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Report to Sen. Daniel K. Inouye, Chairman, Senate Committee on Appropriations: Foreign Operations Subcommittee; by Elmer B. Staats, Comptroller General.

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The University Educational Endowment Fund of the American University in Cairo, Egypt, was established in 1976 by the Agency for International Development (AID) with a local currency grant equivalent to $36 million. The Endowment Fund was intended to earn income to support the University by investing in Egyptian enterprises and business ventures. An audit by AID in July 1976 revealed serious management, financial, and operational deficiencies in the Fund's administration and questioned whether such investment was feasible given the uncertain economic climate in Egypt. Findings/Conclusions: U.S. officials in Egypt strongly support continued financial assistance for the American University in Cairo and believe that the University contributes greatly to United States-Egypt relations. Although AID's severe criticisms of the Endowment Fund administration were valid, circumstances in Egypt appear to have changed since the Fund's original investments were made, and the investment climate is greatly improved. Many of the managerial and administrative shortcomings have been corrected or improved. To be successful, the Fund needs good investment criteria and adequate supervision by the University's Board of Trustees. It also needs to gear investment goals toward income-producing investments which will provide needed cash revenues. Alternative considerations involve liquidation of the fund, replenishment of the fund, and a long-term loan. Recommendations: The Administrator of AID should consider the alternatives, especially a loan and, in consultation with appropriate congressional committees, implement a strategy for financial assistance that will satisfy the long-term needs of the University at an acceptable level of cost and risk to the U.S. Government. He should also: see that the University's Board of Trustees adopts and uses investment criteria for potential

Fund investments, see that the Board of Trustees has established an adequate system for supervising the activities of the Fund managers, and monitor Fund operations through periodic audits and reviews. (RRS)

5504

REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

The American University In Cairo: Alternatives For U.S. Government Support

An Endowment Fund which was granted $36 million in U.S.-owned Egyptian pounds to support the American University in Cairo has been unsuccessful because of political and economic conditions in Egypt and because of poor investment management in the past.

The University is a private, nonprofit institution seeking to demonstrate American educational ideas and practices in Egypt. Embassy officials believe the University contributes greatly to United States-Egypt relations.

GAO concludes that conditions in Egypt may have improved sufficiently for the Fund to succeed now and that the management deficiencies have largely been corrected. GAO is presenting several funding alternatives and recommending further management improvements which will strengthen investment decisionmaking and oversight.

This report was requested by the Subcommittee on Foreign Operations, Senate Committee on Appropriations.

ID-78-20

FEBRUARY 17, 1978

B-156766

The Honorable Daniel K. Inouye, Chairman
Subcommittee on Foreign Operations
Committee on Appropriations
United States Senate

Dear Mr. Chairman:

As requested in your letter of October 13, 1977, we have reviewed the operations of the American University in Cairo, Egypt, with particular emphasis on the University Educational Endowment Fund.

The Endowment Fund was established in 1969, with a local currency grant equivalent to $36 million, to earn income to support the University by investing in Egyptian enterprises and business ventures. It has been under extensive investigation since an audit by the Agency for International Development in July 1976 turned up serious management, financial, and operational deficiencies. The audit criticized the Fund's management and questioned whether such investment was feasible given the uncertain economic climate in Egypt.

We reviewed the charges in the audit and examined the corrective actions taken by the University and the prospects for a successful investment program in Egypt. We believe the University Board of Trustees and Fund managers have corrected most of the problems cited, and they now appear to be properly managing and supervising the Fund's current investments. Investment prospects in Egypt are improving, and specific project proposals are available.

Embassy and Agency for International Development officials in Egypt strongly support the University and believe continued U.S. Government support is essential. We believe that reactivation of the Endowment Fund is the best means of providing the financial support.

Appendix I discusses several alternative approaches and contains recommendations for reinstating the Fund and strengthening its investment decisionmaking and supervision by the Board of Trustees. We are also recommending that the Congress require annual reports by the Agency for International Development on the status of the Fund.

We did not obtain formal written comments from the Agency on this report, but as arranged with your office we discussed our findings and recommendations with Agency officials. They generally agreed with our findings and will seriously consider the alternatives we are presenting.

As agreed with your office, we are sending copies of this report to the Subcommittee on Europe and the Middle East, House Committee on International Relations. Copies will also be available to other interested parties who request them.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

THE AMERICAN UNIVERSITY IN CAIRO:

ALTERNATIVES FOR U.S. GOVERNMENT SUPPORT

BACKGROUND

The American University in Cairo is a private, non-sectarian institution founded in 1919 and incorporated in the District of Columbia. The University opened in the fall of 1920 with 142 students enrolled in two courses of study. One program was taught in Arabic and led to a secondary education certificate; the other was taught in English and led to a junior college certificate. Courses at the upper university level were first offered in 1925 and the first bachelor degree was awarded in 1928. Both secondary and university level courses were offered until 1952, when the secondary program was discontinued. In 1956, the Graduate Faculty was formed and the University now offers bachelor's and master's degrees in all its academic departments. It is the only independent degree-granting institution of higher education in Egypt, and since 1928 has awarded nearly 3,500 degrees. These degrees are authorized by the District of Columbia Board of Higher Education and, under the provisions of a 1976 agreement with the Government of Egypt, are equivalent to degrees granted by the Egyptian national universities.

The University has a full-time enrollment of about 1,500 undergraduate, graduate, and English-language students. About 80 percent are from Egypt, 6 percent from the United States, and the rest from nearly 50 countries throughout Africa and the Middle East, Europe, and North America. About 7,000 additional students were enrolled during 1976 in the Division of Public Service, an adult education program. Students are enrolled in 20 degree programs in 5 academic departments.

--English and Comparative Literature,

--Economics and Political Science,

--Engineering and Physical Sciences,

--Arabic Studies,

--Sociology, Anthropology, and Psychology

The University also has an English Language Institute, a Management Program, an Audio-Visual Resources Center, a Computer Center, a Solid State and Materials Research Center, a Social Research Center, and a Management Extension Service.

In December 1977, there were 152 full-time faculty members; 81 (or about 53 percent) were Egyptian, 56 (or 37 percent) were Americans. Of the 105 faculty members with Ph. D.s, 72 of them received their degrees from American universities.

For the 1976-77 school year, University expenses totaled about $6.2 million--$2 million in dollars and $4.2 million in Egyptian currency.

U.S. Government support

The Agency for International Development (AID) supports the University through the American Schools and Hospitals Abroad program, authorized by Section 214 of the Foreign Assistance Act of 1961, as amended. The primary purpose of the Section 214 program is to demonstrate American educational and medical ideas, practices, and technology to the people of other countries. The institutions should be well-established showcases and should not be completely financially dependent on the U.S. Government or host governments. AID criteria for determining eligibility for Section 214 support are shown in appendix II along with our brief analysis of the University's compliance. We did not specifically review the curriculum or academic activities of the American University in Cairo, but it was clear to us that U.S. Government support is justified and falls within the intent of Section 214.

AID's financial assistance to the University began in fiscal year 1960, about the time a program was begun to increase and improve the physical plant and academic programs. Since then, the University has received grants totaling about $15.2 million, including the equivalent of $4.5 million in U.S.-owned Egyptian pounds (LE), for operating expenses and construction of a new library. In 1969, additional Egyptian pound support was provided in the form of an Endowment Fund.

The American Ambassador and AID Mission Director in Egypt strongly support the University and believe U.S. financial assistance is warranted by the special role the University plays in American-Egyptian relations. The Ambassador on several occasions has pointed out the value of the University as a high-quality representation of U.S. culture. The Director of the U.S. Information Service in Cairo told us that the Service's entire program in Egypt would have to be reassessed if the University were not operating. The University now does many of the same things the U.S. Information Service must do in other countries.

Embassy and University officials point out two main factors which illustrate the special regard the Egyptian Government has for the University. First, the University was virtually the only American presence in Egypt during the break in diplomatic relations from 1967 to 1973. It not only continued operations during this time but actually prospered and expanded. Second, the Government of Egypt agreed to a Protocol with the University in 1976 which assured its continued existence, granted it special tax exemptions, and recognized its degrees as equivalent to those of the Egyptian national universities. Children of Egyptian Government ministers have been students at the University, many ministers have taught there at least part-time, and numerous ongoing University cooperative programs involve the Egyptian ministries.

Endowment Fund

In June 1969, AID gave the University a grant of 25 million Egyptian pounds to use as an Endowment Fund. The Fund was to be invested to produce income to offset the University's Egyptian pound operating deficits. At the current exchange rate, the Endowment would be valued at $35.7 million; at the official exchange rate in 1969, it was valued at about $58 million.1/

The idea for the Endowment Fund was first proposed in 1964 by the University administration. AID endorsed the idea and was close to authorizing the grant when

1/ In 1969, the exchange rate was LE .43 = $1; in December 1977, it was LE .70 = $1. The endowment is sometimes referred to as equivalent to $45 million; this is an exchange rate of LE .56 = $1, the 1967 Egypt-Israeli war broke out. After the war, AID, the State Department, and congressional committees approved the idea and the grant was made in June 1969 using U.S.-owned Egyptian currency. The reasons for believing the Fund could succeed in earning income at that time are not clear from the available records, but the University was unable to set up a mechanism for investing until 1974 and no actual investments were made until December 1974. From then until December 1977, about LE 5.6 million ($8 million) was invested. With AID approval, the rest was used to pay University operating expenses and put into bank accounts. In fiscal year 1975, the Fund was given an additional LE 1,250,100 to replenish amounts used for University operations. Total value and uses of the Fund are shown below.

Status of Endowment Fund
as of December 1977

	Egyptian pounds	U.S. dollar equivalent (note a)
	-------(millions)------	
Original endowment grant, 1969	25.0	$35.7
Replenishment, 1975	1.2	1.7
Total available	26.2	$37.4
Amount invested	5.6	$ 8.0
Amount spent on operating expenses	12.5	$17.9
Amount remaining on deposit	8.1	$11.6

a/ Computed at current exchange rate of $1 equals LE .70.

The University Board of Trustees administers the University and oversees the operation of the Endowment Fund. The Board currently has about 25 members from business, education, and government, who serve voluntarily with no remuneration. It meets twice in New York and once in Cairo each year. (See app. III for list of current Board members.)

To manage the investment program, the Board established a form of limited partnership under Egyptian law. The management office was called the University Educational Endowment Fund and was set up in April 1974 to make Egyptian currency investments. The partners in this Fund were two trustees and a vice-president of the University and a former University business manager. The University itself was a silent partner which paid dollar expenses and provided administrative support. In early 1976, the University was removed as a silent partner and replaced with two corporations, one set up in Bermuda and one in Liechtenstein, to handle foreign currency transactions and shelter the University from American taxes. AID's legal counsel found this arrangement acceptable, and it appears to be a corporate structure frequently used in international business. AID officials informed the Fund that these offshore corporations, while legal, could be embarrassing, but Fund officials believe they are the best means for isolating the University from financial liability and for maximizing Fund income available for transfer to the University.

AID AUDIT REPORT AND OUR OBSERVATIONS

In July 1976, AID auditors issued a report seriously criticizing the operations of the Fund. AID immediately "froze" the Fund and has permitted no new investments since then. The Fund has been under more or less constant investigation since July 1976. The four major criticisms were that:

--All five of the original investments had questionable aspects which indicated a lack of investment expertise.

--The managerial and administrative practices were seriously deficient.

--An unreceipted cash transaction in the purchase of real estate left over $1 million in Egyptian pounds unaccounted for.

--The Fund had little chance of making a profit and the entire concept of an Endowment Fund should be reconsidered.

We examined the charges made in the audit report and reviewed the corrective actions taken by the Fund managers and the University Board of Trustees. It appeared to us that most of the problems cited have been recognized and corrected by the Board of Trustees. The Fund is better staffed, organized, and supervised now and should be in a better position to invest successfully.

Original investments

From its inception in 1974 to the 1976 AID audit, the Fund invested a total of about LE 5.6 million, or $8 million, in five firms as shown below.

Company	Loans	Equity	Total
	-------(Egyptian pounds)-------		
Preinvestment services	-0-	-0-	a/50,000
Cadillac Travel and Touristic Services	13,500	34,000	47,500
Cairo Beverages and Industrial Company	900,000	100,000	1,000,000
Kuwait Food Company	430,000	-0-	430,000
Arab Aluminum Company	b/1,022,878	450,000	1,472,878
Cairo Properties S.A.E.	-0-	c/2,491,000	2,491,000
Total	2,366,378	3,075,000	5,491,378

a/ This expenditure was approved by AID in 1972 to enable the University to explore investment possibilities and approach the Government of Egypt.

b/ LE 375,000 of this amount remains on deposit with the Fund and will be paid out as Arab Aluminum needs it.

c/ About LE 1.6 million of this amount is the cost of real estate which will be transferred to Cairo Properties for equity shares. An additional LE 625,000 in equity has been purchased outright. The remainder has been spent by the Fund on behalf of Cairo Properties and will be credited as equity. The Fund has incurred additional expenses totaling at least LE 160,000 and $41,000 on this project, for which it will be reimbursed.

None of these investments could be described as an unqualified success.

--Cadillac Travel never opened for business; the Fund is trying to liquidate its investment now and stands to lose about LE 17,000 on its equity share. Because the loan terms called for repayment 5 years after the business opened, the Fund could have trouble recovering the loan principal and incur a total loss of LE 30,000, or $43,000 at the 1977 conversion rate.

--The Fund loaned LE 900,000 to Cairo Beverages, but the loan agreement only specified repayment of LE 180,000--one-fifth of the amount. Moreover, repayment was to begin in April 1977 but Cairo Beverages requested a rescheduling of the payments because of what it called a typographical error in the original statement.

--Repayment of loans to Kuwait Food Company has been rescheduled from 1977 to 1979 because of a liquidity problem with both the company and its parent corporation.

--Arab Aluminum Company is a high-risk industrial venture. The loan is subordinated to a dollar loan made by an American bank, so if the company runs into trouble it will pay the bank first.

--Land purchased for development by Cairo Properties in 1975 was still vacant in December 1977. The original financing fell through and the Fund still does not have clear title to the land because of a complicated middleman cash transaction. (See p. 10.)

Despite these problems, the Fund has lost money only on the Cadillac Travel investment. This was the first and smallest Fund venture, amounting to less than 1 percent of the total investments.

A new loan agreement has been negotiated with Cairo Beverages providing for full repayment of the principal, increasing the interest rate, and extending the repayment schedule. The Fund also renegotiated the Kuwait Food loan, rescheduling payments and strengthening its position toward the borrower. The loans are earning interest regularly and the rescheduling will extend and increase interest payments to the Fund.

Fears about Arab Aluminum have been largely allayed by its exceptional performance during construction of the plant. Arab Aluminum was the first large-scale industrial project using U.S. and Arab capital to be completed in Egypt since the 1973 war, and it was completed and ready for production 4 months ahead of schedule. Its 1978 production is already sold out.

The Fund has assured itself that it will get full title to the real estate it purchased, perhaps early in 1978. Plans for development are proceeding under the newly devised Cairo Properties financing arrangement. The new partners were assembled during the past year and the Government of Egypt has given approval for the company to begin business. The Fund believes it will have an agreement soon with a major American bank to be prime tenant in an office building Cairo Properties will construct on the land.

<u>Managerial and administrative practices</u>

The 1976 AID audit report cited numerous accounting and management deficiencies, putting much of the blame on a lack of adequate supervision and oversight by the University Board of Trustees. The report stated that:

> "The Fund's accounting records are so incomplete that it is not possible to draw reliable conclusions about current operations or the financial condition of the Fund. * * * Budget date is sketchy. No one knows when the Fund can be expected to break even. * * * Employee travel and hospitality expense accounts are uncontrolled. * * * Arthur Andersen's [CPA firm] 1975 report was replete with observations on poor internal control. Our own observations corroborate what Arthur Andersen reported. * * * For all practical purposes, the Fund is a one-man operation. Only the Fund Manager is fully informed on what the Fund is doing. The other partners are not. Neither is the Board of Trustees nor AID."

The Board of Trustees did not deny these charges. In fact, it replied that the CPA firm audit had alerted it to many of the problems and it was already taking action on them at the time of the AID audit. It appeared to us that the 18-month freeze on Fund investments had given the Board and Fund officials a chance to tighten up accounting and administrative procedures.

The Board made personnel and organizational changes in an attempt to improve bookkeeping methods, fiancial statement preparation, general administration, and Board oversight.

The original Fund staff consisted of a general manager, one Egyptian employee, and a secretary. The general manager resigned in September 1976, the Egyptian employee accepted a position with Arab Aluminum Company, and the secretary left for personal reasons. The staff now consists of a general manager, a financial analyst, a consultant, three secretaries, and a part-time employee. The Fund does not have specific job descriptions, but, basically, the general manager has overall management responsibility and the financial analyst is concerned with administrative matters, training of staff, and all financial recordkeeping.

The secretarial staff undergoes constant on-the-job training; for example, one girl, a graduate of the University, was initially hired only to answer the telephone but she is now maintaining a good percentage of the bookkeeping. The others are increasing their secretarial skills and gaining experience in the Fund's administrative procedures.

Neither the new manager nor the financial analyst had previous experience in operating an endowment fund, especially in the difficult environment of Egypt. Similarly, the original Fund manager had been a speechwriter and an employee of the University before he was hired as manager. The Fund has been criticized for not hiring professional investment specialists. It appears to us, though, that the new officials have gained considerable on-the-job training during the past 2 years. Although no new investments have been made during this time, these officials have been involved in several important projects which have given them valuable experience. For example, they rewrote and renegotiated the loan agreements with Cairo Beverages and Kuwait Food; the mistakes they corrected in those agreements should not occur again after this experience. They also handled the disengagement of one partner in the Cairo Properties deal and arranged an agreement with two new partners. The manager, because of his lack of investment expertise, sees himself as a conduit to the Board of Trustees and does not plan to make investment decisions himself. With adequate involvement by the Board, therefore, good investments should be possible.

It is difficult to evaluate the effectiveness of Board supervision and oversight of the Fund because no new investments have been made since the AID audit. Some actions have been taken that should improve Board involvement, however. The Investment Subcommittee of the Finance Committee was formed just prior to the AID audit; the chairman works in Munich and travels to the Middle East frequently in his work with an investment consulting firm. He keeps in touch with the Fund manager by telex and tries to be aware of all important developments and problems. The Board requires quarterly financial reports from the Fund containing project activity summaries, budget comparisons, and financial statements. It also receives ad hoc reports dealing with specific items, either at its request or at the discretion of the Fund officials. With the installation of a telex machine, the Fund keeps in frequent contact with the New York office of the Board.

Some problems remain, however. The Fund has had no specific investment criteria for identifying and evaluating new investment opportunities. Both the Fund manager and the Investment Subcommittee have been working on criteria, which they have recently submitted to the Board for its March 1978 meeting. Until formal standards are adopted and approved, the Fund and the Board of Trustees will not have a sound, consistent basis for judging the various investment proposals. Furthermore, the Board of Trustees has not been able to test new procedures for reviewing and approving investment proposals. In the past, the Fund manager and the Chairman of the Board of Trustees made the investment decisions, with little Board review or participation. Now a new system is being adopted. In general, proposals are to be identified and studied by the Fund personnel in Cairo. They will report to the Investment Subcommittee chairman, who will review the projects and pass on to the Subcommittee members those that look attractive. Investment proposals are then submitted and approved at the next full Board meeting (about every 4 months). While this system should provide better involvement and oversight, it has not been adequately tested yet because of the freeze on new Fund investments. Moreover, the Board has no procedures for approving a project before a subsequent Board meeting if a decision is needed quickly. It will be considering a proposal on this matter at the next Board meeting, according to a Fund official.

Land transaction

AID approved an investment of LE 2.5 million for the purchase and development of two parcels of land in the Zamalek area of Cairo in late 1975. The first parcel, called Z-1, was the most expensive and the manipulations involved in its purchase account for the most serious charge of the AID audit--that $1.1 million in Egyptian pounds was unaccountd for.

Z-1 was sold to the Fund for LE 913,368 (about $1.6 million at the exchange rate used in the audit). The official sales price, however, was recorded as LE 300,000, and this is the only amount for which the Fund has a receipt. Most of the money was paid in cash and no receipts were used. Several checks were made out to a middleman, a Fund employee who cashed the checks and paid the seller with cash. Title was transferred to the middleman then to the Fund.

Because of the seriousness of the charge and the amount of money involved, the AID Auditor General directed his Office of Inspection and Investigation to review this case. After extensive investigation, that office concluded there was no evidence of criminal intent to defraud the U.S. Government. The cash transaction was clearly unacceptable and, according to witnesses, was intended to allow the seller to escape Egyptian taxes. However, the AID investigation concluded that no U.S. laws were broken and unless the seller did actually falsify his income tax return no Egyptian law was violated either. Cash transactions are apparently common practice in Egypt. If the seller did evade his taxes, the Fund personnel involved could be considered in conspiracy and fined under Egyptian law.

The Fund manager who arranged and approved the transaction and the Egyptian employee who acted as middleman have both resigned from the Fund and been replaced. The Board of Trustees has forbidden such cash transactions to be made in the future. Moreover, because of a change in Egyptian law, the Fund will no longer be able to purchase and own real estate. Any future land development projects will be handled through Cairo Properties. A consultant associated with both the Fund and Cairo Properties told us that he sees no problem in paying for all future land purchases by check.

We did not independently review this case any further, but we believe the Office of Inspection and Investigation review was extensive and its conclusions founded upon testimonial and documentary evidence.

Feasibility of the Endowment Fund concept

By the time of our review in December 1977, the Fund had completed 3 years of operations without showing a profit that could be used to offset the University's operating deficit. The Fund has received income from interest on its loans and bank accounts, but its equity investments have yielded no returns and its administrative and general expenses have offset the interest income. The University has spent more than $500,000 in dollars and Egyptian pounds to help defer the operating costs of the Fund. This performance has led to skepticism about the possibility for a successful endowment fund in a developing country such as Egypt.

While the Fund's financial outcome has been disappointing, we believe its performance must be put in perspective. From 1967 to 1973 the United States had no diplomatic relations with Egypt, war in the Middle East was threatening, and the Government of Egypt had not created incentives for private investment. The Endowment Fund was being depleted for University operations. In 1974, with the reestablishment of diplomatic relations and Egypt's announcement of an open-door investment policy, pressure mounted to begin investing the Endowment Fund. At that time, there were virtually no American banks or companies in Egypt and there had been no private industrial or business sectors for 20 years. Foreign companies were slow to respond because of lingering problems with exchange rates and capital repatriation.

The Fund's revenues were derived from investments of LE 5.6 million--about 20 percent of the full amount of the Endowment. Moreover, two-thirds of the LE 5.6 million was in equity shares of new companies or in real estate held for development. By their nature, these investments would take time to earn profits for the Fund. For example, land purchased in 1975 will take several years to develop and build on before it can make profits. No dividend returns are expected until 1981 at the earliest. Fund officials projected that interest income on the approximately LE 2 million in loans will total about LE 912,000 by the time the loans are repaid--an average return of 8 percent a year. By 1982, moreover, equity investments of approximately LE 3 million are expected to be worth LE 11 million and to be producing sizable dividend income. This equity growth, however, largely depends on the success of Cairo Properties, which is expected to account for LE 9.6 million of the LE 11 million.

CAN THE FUND SUCCEED?

The University Trustees and the Fund Manager believe the problems found by their own and AID's auditors in 1975 and 1976 have been corrected and that the Fund is in a position to resume making investments with a reasonable chance for success. To assess just how good the chances are, we examined the University deficits the Fund is designed to meet, the investment climate and prospects in Egypt, and the Fund's investment goals and proposals. With normal fiscal restraints by the University, a stable political and economic climate in Egypt, and some adjustments in the Fund's investment goals, we believe the University could be supported by revenues from Fund investments in a reasonable number of years. The concept appears more valid and workable now than in the early years of the Fund's operation.

University deficits

From June 1969 to December 1977, the University used a total of LE 12.5 million to cover its annual operating expenses. This is an average yearly deficit of LE 1.5 million, which is over half the annual local-currency operating budget. Unlike private American universities, which derive substantial income from tuition and alumni contributions, the American University in Cairo covers less than 15 percent of its costs with tuition charges and receives virtually no alumni contributions. Tuition for Egyptian students has been doubled since 1973, but it still amounts to less than $300 per year. Officials believe they cannot raise tuition much further because Egyptian universities are free, and the American University will be unattractive if tuition is much greater than the current level.

The University's local-currency expenses have been increasing an average 12 percent a year since 1973, and officials expect this rate to accelerate in the next few years. Staff salaries have not been raised in 3 years and a raise is inevitable. Housing provided to American and other foreign staff members is leased and rents will skyrocket when the leases are renewed. Maintenance and equipment expenses have been deferred but will eventually have to be faced. All these factors lead officials to predict a significantly higher operating deficit in the future. For the 1977-78 school year, the University budget will need LE 2 million from Endowment Fund money remaining on deposit. Future needs are difficult to predict because of the University's limited budgeting capability; however, LE 2 million to LE 3 million can be generally expected in the near future.

Investment prospects

We spoke with many private businessmen in Egypt, both American and Egyptian, about the economic climate and the prospects for profitable investments. Their overwhelming consensus was that Egypt is improving continually as an investment location and that more opportunities are presenting themselves every month. Since Egypt passed Law 43 in 1974 and its amendment in 1977 implementing the open-door policy, foreign companies are finding Egypt more attractive. More than 600 companies, including about 60 American companies, have had proposals for commercial or industrial projects approved by the Government of Egypt. Such large U.S. companies as Ford, Xerox, Colgate-Palmolive, and American Motors are proceeding with investment plans. Many foreign firms will be seeking local investment partners, and businessmen we talked with believe the University Fund would be in a good position to invest Egyptian currency in partnership with these firms. Through the Arab Aluminum Company project, the Fund has already demonstrated that it can successfully carry out a large-scale venture and guide it through the bureaucratic requirements of the Egyptian Government.

Embassy and AID officials in Cairo, although less enthusiastic about the economic outlook for Egypt, were mildly optimistic that the Fund would find some good, reasonably safe investments in the coming years. One official said that, even if the Fund makes little more than normal bank interest, its projects will be contributing to Egypt's economic development.

We also met with the director of the Egyptian Investment Authority, which regulates foreign investment under Law 43, who told us that the government believes it now has adequate incentives, including tax holidays and foreign exchange regulations, to attract sizable foreign investments. Some 300 proposals are approved every year, and, although many of them are never actually implemented, there is a more serious attitude on the part of investors now since the 1977 amendment. A local investor like the Fund could be valuable in attracting American firms to Egypt.

Fund's investment goals need to be adjusted

The Fund must have definite investment goals and plans in order to raise LE 2 million to LE 3 million a year in the Egyptian investment climate. The types of industries to invest in and the mix between loans and equity investments are important in evaluating the income-producing potential. At the time of our visit in November and December 1977, the Fund had no long-range plans or goals for its investments. The Manager indicated he had some general ideas in mind but had never formalized them because of the doubt over the future of the Fund. During our visit he prepared a series of tables showing the industry and debt-equity mix and potential income the Fund would use as targets if it is restored to its original size. As indicated in these tables, the Fund's goals have the following main characteristics.

--Out of a LE 25 million Fund, only LE 5 million would be in bank deposits or commercial loans, the rest would be in equity shares of new businesses.

--About LE 11 million (or 44 percent of the total) would be in real estate development.

--It would probably take until at least 1984 to achieve these investment goals.

--Equity investments would involve about 19 ventures.

The Manager told us he would present these documents to the Board of Trustees in time for consideration at the March 1978 meeting. We believe that, if the Fund is to resume making investments, long-range plans of this type are essential and the Board should carefully consider the nature of these goals.

Our discussions with Embassy and AID officials and with private businessmen indicated two potential problems with the plan proposed by the Fund. First, the heavy emphasis on equity investments may limit the income produced to support the University. New businesses and land developments typically take many years to make a profit and may not pay cash dividends for several more years. For example, plans for the Arab Aluminum Company were started in 1975 but the plant was not constructed until 1977; the company will return a very small profit in 1978 and will probably not pay a dividend--even by the Fund's estimate--until 1981. If a new company is successful the value of the equity shares will increase, but until dividends are paid these paper profits will not provide income for the University. The Manager believes equity investments are the only way to obtain returns that keep up with inflation in Egypt, but we believe the heavy concentration on equity investment will limit for years the cash income that could be transferred to the University.

The second potential problem concerns the plan for numerous large investments in real estate development and leasing. Cairo currently has a severe shortage of housing and office space, but many officials and businessmen we talked with believe this is a temporary condition. In a few years the city may be overbuilt and ownership and development of new housing or office space may not be so lucrative. As one official said, real estate is very often a boom or bust investment; the workings of supply and demand seem to cause wide swings in the profitability of real estate investment.

A banking official and Fund officials told us that the current maximum interest rates of 9 percent on commercial loans will be raised over the next few years and rates of 11 to 12 percent may be possible. It appears to us that well-researched and secured loans at these interest rates should provide a good income to the Fund. As much as half of the Endowment could be in loans and together with carefully selected equity investments, could provide a good mixed portfolio, according to some officials.

ALTERNATIVE APPROACHES FOR SUPPORTING THE UNIVERSITY

The U.S. Government had about LE 151 million on deposit as of June 1977 which had been earned through Public Law 480 loans in the 1950s and 1960s. The United States earns only nominal interest--about 1/2 percent--on these local-currency deposits. Egypt is still repaying these loans and the United States receives about LE 10 million a year in repayments and interest. Egypt is designated an excess-currency country because the United States has more Egyptian pounds--and more coming in each year--than it has local-currency expenses. By agreement with the Egyptian Government, this money cannot be used outside of Egypt.

If the U.S. Government decides to continue its support of the University, we believe there are five alternative methods of providing financial assistance, all of which involve the use of U.S.-owned Egyptian pounds.

1. Liquidate the Fund and deposit the proceeds in bank accounts; draw down the interest and principal to support the University for as long as the money lasts.

2. Liquidate the Fund and provide annual AID grants to the University to cover operating deficits for as long as U.S. assistance is warranted.

3. Replenish the Fund to the original amount and begin making more investments; draw down the principal to support the University until the Fund is making sufficient income.

4. Replenish the Fund, begin making investments, and support the University with additional AID grants to cover the annual deficit until the Fund's profits cover the deficit.

5. Provide a long-term loan to the Fund and have interest from the loan cover much of the University's operating deficit.

Proposals similar to the first four have been discussed by AID and the University in the past; the fifth approach is one that we developed and explored during our review.

Liquidation alternatives

The first two alternatives call for liquidating the Fund's approximately $8 million in investments. This, together with funds remaining in bank deposits, would provide a total of about $20 million in Egyptian pounds. Under the first alternative, this amount and any bank interest earned on it would be used by the University to cover annual deficits until it was depleted. At the current rate of deficits --about LE 2 million ($2.8 million) a year--the funds would be gone within 10 years. At that time, the University would have to find other revenue sources, approach the U.S. Government again, or go out of business.

The second liquidation plan would return the money to AID. The University would be supported by annual AID grants in the amount of the anticipated deficit each year. These grants would presumably continue as long as U.S. financial assistance was justified and approved by the Congress.

Neither of these alternatives is considered desirable by AID or University officials. AID officials believe it is in the best interest of the University and the U.S. Government to avoid prolonged annual budgetary support.

University officials stated they would prefer greater independence from U.S. Government financing. Both alternatives, however, would make the U.S. Government the almost permanent financial guardian of the University. Under alternative one, it is unlikely that the University could find an alternate source of income by the time the funds ran out. It would have to seek AID assistance, and, if its continuation was still in the U.S. interest in Egypt, AID would probably provide the support. The second alternative could result in long-term financial support with little knowledge of the eventual total cost to the United States. AID would have to program and administer a grant every year to keep the University solvent.

Replenishment alternatives

About LE 12.5 million of the original Endowment has been spent for university operations since 1969. In 1975, about LE 1.2 million was granted to replenish part of these expenditures. Under the third and fourth alternatives, about LE 11.3 million ($16.1 million) would be granted to the Fund to complete replenishment; the Endowment could be drawn down to support the University until the Fund is producing sufficient income and profits to cover the deficits. Under the fourth alternative, AID would provide annual grants to the University until the Fund is producing profits that cover the University's deficits.

These alternatives assume that the Fund has a reasonable chance of success in earning income from investments. Our inquiries in Egypt indicate that the investment climate is improving and opportunities for reasonably safe, profitable investments will be increasing in the future. If this is the case, a properly managed Endowment Fund could provide a means for the University to avoid prolonged dependence on the U.S. Government. Some officials we talked with in Egypt believe the Endowment Fund is virtually the University's only hope for achieving some degree of financial security.

We believe there are some disadvantages to both approaches. Replenishing the Fund with a grant and resuming business as usual assumes that all management and investment practices have been corrected and the past mistakes will be avoided. We have noted numerous administrative changes, but the Fund has not been actively seeking new investments during the past 2 years and the effectiveness of the changes has not been tested. We have cited improvements that are still needed in the investment criteria, goals, and supervision.

The Fund must pay income taxes to Egypt, currently about 40 percent, on its profits before it can transfer money to the University. This means it would have to earn LE 3.3 million in profits to transfer LE 2 million to the University. A profit of LE 3.3. million on a total investment of LE 25 million is an average return of 13.2 percent. We believe the Fund feels forced into speculative equity ventures to try to earn that high a return. The risks could be unacceptable and the probability of success low.

Moreover, the eventual total cost of these alternatives is difficult to predict. The third alternative would allow draw-down of the Endowment principal; it is conceivable that the Fund would be so depleted that it would be back requesting a new replenishment within a few years. Such a request would renew the debate over support to the University all over again. The fourth alternative provides for AID grants for as long as it takes the Fund to earn enough revenue. The University and AID have endorsed this approach in the past. This is again an open-ended provision which gives the Fund little incentive to invest wisely in income-producing projects with a specific goal in mind and the University little incentive to control its expeditures. Provisions could be written into the grant agreements to cover these measures, but these could be cumbersome to enforce and could involve AID in the details of Fund and University operations.

Loan alternative

A fifth alternative developed during our review in Egypt would provide a loan from AID to the Fund. AID and the University would have to negotiate specific provisions, but the general outline of the plan would be as follows:

--LE 25 million loan,

--20 to 25 year term with repayment of principal at the end of the term,

--8 percent interest rate (interest payments would be LE 2 million a year), and

--the first 3 years' interest would be forgiven (no payments until 3 years after loan is advanced).

The Fund would keep its existing investments and invest this new money as it saw fit; it would owe AID LE 2 million in interest every year starting in the 4th year. AID would use this interest payment to make a grant to the University for the same amount. This transaction could be handled through bank account transfers with little administrative action. Any additional after-tax profits could be transferred to the University to cover any additional cash needs. During this school year and the first 3 years' grace period, the University would draw down the LE 8 million now on deposit from the original Endowment.

We believe this approach:

--Assures a good level of U.S. support to the University with no annual administrative burden.

--Eliminates Egyptian income taxes on the LE 2 million in interest payments; the Fund, as an Egyptian partnership, is liable to taxes on its profits but these payments would be an expense, not part of the profits. As described earlier, the Fund will have to pay about 40 percent in taxes on the remainder of its profits before transferring anything to the University.

--Puts the Fund on a solid business footing, with freedom to manage the full amount of the Endowment to maximize its income. It also gives Fund managers a clear picture of minimum cash flow needs and will force them to choose revenue-producing investments as well as long-term growth investments.

--Provides a level of U.S. assistance low enough to force the University to be cost-conscious and to seek other sources of revenues as much as possible.

--Provides flexibility at the end of the loan term. Should the U.S. Government need the Egyptian pounds at that time, the loan could be repaid; should the money still be needed by and justified for the University, the term could be extended and interest payments continued.

--Gives the U.S. Government a good return on its excess currency (even though the interest income is clearly earmarked for the University).

> Currently, the Government earns only about 1/2 percent interest on its Egyptian pound bank accounts.

The LE 25 million ($36 million) cost of this alternative is high, but, as noted earlier, the eventual cost of the other approaches is difficult to measure and could exceed this one-time loan. Moreover, because it is a loan, the United States stands to recover the full amount if it decides support of the University is no longer necessary or desirable.

During fiscal years 1976 and 1977 and the Transition Quarter, the Congress appropriated a total of $15.75 million equivalent (LE 11.025 million) to replenish the Fund. AID has withheld this money from the Fund pending satisfactory resolution of the audit deficiencies. To implement the proposed LE 25 million loan plan, the Congress would have to appropriate an additional $19.964 million equivalent (LE 13.975 million).

We discussed this approach with Embassy and AID officials in Egypt, University administrators, and Fund managers, who all agreed that the plan had several desirable aspects, especially the tax advantage. University officials believed the Endowment's LE 25 million level helped to assure that the University would have sufficient income to preclude further reliance on AID. The Fund managers believed that the plan was fair to them and that there was a reasonable chance it could successfully support the University within 3 years under this arrangement.

We did not obtain formal written comments from AID but did discuss this report with AID officials. They agreed that the loan alternative had many advantages and believed it would force the Fund managers and Board of Trustees to exercise discipline and sound business judgment in investing the Endowment. However, the officials stated AID could be criticized for making a loan with little security and relatively little chance of being repaid. They suggested instead a grant to the Board of Trustees, stipulating that the Board should loan the money to the Fund. The Fund would pay interest to the Board, which would turn the interest income over to the University. This approach would have almost all the advantages of alternative five; the main difference under a grant is that AID would not be repaid unless the University broke one of the grant provisions.

We think both versions of this loan alternative have merit and deserve more study by AID.

CONCLUSIONS AND RECOMMENDATIONS

The American University in Cairo represents American education and culture in Egypt, and U.S. officials there strongly support continued financial assistance for it. AID's severe criticism of the University Educational Endowment Fund was valid, but circumstances in Egypt appear to have changed since the Fund's original investments were made and many managerial and administrative shortcomings have been corrected or improved. The investment climate in Egypt is greatly improved over that of 1974, and businessmen in Egypt believe the Fund concept is viable.

To be successful the Fund needs good investment criteria and adequate supervision by the University's Board of Trustees. It also needs to gear investment goals toward income-producing investments which will provide the needed cash revenues to support the University in the near future.

If the U.S. Government decides to continue supporting the American University in Cairo, serious consideration should be given to the five alternatives outlined herein for reactivation of the Fund. We believe the use of a loan as discussed in alternative five has some good advantages over the other alternatives and may be the best means of achieving a reasonable promise of supporting the University's operational needs.

Therefore, we recommend that the Administrator, Agency for International Development:

--Consider the alternatives presented in this report, especially a loan incorporating the provisions discussed under alternative five, and, in consultation with appropriate congressional committees, implement a strategy of financial assistance that will best satisfy the long-term needs of the University at an acceptable level of cost and risk to the U.S. Government.

--See that the University's Board of Trustees adopts and uses investment criteria in identifying and reviewing potential Fund investments.

--See that the Board of Trustees has established an adequate system for supervising the activities of the Fund managers.

--Monitor Fund operations through periodic audits and reviews.

Because of the size and uniqueness of the Endowment Fund, we also recommend that the Congress require the Agency for International Development to submit annual reports on the Fund's status and progress as part of the American Schools and Hospitals Abroad presentation.

AID ELIGIBILITY CRITERIA

AMERICAN SCHOOLS AND HOSPITALS ABROAD

AID criteria	Analysis of University compliance
1. School must be located abroad and founded or sponsored by U.S. citizens.	1. It is in Cairo, Egypt; founded in 1919 by U.S. citizens, and the Board of Trustees consists of U.S. citizens.
2. School must be private, nonprofit, and not under direct control of any government.	2. It is private, nonprofit and incorporated in the District of Columbia. Protocol with the Government of Egypt grants the University autonomy.
3. Sponsors must participate in management of the school and contribute to its financial support. School must not be completely dependent on AID support.	3. The Board of Trustees meets regularly to consider University matters. Trustees make sizable contributions to the school and AID provides about 60 percent of its local-currency revenue.
4. School must not discriminate on bases of race, creed, or color and must not promote religious activities with the grant.	4. It is nonsectarian and has students from about 50 countries of many races and religions.
5. Majority of students must be from countries other than the United States.	5. Only about 6 percent of students are from the United States. Over 80 percent are from Egypt and other Middle East countries.

AID criteria	Analysis of University compliance
6. Criterion 6 applies to hospitals or medical schools only.	6. Not applicable.
7. Faculty must include U.S. citizens or other nationals trained in U.S. institutions.	7. Faculty includes about 37 percent Americans; about 70 percent of the faculty with Ph. D.s earned their degrees in the United States.
8. Schools should provide instruction in American studies program. English should be used in teaching or should be taught as a second language.	8. Numerous courses in U.S. history, literature, and political science are offered. English is used for classroom instruction; an adult education program provides English-language training for thousands of Egyptians annually.
9. Criterion 9 applies to vocational and subprofessional schools only.	9. Not applicable.
10. School must demonstrate competence in instructional skills, management, and financial operations.	10. Many officials consider the University's education superior to that provided by the Egyptian national universities. It is recognized for its English-language programs and business management instruction.
11. Institution must demonstrate capacity to ensure effective use of the assistance requested.	11. Most support to the University has been given to cover a deficit in its operating budget.

THE AMERICAN UNIVERSITY IN CAIRO

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Frank Jungers Chairman of the Board Arabian American Oil Company Dhahran, Saudi Arabia	1976
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Member	Elected to Board
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APPENDIX III

Member	Elected to Board
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