It has a dedicated budget, sources of revenues, bank account, accounting and internal control system. The SHF may finance, manage and build social housing units, and provide the services necessary for these units. These "supply side" activities will not form part of the PforR expenditure program.

25. The SHF will be managed by an Executive Director and will have its own Finance Department. The staffing process for senior SHF positions, and the assessment of the administrative units within the Ministry that will be consolidated within the SHF has already started.

26. The SHF Board, which is chaired by the Minister of Housing and includes representatives of the Ministry of Finance and Ministry of Planning, will approve the SHF budget as well as its

³ Final accounts of each accounting unit are sent to the Ministry of Finance's Final Accounts sector by end of July. The Central Audit Organization (CAO) completes its audit by end of August. During the month of September, adjustments are discussed and agreed between the accounting entities and the CAO. By the end of October, the Final Accounts sector consolidates the state final accounts report to be presented to the legislative body, the CAO and the Ministry of Planning. The CAO prepares its annual audit report by the end of November and presents it to the legislative body before the end of December of each year.

annual accounts. The Board can establish committees for specific areas such as auditing or finance.

27. The SHF's budget will be attached to the State budget. Unused budget resources will be carried forward to the next fiscal year. The SHF's banking accounts will be held at the Central Bank.

28. The SHF will establish reporting mechanisms for each program it manages or oversees, in addition to the SHF's reporting on its own operating expenses. An analytical cost system will be implemented. No financing across programs will be allowed, except by a decision of the Board stating the amount and purpose of such cross financing. SHF accounts are subject to audit by the CAO and oversight by the Ministry of Finance, which appoints a Financial Controller. The SHF Board can also appoint independent auditors.

29. **Sub-programs.** The PforR-supported expenditure Program will consist of:

- *Mortgage-linked ownership subsidies* to targeted beneficiaries, i.e. the Affordable Mortgage Program.
- *Rental subsidies* to tenants and to investors who would commit themselves to rent out their units to targeted households.
- *Related operating costs*, such as beneficiary targeting and tracking; data collection, database management, and analysis; M&E.

30. The mortgage-linked ownership subsidy program has two components: (i) a mortgage loan payment subsidy (buy down); and (ii) for the lowest income groups, a down payment subsidy as well. The program is intended to enable first-time homebuyers who are low-income borrowers to qualify for market interest rate mortgage loans. An eligible beneficiary can benefit from a buy down subsidy or a combination of a buy down subsidy and an up-front (down payment) subsidy, based on the level of household income. The program is executed in line with the Affordable Mortgage Finance Procedure Manual.

31. For the buy-down subsidy, the AMP pays the mortgage lender the difference between the monthly loan payments affordable to the borrower, and the monthly payments of a market loan. The AMP payments to the lender decrease over a number of years as the borrower payment increases according to the program rules. The total amount of subsidy received is determined by the AMP according to the income of the borrower. The down payment subsidy is limited to the lowest borrower income groups, is set according to AMP rules, and is in addition to the down payment provided by the borrower.

32. The lenders employ their own underwriting criteria in determining the borrower's loan approval or declination. The AMP verifies beneficiaries' compliance with the eligibility criteria. To verify applicants' information and eligibility, the AMP utilizes the services from a specialized company that conducts background checks on applicants' data and income. The AMP also counts on the banks credit I-score reviews to verify applicants' credit performance and worthiness.

33. The amount of the buy down payment subsidy (on a present value basis), along with any down payment subsidy provided to the borrower, is paid upfront to the lender through an escrow account open for the length of the buy down period. Every month, simultaneously with receipt by the lender of the borrower's share of the loan payment, the scheduled subsidy escrow account amount is applied to the total monthly principal and interest due. No escrow funds can be disbursed by lenders without receipt of the borrowers' share of the monthly payment.

34. Any unused subsidy funds that remain in the borrower payment escrow account must be remitted to the AMP if the loan is paid off before those funds have been applied. Additionally, the borrower is liable for a pro rata return of the mortgage down payment subsidy if the loan is paid off before it is 5 years old.

35. To operate the AMP, the GSF/SHF enters into master program participation agreements with lenders acceptable to the GSF/SHF. The master agreements are standard among all mortgage lenders. The authorized lenders must: (i) be a licensed financial institution authorized to provide mortgage loans to consumers; (ii) be in good standing with its regulatory authority, CBE or EFSA; (iii) agree to GSF/SHF monitoring of its program performance; and (iv) agree to GSF/SHF audits of subsidy program compliance (inspection of mortgage loan files, reports, records, books, or accounts).

36. All lenders are required to report monthly the status of all the subsidy loans that the lender is servicing. This includes new originations and existing subsidy loans segregated by current loans, delinquent loans, loans in foreclosure or forced sale status, and any loans that have been paid, retired or otherwise removed from the lenders future servicing reporting.

37. AMP related IT systems and procedures are in place and have been tested to handle a large volume of applicants. The system is set up to generate monitoring reports that include information on household level information (location, gender, income), loan and subsidy level information (size, down payment, interest rate, tenure, product, type and amount of subsidy), and lender information (type of institution, escrow amount).

38. The AMP receives funding from the State budget as well as self-generated revenue, largely from interest on time deposits. Its final accounts for 2012/2013 showed significant savings in "Chapter 4" expenditures (mortgage subsidies), mainly because of delay in completion of housing units. The actual expenditure was only 8 percent of the budget. Significant improvements are expected over the coming years to result from measures to improve supply of housing solutions and an integrated social housing policy with well-coordinated programs.

39. GSF's accounting system makes use of the Government's chart of accounts and related procedures, but not of the GFMIS. The accounting unit is overseen by a Financial Controller from the Ministry of Finance responsible for ex-ante controls. GSF is subject to periodic audits by CAO, but the Bank was informed that annual audit reports are not available.

40. **Procurement.** Given that the financing under the PforR Program will be limited to demand side incentives and operating costs, there will be no major procurement involved. Therefore, country-level procurement capacity limitations are not expected to significantly impact Program implementation.

41. **Fraud and corruption.** The latest amendments of the mortgage finance law in July 2014 introduced stricter rules and penalties on fraud by beneficiaries. These include: (i) restricted use of the subsidized unit to the beneficiary and his/her household; (ii) banned disposition of purchased unit for seven years to discourage speculation; and (iii) imprisonment or financial penalties (LE 50,000 to LE 100,000) for providing fraudulent data in applying to the mortgage subsidy. The GSF receives complaints through its website as well as its Facebook page. Its manual requires handling complaints within 48 hours of receipt. All fraud cases or information that has driven to rejection based on GSF requirements, are required to be compiled in a "black list" that must be checked when a new file is appraised.

Fiduciary Risk Assessment

42. **Country system risks.** While the Egypt's public financial management (PFM) systems have been deemed adequate for budget support operations, the stagnation in some areas of PFM reform is a concern that influences fiduciary risk. The Bank is engaged in dialogue and technical advice with the Government in the areas of financial controls, public procurement, and supreme audit institution development. Furthermore, the Bank and the Ministry of Finance are starting to collaborate towards the modernization of the budget legislation and revamping the PFM reform strategy.

43. **Program-specific risks.** Considering that the institutional structure and systems of the Program implementing entity (SHF), and some of the sub-programs, are still under development, the fiduciary risk is substantial. The fiduciary risk also involves the risk of providing subsidies to ineligible beneficiaries, either due to fraudulent application by beneficiaries, political interference to influence targeting, or errors. To mitigate this risk, the Bank is providing technical support to improve subsidy targeting systems and procedures in the SHF, with a view to ensure that the funds reach the intended beneficiary households. Stricter penalties on beneficiary fraud were introduced by the Government through recent amendments to the Real Estate Finance Law.

44. The Bank is also playing an important role advising the development of institutional governance and systems of the SHF. The positive experience with the operation of the AMP, administered by the GSF, exemplifies the Government's track record with development of monitoring systems for similar programs. The systemic fiduciary risk mitigation issues will be addressed through the Program Action Plan (see next section) and selectively through the DLIs connected to the SHF capacity development and program effectiveness.

Fiduciary Elements of the Program Action Plan (PAP)

45. This section lists key technical and capacity development measures that aim to increase the operational efficiency of the Program, ensure full transparency and proper accountability mechanisms, and mitigate existing fiduciary risks.

46. **Rules and regulations.** The operational and financial management arrangements for the rental subsidy sub-programs should be laid out in regulation and detailed in Procedures Manual, consistent with GSF's Manual when applicable. The Procedures Manual should also regulate the budgeting, cash management, accounting, financial reporting and audit arrangements applicable to the SHF. These arrangements should be consistent with the general PFM regulatory framework.

47. **Budget system integration.** As a special fund, the SHF will benefit from specific flow-of-fund and record keeping arrangements. However, its programs should be integrated with the State budget, using the national budget classifications and chart of accounts.

48. **Program MIS development and integration.** For the new rental subsidy sub-programs, beneficiary enrollment, monitoring, and payment databases should be integrated in the program's management information system (MIS). Building upon the GSF system, a unified social housing beneficiary database with cross-checks to other pertinent databases should be developed. The payment database should be linked to the program accounting system.

49. **Internal audit.** The internal audit function should be established in the SHF, reporting to the Board through the Audit Committee, to contribute a systematic and disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes of

the SHF. As opposed to the transaction-level reviews performed by financial controllers, the internal audit function would focus on:

- Measuring the inherent and residual risks associated with improper benefit payments, and planning its audit work program accordingly.
- Using analytical procedures, information system audit and assurance standards, and data mining tools – for which due access to the MIS databases for audit purposes should be secured.
- Undertaking spot checks and field visits regularly to validate continued relevance of internal controls, including the quality of the complaints mechanism.
- Following up on the timely implementation of audit recommendations.

50. **Financial reporting.** The SHF and its sub-programs should be subject to periodic and timely reporting on budget execution, using the GFMIS or an accounting system that can seamlessly feed information into the GFMIS. Additional financial information should include the geographical distribution of benefits and the correlation of benefits paid to income level of beneficiaries. The financial reports should be publicly available through the SHF websites.

51. The Bank will work with the SHF to develop an Integrated Reporting pilot. This will present a pioneer opportunity in the MNA Region to bring different elements (financial, nonfinancial, governance, environment and social) together, under an incremental capacity development approach that will lead to the issuance of reports around year three of implementation.

52. **External audit.** Program financial statements would be audited by an independent audit firm, with terms of reference that will also include verification of some of the DLIs. The results from these audits should be made public as per the provisions of the financing agreement.

53. **Complaints and grievances mechanisms.** The SHF needs to develop the mechanisms for handling complaints and grievances by June 30, 2016⁴. Program beneficiaries or third-parties should be able to lodge complaints through easy-to-access channels. Each complaint or grievance should be recorded and addressed to the appropriate level for action, with feedback given to the complainant on the action taken applying service standards. Special procedures should be in place for the proper handling of complaints relating to allegations of fraud and corruption.

⁴ As specified in the Program Action Plan (Annex 8 of the PAD).