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**HOST COUNTRY CONTRACTING:
ASSESSING HOST COUNTRY CAPABILITIES AND
PRACTICES, AND REPORTING HOST COUNTRY CONTRACTS**

AUDIT REPORT NO. 84-38

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EXECUTIVE SUMMARY

The Agency for International Development (AID) established a policy in 1976 that, whenever feasible, contracting for procurement of AID-financed goods and services required to implement bilateral project agreements should be done by the host country rather than by AID. This policy implemented a basic objective of the Foreign Assistance Act which is to assist in developing host country contracting capabilities and practices. AID General Notice, dated December 28, 1983, Responsibility for Procurement, changed the policy so that there is no longer a stated AID preference between AID-direct and host country contracts.

Consistent with the thrust of the earlier policy, increased amounts of AID-financed goods and services were procured through contracts awarded by implementing agencies of other governments so that as of October 1, 1983, there were reported 448 active host country contracts over \$100,000 with a total value of about \$2.2 billion. Contracts under \$100,000 approximated another \$200 to \$300 million. About 70 percent of the total value of host country contracts reported were by the Government of Egypt.

The purposes of this review were to examine (1) Mission compliance with the requirement that assessments of host countries contracting capabilities and practices be made precedent to assigning procurement responsibility to host governments, and (2) the accuracy and completeness of AID's reporting of host country contracts. We met with numerous officials in Washington and in six AID Missions abroad, Egypt, Indonesia, Thailand, Philippines, Kenya and Panama. Our work abroad covered Missions that constituted about 75 percent of the total value of the reported host country contracting activity. We made the review during the period January through July 1984.

This is the second report we have issued on host country contracting. In 1979 we identified problems with regard to Missions not making the required assessments. Management officials agreed with the findings and corrective action was promised; however, our recommendation that the required oversight controls be established to ensure that assessments are made and included in the project paper was not carried out.

AID has had little success in implementing its policy guidance requiring assessments of host country contracting capabilities and practices, and development of an accurate data base on host country contracts. Accordingly there is no verifiable basis for assigning procurement responsibilities to host governments. As a result of not realistically assessing host country contracting capabilities and addressing recognized problems early in the relationship, costly project delays have been experienced and a high degree of risk introduced into AID's payment processes. Moreover, the data base on reported host country contracts is incomplete and inaccurate.

These conditions exist because at all management levels a low priority was accorded to making assessments and reporting on the number of host country contracts. Additionally, responsibilities were diffused and were assigned to offices that did not require compliance or possess adequate monitoring

capability, and there was a lack of internal controls over the management systems in place.

We are recommending that the Administrator resolve these problems by assigning one office specific responsibility for the host country contracting area.

Assessments of Host Countries' Contracting Capabilities and Practices

AID requires that assessments be made in the design stage of a project and precede a decision to use that mode of contracting for implementing bilateral projects. It is generally understood that Missions are responsible for making the assessments, and the Bureau for Management and the regional bureaus are responsible for ensuring they are adequately performed. Most AID officials and the two contractors we met with agreed that comprehensive assessments should be made, but we found no evidence that such assessments were, in fact, made. To the extent any analysis of host governments was done, such analysis was based on the general experience of project officers and others at Missions with no formalized approach. The Bureau for Management and the regional bureaus seldom, if ever, questioned the decisions to use host country contracting on projects. The principal reasons offered by AID officials for not making the required assessments were the previous AID policy preference for host country contracting, inadequate guidance on what should be covered, and lack of staff. In an effort to strengthen controls over host country contracting in December 1983 the Administrator assigned Mission Controllers the authority to ensure that assessments were made and included in the project papers.

Without the required assessments, Missions were not in a position to know what impediments to timely project execution existed in the host governments, to direct its assistance to areas where the implementing agencies needed help, or to structure a response to overcome or accommodate such problems.

As suggested by AID policy, host government awards of contracts under loan and grant agreements should assist AID's development objectives because these governments gain experience in the procurement aspects of conducting large scale economic development projects. The term "Host Country Contracting", however, can be misleading. This is because, although host governments award contracts, AID Missions and contractors staffs are deeply involved in every major aspect of the procurements. Among other things, this involvement includes identifying requirements, developing requests for bids, evaluating bids and recommending contract awards, and approving payments to contractors. Most major procurement actions, therefore, are really the products of the host governments, AID, and others.

Host governments and AID Missions have not functioned as effective forces for accomplishing procurements. Often, these efforts have been redundant and counterproductive. The current operating mode significantly increases the cost of doing business and it adds little of instructive value in increasing host country capability to function in a manner acceptable to AID. Indeed, AID has found it necessary to supplement the capabilities of host governments by entering into costly contracts with firms to perform the procurement functions.

Notwithstanding the attention accorded procurement matters, problems persist. These problems have cost host governments, and AID, enormous amounts in terms of the economic and other benefits contemplated when the projects were approved. A six-year delay in constructing a grain storage silos project, for example, resulted in estimated grain losses valued at about \$180 million. A three-year delay in constructing a thermal power plant resulted in net losses of power after operating costs valued at about \$108 million. Delays in implementing five other projects resulted in estimated losses of about \$400 million. In addition to the quantifiable economic losses, there were those associated with missed opportunities to provide better medical care, education, water, housing, and food.

Project delays that manifested in these lost benefits were common in the six countries visited. In fact, 122 of the 135 active and completed projects approved after October 1, 1976, and having a planned completion date prior to April 1, 1984, were extended. These delays based on the actual or planned completion dates at the time of our review averaged about 27 months. AID obligations for the 122 delayed projects totaled \$2.5 billion.

Host country contracting was not the only reason for these delays and lost benefits. There are many and varied reasons for project delays, but in the view of Mission officials and contractors host country contracting was an important reason, perhaps the predominant reason in many instances. Problems encountered in host country awards included protracted negotiations, delays in opening letters of credit, and slowness in making procurement decisions. Also, many levels of approval were needed on contractual documents. Each of the countries required the approval of other government agencies in addition to the implementing agency for certain AID-financed procurements. Mission officials also attributed delays to a lack of qualified host country officials to approve contracting actions or a general attitude that prompt approvals were not necessary, and laws or procedures that conflicted with AID procurement requirements.

Because Missions have not made the assessments required by AID regulations, no definitive basis exists for addressing the root causes of the problems of delays, controls over payments and equipment, or for reconciling the inherent weaknesses of host country procurement capabilities with AID's need to protect the U.S. interest. Moreover, the contemplated benefits of reduced AID staff involvement due to the host governments activities are unrealized. A significant extension of these conditions is that AID is highly vulnerable to financial abuses because Mission staffs don't have the knowledge of host government procedures for ensuring proper payment under contracts. This conclusion was reached by an independent public accounting firm based on a review of controls at one of the Missions included in our review. This Mission had about 200 active contracts valued at about \$1.6 billion.

Reporting Host Country Contracts

Since 1977, AID has been attempting to develop a centralized inventory of host country contracts and progress has been made in the past two years, but it still does not have an effective system for identifying and reporting such

contracts. Without an accurate data base, several AID offices can not carry out their statutory and administrative responsibilities. Responsibility for managing the inventory has been assigned at various times to the Office of Contract Management, to the regional bureaus, and to the Office of Legislative Affairs. Currently, the Office of Financial Management has this responsibility. These offices and bureaus have relied solely on Missions to furnish accurate and complete information with no monitoring above the Mission level to ensure the integrity of the data reported. AID offices need this information for a variety of reasons. The Office of Legislative Affairs, for example, must report to the Congress when host country contracts are awarded to U.S. firms. The regional bureaus and the Bureau for Management need the information to ensure compliance with Federal and AID procurement regulations. The Office of Inspector General needs the information so it can ensure adequate audit and inspection coverage.

The six Missions reported understated numbers and values of host country contracts. As of October 1, 1983 these Missions reported a total of 193 contracts over \$100,000, for a total value of \$1.6 billion. We readily identified from records at the Missions an additional 157 contracts and contract values of about \$80 million. A more detailed examination of host records probably would disclose an even greater number of contracts and values that should have been reported.

Part of the problem of not reporting correct data was the lack of adequate guidelines on what contracts should be reported. For example, some Missions did not think construction or personal services contracts had to be reported. In addition, some Mission staffs were not convinced there was a need for the data, so these reports were incomplete or inaccurate. None of the Missions or the offices assigned responsibility for establishing the centralized inventory had established controls to ensure the integrity of data reported.

Management Comments

We provided a draft of this report to the Assistant to the Administrator for Management and Assistant Administrators for the four regional bureaus. Formal comments were received from the Assistant to the Administrator for Management and the Deputy Assistant Administrator, Bureau for Asia (see Appendixes A and B). They generally agreed with the report's findings and conclusions but did have suggestions to improve the report. For example, the Assistant to the Administrator for Management noted recent progress made in the reporting of host country contracts. The Deputy Assistant Administrator, Bureau for Asia, took exception to a recommendation that would assign an office over the regional bureaus to ensure assessments were made of host country contracting capabilities and practices. These comments were considered and appropriate revisions were made in the preparation of the final report.

BACKGROUND

In 1976, the Agency for International Development (AID) established a policy that, whenever feasible, contracting for AID-financed goods and services necessary for implementing bilateral projects be done by the host country rather than directly by AID. This policy, conforms with the requirements of Section 102, Foreign Assistance Act, to develop the institutional capabilities of host countries, and was premised upon the following considerations.

- The ultimate responsibility for all development projects rests with the host government.
- The process of implementation itself is an important opportunity for developing technical, institutional and administrative skills in the host country.
- AID must conserve its own staff resources for monitoring project implementation.

In December 1983 AID's policy was modified to reflect the Administrator's decision that the Agency no longer has a stated policy of preference for host country contracts.

Although up to December 1983 there had been a clear policy preference for using host governments, AID's policy actually required the responsibility for procurement be assigned in a manner that would most effectively implement AID-financed projects. The decision to go either with the host government or with AID itself handling the procurements is supposed to be based upon a careful assessment of the host country's abilities in this area:

The term "Host Country Contracting" implies the foreign government receiving AID's loan or grant funds independently carries out procurement responsibilities on projects. In actual practice, the AID Mission and often procurement service agents and consulting contractors, among other things, prepare specifications for bid, review the bids received and recommend the selection of contractors, and approve payment vouchers under the contracts. Thus, the contracting function is really a collective undertaking in most cases.

Responsibility for making the assessments and for ensuring assessments are made is jointly shared by Mission Directors, Project Officers, the Office of Contract Management under the Bureau for Management, and the regional bureaus. It is generally understood, however, that Missions are responsible for making the assessments. The Regional Bureaus and the Office of Contract Management are responsible for ensuring the assessments are done.

In 1979, the AID Office of Inspector General reported that Missions were not making the required assessments and AID Headquarters offices were not ensuring the assessments were being made. In response to that report (79-71), the Assistant Administrator of each regional bureau commented they would direct their staffs and overseas posts to ensure that an assessment was made and included in the project papers that are submitted for Headquarters approval before the project is actually implemented. The AID Controller also agreed

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with our findings. He sent a memorandum to the Assistant Administrators of the regional bureaus and to each Mission Controller stressing the importance of Controllers' evaluating the host countries' capabilities with regard to financial management of host country contracts and performance of contract audits.

On February 25, 1983 the Chairman, Senate Committee on Appropriations expressed concern to the AID Inspector General about the Agency's administrative and managerial competence. The Chairman solicited the Inspector General's views regarding unrealistic expectations of host country participation in AID supported projects and programs.

The Inspector General responded by letter dated April 26, 1983. In it he said:

"The Agency's host country contracting procedures require that an assessment of host country capabilities precede a decision to use the host country contracting approach in implementing a project. If carried out thoroughly and conservatively this pragmatic planning step should reduce the incidence of host country related implementation problems of the kinds noted above. It is unrealistic to think that they can be totally eliminated in the risky environment of the foreign aid program. In projects reviewed by the IG the records dealing with the decision point to use the host country contracting approach are frequently incomplete or in some cases essentially non-existent. Yet, there is enough information available to suggest that in the face of significant evidence to the contrary, A.I.D. planners have over optimistically assessed the various capabilities of the host government necessary to project success, or essentially overlooked this vital planning step. I think it is appropriate for me to note that although my reporting continues to reflect serious, even egregious problems of implementation associated with the host country contracting process, there is in fact a new awareness of these problems in the Agency. Efforts to strengthen and improve our performance and that of the host countries are in train. The typical, repetitive kinds of implementation problems that occur in these situations are extremely difficult to deal with; the success of the Agency's efforts to confront them will, in my judgment, remain in doubt for some time."

Regarding this problem, the Mission Director of one of the largest AID programs covered by our review noted in a cable dated June 20, 1983 to the AID Controller that:

"USAID (the mission) believes that the areas of highest vulnerability are in the contracting and contract management capabilities of the host government and contractor procurement and control of project commodities". The Mission Director noted that in analyzing the Near East missions vulnerability assessments, the Bureau's Controller had "...concluded that the contracting process, particularly host country contracting, was the most frequently noted area of weakness in internal control."

He also noted that an audit report by the Office of Inspector General "...raised certain host country contract vulnerability issues to which this USAID can relate, particularly in the areas of contract cost effectiveness, current negotiating procedures, and evaluating overall contract performance."

The ten Near East countries referred to by the Mission Director in the above quotation reported 209 active host country contracts valued at \$100,000 or more as of October 1, 1983. The total value of these contracts was \$1.7 billion.

Since about 1977, AID has been in need of a system for reporting host country contracts. The need for an accurate reporting system has increased with the congressional emphasis on demonstrating that assistance funds are directly benefiting the United States economy. The system is also needed for meeting various contract management and administration responsibilities within the Agency.

As of October 1, 1983, AID's reported inventory of active host country contracts of \$100,000 or more in value consisted of 448 contracts with a total value of \$2.2 billion. AID estimated the value of host country contracts under \$100,000 was \$200 to \$300 million.

Objectives, Scope, and Methodology

The purposes of this review were to (1) determine whether assessments of host country contracting capabilities and practices were being made, as required by AID regulations, and (2) evaluate the accuracy and completeness of AID's system for reporting host country contracts.

Our review included discussions with officials and a review of documents in the Bureau for Management, the Office of Legislative Affairs, the four regional bureaus, and six overseas Missions (Panama, Philippines, Thailand, Indonesia, Egypt, and Kenya). These Missions constituted about 75 percent of the reported host country contracts. We met with officials of the World Bank; Asian Development Bank; Defense Contract Administration Services, Department of Defense; Department of Energy; and two American contractors with host country contracts. We also reviewed Office of Inspector General reports issued between 1981 and 1984 that identified problems related to host country contracting in the six countries visited.

The basic methodology followed after establishing that assessments were not being made by Missions, was to determine whether projects were adversely affected by host government procurement problems. In those cases where projects were affected, we considered whether an assessment at the outset of the project might have precluded the problem or mitigated its effects.

With respect to the reporting of host country contracts, we examined reports submitted by the Missions included in our review and the summary reports prepared by the Office of Financial Management. By examining records at the Missions and discussions with project officials we assessed the accuracy and completeness of the reports.

We did not attempt to quantify or develop the full extent of the problems discussed in this report at each Mission. However, the work performed coupled with the disclosures of Office of Inspector General reports in recent years showed that the problems were systemic in nature and warranted high level management attention.

Our work was done in accordance with the Comptroller General's Standards for Audit of Government Organizations, Programs, Activities and Functions. The work was done between January and July 1984.

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

NEED FOR REALISTIC ASSESSMENTS OF HOST COUNTRIES CONTRACTING CAPABILITIES AND PRACTICES

Substantial host country contracting problems exist which could have been precluded or reduced if AID had assessed the host countries' contracting capabilities and practices. Although AID policy requires that such assessments be made prior to using this mode of contracting the assessments are not performed. A major reason is the low priority given to these functions by the responsible offices. Also, AID has not developed a methodology for undertaking the required assessments.

Because the required assessments were not made, AID lacked the necessary detailed knowledge about the true capabilities of host governments to carry out the procurement function. More importantly, it could not address possible solutions to the underlying reasons for procurement problems early in the relationship with implementing agencies. These types of problems eventually lead to inefficient and ineffective use of contracting staffs, delays in obtaining millions of dollars of benefits to host countries, and significantly increased project costs.

Requirements and Responsibilities for Assessments

AID policy and procedures require that procurement responsibilities be assigned so that the project is implemented in the most effective manner. Accordingly AID policy cautions that the determination to assign procurement responsibility to a host country must be based upon a careful case-by-case assessment of its capabilities and practices in the procurement areas. Handbook 3, Supplement B, states:

"There is at present no prescribed Agency methodology for undertaking these assessments. In general, what is required is a reasonably detailed examination of the host country's system and policies, with emphasis upon the adequacy of the major contracting processes characteristic of sound, business-like procurement. For example, the fairness and defensibility of the Contracting Agency's procedures relating to advertising, competition, bidding and evaluation, contractor selection, handling contractor complaints and bid protests, and similar matters should be given close attention during this review. The capacity of the Contracting Agency to provide (or arrange for) appropriate logistical support of contractors in essential areas (such as housing; office space; customs clearances; etc.) should also be specifically addressed."

Handbook 3, Supplement B, provides some basic questions that should be explored when performing assessments and also requires Project Officers to develop their own checklists of relevant questions and areas warranting review. The Handbook also requires that if assessments reveal that the host country agency needs external assistance to meet its procurement responsibilities, the precise nature and extent of such assistance must be determined and built into the project as an additional element.

Handbook 3, Supplement B, recognizes the importance of contracting to project implementation. It states:

"Successful implementation of most projects hinges upon the effectiveness of contracts for project-related services and commodities. In fact, no aspect of project implementation is more important, nor more prime to problems and frustrations, than the procurement function. Hence, determining by whom, when, and how needed services and goods are to be acquired are pivotal decisions which must be made by the Mission during the project development stage."

Responsibility for ensuring the assessments are made is diffused--no single AID office is assigned the overall responsibility. Responsibilities instead are assigned concurrently to several offices. AID Handbook 3 assigns the responsibility to perform and ensure performance of the assessments to both Mission Directors and Project Officers. AID Handbook 17 assigns the same responsibilities to the Office of Contract Management under the Bureau for Management.^{1/} AID Handbook 17 also assigns Regional Bureaus the responsibilities to guide and approve project designs including the area of host country contracting.

In December 1983 the Administrator's concern about weak financial and administrative controls over the host country contracting area led to yet another organization being assigned the task of ensuring assessments are made. This latest assignment delegated authority but not responsibility to Mission Controllers for ensuring that assessments were included in project papers.

Mission Controllers were in the early stages of implementing the new policy guidance when we finished our field work. There was, however, concern among Mission Controllers we contacted about how their new assignment was to be carried out. They indicated that they did not have adequate staff resources or technical expertise to direct appropriate attention to this area. Mission Controllers, therefore, may not be in any better position to ensure assessments are made and included in the project papers than are the Mission Directors, regional bureaus, and the Office of Contract Management who have had these

^{1/} In response to the draft report, the Assistant to the Administrator for Management stated that the Handbook is not accurate in assigning review responsibility, and that the Office of Contract Management would take action to have it changed.

same responsibilities for many years. In fact, this latest assignment tends to further diffuse responsibility in this area of assessments. From a management standpoint we view a lack of accountability to be a major reason assessments were not conducted and a contributing factor to the lack of success of the host country contracting policy. This situation still exists.

Assessments Not Performed

It has been eight years since AID established the major policy on host country contracting. This policy was to have been a major step towards assisting host governments to become self-dependent and reduce the need for direct involvement by AID. However, a methodology for conducting assessments--a basic first step to implementing the new policy--was never developed. Responsibility to ensure policy implementation was never fixed in one office.

The six countries we reviewed had a total of 235 projects valued at about \$5.1 billion active as of March 31, 1984. With the exception of a limited attempt in 1978 by a consultant to assess the contracting capabilities of a single agency in one of the six countries included in our review, we found that Missions had not made the required assessments.

As mentioned previously, AID Handbook 3 provides some basic questions that should be explored in performing the assessments; but, requires the Project Officer only to develop a checklist of relevant questions and areas warranting review. None of the 25 project officers we contacted had even prepared checklists, and we could find no evidence that even the basic questions had been seriously considered. Officials at the six Missions visited, the Bureau for Management and the four regional bureaus told us they did not have the staff levels or skills to perform assessments. These officials frequently noted that one problem was the lack of comprehensive AID guidelines on how to perform a realistic assessment.

Offices responsible for ensuring that assessments were made essentially ignored this function. Regional Bureau officials said the requirement received low priority and that they hardly ever questioned the decision by the Missions to use host country contracting. The reasons given were (1) the general policy preference was for that mode of contracting and (2) the Missions were in the best position to make decisions on whether or not to use host country contracting. Neither the Bureau for Management nor the regional bureaus established internal control systems to ensure that realistic assessments were made.

In all countries visited, we found there were cumbersome contract approval processes involving other government organizations in addition to the implementing agencies. Also, host country regulations often severely hampered the adherence to AID procurement requirements. Project papers, in some cases, nevertheless contained a general opinion that the implementing agency had the capability to perform the contracting functions. However, there was no supporting documentation that an assessment had been made.

There was, however, recognition that the host country would need help to carry out its contracting responsibility. Project papers usually identified a need for contractors to develop the procurement capabilities of the host country implementing agency, assist in the procurement, or actually do the procurement for AID-financed goods and services. Since detailed assessments were not done the project papers did not identify the specific weaknesses of the host country practices or the specific areas where the contractor was to develop the host country capabilities. Rather, references to host country contracting capabilities were little more than subjective opinions by the Missions' staffs.

Some Mission officials did not believe formal assessments should be made. These officials said it was a political necessity to let a host country do the contracting if they so desired, especially for loans and certain economic support grants. Other reasons cited by these officials were (1) realistic assessments would embarrass some host country implementing agencies or governments and (2) host countries frequently have changes in the procedures or staff of the implementing agencies which would alter the conclusion of the original assessments. Considering the very substantial amounts of Federal funds involved we do not believe these are acceptable reasons to forego assessments.

Assessment Methodology

Although AID policies require detailed assessments, guidance is far from adequate. Assessments are essential in order to identify the strengths and weaknesses of the host countries contracting capabilities. Such assessments would enable Missions to have a sound basis for deciding on the appropriate mode of contracting while the project is in the design stage. With such an assessment Missions could also direct their technical assistance towards strengthening areas of weakness in host countries procurement systems. These weaknesses have long been a cause for costly and extensive delays in implementing projects as well as loss of controls over payments and project equipment. Other U.S. Government agencies that routinely perform similar assessments of contractors' activities have been able to make substantial improvements in the procurement process. Also they have prescribed methodologies which AID could possibly adapt for its own use.

Other Federal Agencies

Like AID, the Department of Defense and the Department of Energy deal with organizations that procure goods and services with government funds. Unlike AID, these departments routinely examine the procurement systems of these organizations to ensure the systems provide appropriate safeguards. These agencies have developed methodologies for performing procurement systems reviews which AID could adapt for use in making assessments of host country contracting capabilities. These methods address major aspects of the procurement process including procurement policies and procedures, purchase requirements, source selection, pricing, receiving procedures, and contract administration. Officials estimated that an initial assessment of a large contractor takes an average of between 6 and 9 staff weeks of effort. Subsequent assessments require much less effort.

Assessments by these agencies have resulted in substantial monetary benefits through improved procurement systems. Examples of specific areas of improvements and benefits included (1) conversion from noncompetitive to competitive procurements, (2) better use of price or cost analysis and negotiation techniques, and (3) reduced administrative costs to both the U.S. Government and the contractors. The Defense Contract Administration Services, a part of the Department of Defense, reported savings and cost avoidances in excess of \$280 million resulting from about 220 reviews performed in Fiscal Year 1983. The Department of Energy had not developed similar data, but responsible officials advised us that significant benefits had accrued to the government as a result of its reviews.

Contracting Capabilities and Practices

Problems encountered on the projects we reviewed showed that AID's major policy thrust has not been successful in enhancing the capability of host governments to carry out the procurement function in accordance with AID requirements, thereby reducing the strain on limited AID staff resources.

Without adequate assessments AID has been unable to reconcile the inherent weaknesses of host countries' procurement capabilities with its need to protect U.S. interests. As a consequence, host governments, contractors and AID Missions have not functioned as a cohesive force for accomplishing procurement actions. In fact, these efforts often have tended to be redundant and sometimes counter-productive.

For example, a consulting engineering firm advising the host government, evaluated the bids received on a potential contract. The host government made its own independent evaluation of the bids. Agreement was reached on the bids after about 3 months. The package then was submitted to AID who rejected it 2 1/2 months later. The process started all over again. Eventually a contract was awarded for about \$68,000 after being in process for about 9 months.

The consensus of most project officers contacted was that host country contracting adds significantly to the overall cost of doing business, does not reduce AID staff involvement in the procurement function, and is of little value in increasing the host country's ability to function effectively. A cost effective use of AID staff and enhancement of host country contracting capabilities could be achieved, however, through realistic assessments. Assessments could be used, for example, to determine the dollar threshold of procurements transactions presently requiring prior AID approval such as in the case described above.

For example, the Contractor's Procurement System Reviews performed by the U.S. Department of Defense Contract Administration Services and the Department of Energy reportedly have resulted in improvements in contractors procurement systems which increased approval thresholds and correspondingly decreased staff workloads. The increased threshold on subcontract approvals by one contractor reduced the Defense Contract Administration Services workload for approving procurement transactions in one year by more than 1,000 staffdays. Similar benefits could accrue to AID.

Project Implementation Delays

Delays in implementing projects result in billions of dollars in lost benefits to the host countries and increased project costs to both AID and the host countries. Additionally, there are losses associated with missed opportunities for providing better medical care, education, water, housing, and food that were envisioned when the projects were approved. The significance of the delay problems is illustrated by the projects in the six countries reviewed. AID established the policy for host country contracting in October 1976. About 90 percent of the active and completed projects approved after October 1976 that had an originally planned Project Assistance Completion Date (PACD) prior to April 1, 1984 were extended. These delays based on the PACDs at the time of our review have averaged about 27 months. As projects stretch out, costs tend to rise and the benefits of completed projects are not available to host governments.

<u>Country</u>	<u>Number Projects Completed On Time</u>	<u>AID Obliga- tions (\$000)</u>	<u>Number Projects PACD Extended</u>	<u>Average Months Extended</u>	<u>AID Obligations (\$000)</u>
Egypt	1	4,842	46	34	1,871,667
Indonesia	3	644	24	26	340,600
Thailand	3	751	7	22	31,380
Philippines	3	19,917	19	20	154,853
Kenya	3	1,273	11	22	26,384
Panama	0	-	15	25	57,916
	<u>13</u>	<u>327,427</u>	<u>122</u>	<u>27</u>	<u>32,482,800</u>

AID Handbook 3 requires that an economic analysis be included in each project paper. These analyses identify projected benefits to the host country which are an essential factor in deciding whether to undertake the project. Office of Inspector General reports on AID projects, and Mission project status reports have disclosed numerous cases of delays caused by host country contracting. A significant and widespread problem concerns the many levels of approval needed in host country's procurement system. Each of the countries required the approval of government agencies in addition to the implementing agency for certain AID-financed procurements. Also, there were either a lack of qualified officials to approve contracting actions or the attitude of responsible officials that timely approvals were not necessary. In other cases, host countries' laws or procurement practices conflicted with AID requirements.

Regional Bureau officials said there was a need to resolve these conflicts between AID procurement requirements and normal host country practices. These officials said that many host countries have adequate procurement practices, but have great difficulty in meeting AID's regulations. An example is AID's regulation that does not allow price to be considered in evaluating proposals for technical services. They suggested that AID might be more flexible in placing less stringent procurement requirements on host countries. We believe this is a proper concern.

There are many reasons why development projects are delayed. In the examples discussed below, host country contracting problems were viewed as important contributing factors, but not the only reason, for the delays and lost benefits. The problems and other difficulties associated with host country contracting are the type that would probably have been identified and documented by detailed assessments. Actions could then have been taken to preclude or minimize the problems.

Grain Storage Silos Project

In 1975, AID and a host government decided to undertake a project to build grain storage silos at a port facility. The economic analysis presented in the project paper stated that the host government would begin realizing annual savings of about \$30 million from reduced waste, labor cost, sacking, demurrage, and equipment operations when the project was completed in June 1979. When we completed our field work in May 1984 the project was six years behind schedule with an estimated completion date of June 30, 1985. AID has obligated \$57.8 million for this project.

The project records showed that a major reason for the delay in completing the project concerned the host government's slowness in making contracting decisions. For example, problems in negotiations between the host country and an architect/engineering firm delayed project startup by 18 months. The project was further delayed several years due to difficulties in getting the required host country approval of contracts for equipment and in opening Letters of Credit.

A six year delay in constructing the grain silos translates into lost benefits of about \$180 million using the original estimate of the benefits to be realized.

Food Storage and Distribution Facilities

In 1977, AID and a host government agreed on a project to construct and equip facilities for the receipt, storage and distribution of food grain, tallow, vegetable oil and fat. The economic analysis in the project paper and a project report estimated annual benefits to the host government of about \$20 million from more efficient unloading of commodities from ships, reduced freight charges, and cost efficiencies in buying when the project was completed in September 1981. When we completed our field work in May 1984, the project was three years behind schedule with a new estimated completion date of September 1984. AID has obligated \$37 million for this project.

An Office of Inspector General report issued in January 1984 and project records show that a major construction contract, which was to be awarded in September 1978 was not awarded until over three years later in November 1981. The major causes for the delay in awarding the contract were identified as difficulties in preparing the requests for bids and receiving the bids for construction, lengthy negotiations between the host government and the contractor, and five months to get the approval of another host government activity after the contract was approved by the host government implementing agency.

A three-year delay in completing the project translates into benefit losses of about \$60 million using the benefits projected in the project report and the project paper.

Urban Electric Distribution Project

In 1977, AID and a host country agreed on an urban electric distribution project which would rehabilitate and expand the country's electric distribution system. The economic analysis in the project paper stated that the increased sale of electric energy resulting from the extension of the system and reduced energy losses resulting after rehabilitation of the existing system would produce economic benefits to the host country of about \$20 million annually. The scheduled project completion date was extended over five years, from July 1980 to September 1985. AID has obligated \$56 million for the project.

Project records show that there were serious implementation problems caused by delays in contracting actions by the host country. For example, the evaluation of bids, and contract execution for most procurements required 9 to 12 months rather than the planned 3 to 4 months. Shipments of commodities were delayed many months due to the failure of the host country to conform letters of credit to contract terms. Six years after the decision was made to use host country contracting the Mission in 1983 noted concern at the slow pace of the host country in its subcontracting for equipment installation and utilization. The Mission believes planning in these areas must be spelled out more clearly and implemented more expeditiously.

A five-year delay in completing this project again translates into significant losses to the host country. Annually economic benefits alone were projected to be \$20 million.

Thermal Power Plant

The agreement for this project was signed in 1976. The project paper economic analysis stated that the economic value to the host country from the electricity generated by the plant would be about \$34 million annually when the project was completed in April 1981. Current plans indicate that this project will not be completed until about June 1984. AID obligated about \$141 million for this project.

The project records show that delays in awarding a consultant engineering contract and the major construction contracts were a major reason for the project implementation delay. The original project paper planned for the consultant engineering contract to be signed by September 1976, 120 days after the agreement signing. A project paper amendment noted that it actually took 261 days to sign this contract and that the excessive time was "normal in host country contracting". The amendment also noted that implementation was delayed an additional four months due to problems in opening a Letter of Credit because the local banks were not familiar with AID procedures. The construction contract was signed one year after the planned date, and delayed another five months until the required Letters of

Credit were issued. When we completed field work, construction of another plant has been authorized but already was delayed eight months because of difficulties in negotiations between the host government and the contractor.

The 38-month delay in completing this project translates into economic losses of about \$108 million using the benefits projected in the project paper.

On-Farm Grain Storage Facilities

The agreement for this project was signed in 1981. The economic analysis in the project paper states that the primary beneficiaries of the project are the smallholder farmers in the host country and the ultimate benefits are reduced postharvest grain losses on smallholder farms due to molds, insects and birds. The benefits were projected to increase annually. When we completed field work in May of 1984 the project had already been delayed about 18 months. AID has obligated \$7.8 million for this project.

Essentially the entire project is to be carried out under a single host country technical assistance contract. The contractor was selected by the host government's implementing agency and approved by AID in December 1981. According to the implementation schedule in the project agreement, this contract was planned to be signed by February 1982, but was not signed until 17 months later in August 1983. The delays in signing the contract were caused by lengthy negotiations between the implementing agency and the contractor, obtaining approval of other host government agencies, and a decision by the implementing agency to perform a second complete review of the contract. This second review resulted in some minor changes which required the contract to once again go through the host government's contract review and approval process. During 1982 and 1983 the Mission sent several letters to the implementing agency and another host government agency stressing its concern over the magnitude of the problem created by the host government's delay in approving the contract.

The savings in food grain losses depended upon the number of farmers in the program. As more farmers adopted the savings measures, the benefits increased so that over the 15-year life of the project savings of \$61.4 million would be realized. By taking the average savings of the earliest 4 years of the project, the 18-month delay in implementing this project translates into losses of food grain valued at approximately \$1 million annually based on the original estimate of benefits presented in the project paper.

Crop Protection Project

In 1978, AID and the host government agreed on a project to research, test and disseminate information on pest control techniques to farmers. The economic analysis stated that farmers could reduce pest damage to grain and other food crops by improving pest controls. The analysis showed projected benefits of \$41.3 million would be realized in Fiscal Year 1982 and 1983 with a planned project completion date of September 1982. The projected benefits from reduced pest losses for Fiscal Years 1984 and 1985

were valued at \$79 million and \$119 million, respectively. As of March 1984, the estimated project completion date had been extended two years to September 1984. AID has obligated \$5 million for this project.

Much of the implementation delays of this project is attributed to problems in the host government's equipment procurement practices. In March 1983 an Office of Inspector General report identified a general lack of internal control by the host government implementing agency to identify equipment needs and account for the receipt and distribution of equipment. The report recommended that the Mission not approve any additional equipment purchases until it ensured the equipment was needed. The Mission agreed with the recommendation. In connection with the freeze on purchases, a Project Implementation Report as of September 30, 1983 prepared by the Mission stated: "Limited procurement actions deemed critical for achievement of project goals are being authorized and AID/W notified that project's commodity procurement completion date has been administratively extended to March 30, 1984 to allow for completion of all procurement actions."

The two-year delay in completing this project will result in a net loss to the host country in food products valued at \$157 million because of pest damage in Fiscal Years 1984 and 1985 based on the economic benefits projected in the project paper.

Integrated Rural Development

AID and the host government agreed on this project in 1977. The project's objective was to increase agricultural production in the host country through the use of irrigation. The economic analysis estimated that the value of production would increase about \$2 million annually starting in about the third year. The project completion date has been extended from September 1982 to September 1985. AID has obligated \$3.6 million for this project.

Project records show that host country contracting has been a major reason for delays in implementing this project. The Mission and the appropriate parties within the host government worked together over a year to agree on the specifications for the Invitation for Bid for the project's maintenance equipment. The equipment was termed essential to the success of the project. In January 1983, because agreement could not be reached with the host government regarding the terms and conditions of the Invitation for Bids, the Mission deobligated \$1 million originally set aside for purchase of the equipment.

Another procurement problem was disclosed in a September 1983 Project Implementation Report prepared by the Mission. The report noted that an extension to a major consultant contract on the project which expired on that date had to be negotiated and signed. The same report, six months later, on March 31, 1984 stated: "Mission must continue to press for execution of the contract. A letter to the Ministry of Finance requesting immediate action on the contract appears necessary at this point."

A three-year delay in completing the irrigation project will result in annual food production losses of \$6 million based on the expected benefits stated in the project paper.

Based upon information in documents authorizing the projects, these seven examples of lost benefits amount to more than \$600 million. This amount would even be higher after considering that 90 percent of the projects in these countries were delayed about 2 1/4 years on the average. Losses such as those indicated conceivably could have assisted these lesser developed countries in their development efforts and lightened the burden of debt repayment which many of these projects involve.

Delays also tend to increase the costs of projects. The grain silos construction delay, for example, increased the project costs by at least \$13.5 million as a result of inflation and additional work by contractors.

Obviously there are other major reasons than host country contracting problems that cause the types of delays discussed in this report. Two examples of these reasons are overly optimistic timeframes for completing projects and the failure by the host government to provide counterpart funding. It would be impossible to quantify the impact on project implementation of each reason. Nevertheless, there was a clear consensus on the part of Mission and Bureau officials that host country contracting was a major problem area that needed attention.

One of the first steps in resolving this problem is to identify and document weaknesses in host country contracting activities. Accordingly, we believe that AID should enforce the policy requiring detailed assessments of a host country procurement capabilities prior to approving projects providing for host country contracting.

Host Country Payment Processes and Accounting Controls

Controls over payments under host country contracting arrangements are weak. This has led to a significant amount of funds being paid which later were determined to be questionable or unallowable. In addition, excessive cash advances have routinely been made to contractors resulting in very significant unnecessary interest charges. The weaknesses in the payment processes could have been identified and appropriate action taken had AID performed the required assessments.

Under AID's operating procedures, contractor's vouchers submitted for payment are reviewed first by the host government. Once approved, vouchers are submitted to the AID Mission where they again are reviewed and eventually paid by AID. Missions rely mainly on the host government for reviewing vouchers. The Mission simply determines that the costs claimed are valid on their face and that sufficient project funds are available for making payment. Many contracts provide, however, that if the host government doesn't process the voucher within 30 days of receipt, contractors can submit claims directly to AID and receive payment. In these cases the requirement for a detailed review by the host government is by-passed.

Office of Inspector General reports are replete with examples of excessive cash advances by host countries to their contractors and payments to contractors that were questionable or unallowable. For example, in October 1983 the Inspector General reported that a host country contractor received excess advances averaging about \$1.6 million per month. We estimated that it cost the U.S. Government as much as \$680,000 in unnecessary interest charges.

In some cases, Missions have undertaken reviews of claims as a means of checking on host country accounting controls. At one Mission the Controller's office reviewed host country records to verify its requests for reimbursement of allowable project costs. During the period September 1983 through January 1984 the Controller disallowed approximately \$700,000, or about 14 percent, of the \$5.1 million claimed. The disallowances were made because contractors had failed to provide the host country with adequate supporting documentation and payments made to the contractors were in excess of approved amounts.

Weaknesses in accounting controls over the payment processes were further illustrated in an April 1984 study by an international accounting firm. The firm concluded that there was a lack of knowledge by the Mission's staff of what procedures were actually performed by the host government to assure proper payments under host country contracts. Had a detailed assessment been performed, as required by AID policy, this information could have been available. The firm also concluded that the Mission's system of internal controls over the host country contract payment process system did not provide reasonable assurance that (1) payments under these contracts were made in compliance with applicable law, (2) funds were adequately safeguarded against waste, unauthorized use or misappropriation, and (3) transactions related to these contracts were executed in accordance with AID regulations. The firm reported that the Mission had almost 200 active host country contracts with a total value of over \$1.6 billion. However, no formal assessment of the host country contracting capabilities had ever been performed.

Requirement and Performance of Audits

Final cost audits are poor substitutes for adequate host country internal control systems over contract expenditures. Nevertheless, AID Missions rely to an unusual degree on final audits as financial control mechanisms. These audits, however, sometimes are not made and, if made, are several years past the payment date. AID Handbooks 3 and 11 require audits of host country contracts. AID Handbook 11 requires cost reimbursement contracts to be audited for compliance with all contract provisions (including allowability, allocability, and reasonableness of costs) while fixed price contracts are audited only for nonfinancial requirements of the contracts (source and origin, use of U.S. Flag Carriers, markings, etc.) AID Handbook 3 stipulates that:

- Audits of host country contracts are the responsibility of the host country and should be stipulated in the Project Agreement.
- The capability of the host country to conduct such audits should have been determined by the Mission in its analysis of the country's management capabilities during the project development stage.

- The Mission Controller is responsible for assessing the technical capability of the host country in the financial area.
- The project officer or Mission Controller is to assure that the host country meets the responsibility for the conduct of such audits.
- The project officer is to notify the Mission Director of audits that are not performed so that he may review the issue with appropriate officials of the host country.

None of these responsibilities were being met. With respect to the first responsibility, none of the project agreements we examined stipulated that the host country was responsible for audits of host country contracts. The agreements usually were vague on whether audits were, in fact, required. Missions staffs also did not know (1) what the host countries capabilities and practices were for conducting audits of host country contracts or (2) the number of host country contracts that required audits. Similarly, none of the other Handbook 3 and 11 requirements were being fulfilled.

Inadequate Controls Over Project Equipment

Inadequate host country controls over project equipment, including vehicles, have been disclosed on numerous occasions. A common problem concerns the lack of an adequate accounting system to identify AID-financed equipment purchased by contractors. Under one project, for example, neither the contractor nor the host government could account for equipment and related supplies valued at approximately \$3 million.

Another frequent problem concerns equipment not being effectively used. For example, there were no plans for installing or using equipment valued at \$784,000 which had arrived in the host country 2 to 4 years earlier. In another case, most of the equipment valued at about \$2 million that had been received more than two years earlier had not been used, or used only rarely.

The significance of inadequate controls over equipment was evidenced by the agenda for an October 1983 meeting between one Mission and its host government's staffs. An agenda document stated:

"A special problem in procurement and control centers on USAID financing of vehicles and their subsequent uses. Given the extreme difficulties of ensuring proper control, maintenance and use of vehicles, and the resulting audit problems, USAID believes special measures must be taken in this area, including consideration of the possibility that all passenger vehicles procurement be done with (the host government) rather than USAID-provided resources."

Instead of working to develop the host government's capabilities, the Mission subsequently developed a computerized inventory of AID-financed vehicles and increased its monitoring of vehicles. At the time of the meeting there was approximately 900 AID-financed vehicles in country with a total cost of over \$8 million.

Conclusions and Recommendations

AID's use of host countries to contract for AID-financed goods and services has been seriously deficient in terms of efficiently and effectively using AID loan and grant funds, and developing the host countries contracting capabilities and practices. This situation results in large part from the failure to make the assessments required by AID policy. There has been a diffusion of responsibilities and a low priority at all levels to ensure realistic assessments were made. Almost ten years after adopting its policy, AID had not developed a methodology for making assessments.

The current operating mode of using contractors and others to supplement existing procurement competence significantly increases the cost of doing business and adds little of instructive value to host governments in improving their contracting capabilities and practices in a manner acceptable to AID.

Adequate attention has not been focused on assessments despite well known difficulties with host country contracting. Accordingly, we believe that AID now needs to consider different alternatives for resolving this pervasive problem. A single office could be made responsible for examining the issues across Mission and bureau lines. An organization void of the day to day activities of a Mission or bureau could concentrate on developing appropriate procedures for ensuring assessments are made and for developing an acceptable methodological approach to making assessments. Visibility to the Administrator would ensure the organization gets the attention it needs to function effectively.

We believe that such an organization could mitigate many of the problems presently being experienced. It could ensure that a realistic basis exists for choosing between the host country and AID direct modes of contracting and for directing technical assistance to recognized areas of weakness. Finally, the organization also could help AID achieve its policy objectives of developing host country contracting capabilities. The significance of the problems warrant high level management attention. Accordingly we recommend that:

Recommendation No. 1

The Administrator make one office specifically responsible for the area of host country contracting. This office should (a) be independent of organizations already assigned responsibilities to perform assessments and assure that the assessments are performed, (b) have the authority and staff resources to ensure implementation of AID's policy on the use of host country contracting, and (c) report semi-annually to the Administrator on the compliance with AID's policy on host country contracting, accomplishments toward the policy's objectives, and problem areas requiring attention.

Recommendation No. 2

The Administrator should establish a task force to develop (a) a methodology for performing realistic assessments and (b) procedures for ensuring that assessments are performed in the design stages for future projects and timely scheduled for current projects.

Recommendation No. 3

The accountable office should develop a program and procedures for monitoring the overall areas of host country contracting.

NEED FOR MORE ACCURATE INVENTORY OF HOST COUNTRY CONTRACTS

An accurate inventory of host country contracts is needed for AID offices to carry out their statutory and administrative responsibilities. For more than seven years AID has attempted to develop a centralized inventory of such contracts. Although some progress was made in 1983, the inventory is significantly understated. The basic problems are caused by the (1) inadequate guidelines on what contracts and data should be reported by the Missions and (2) inadequate internal controls to assure the accuracy of the inventory.

Background

In March 1977, the AID Administrator directed regional bureaus and Missions to establish procedures to ensure that copies of all AID-financed host country contracts were submitted to the Office of Contract Management under the Bureau for Management, where a centralized file and data bank would be established and maintained. The purpose of establishing a central point for recording and keeping track of these contracts was to overcome AID's recurring problems in reporting such activities to the Congress and the need for this data within AID offices responsible for matters such as the administration of contracts. In December 1977 and in January 1979 Missions were reminded of the requirement to provide data on host country contracts for input into the contract information system.

In May 1979 and June 1982, the Office of Inspector General and the General Accounting Office, respectively, reported that a centralized inventory of host country contracts had not yet been established. Between 1979 and 1982 AID regional bureaus, the Office of Contract Management in the Bureau for Management, and the Office of Legislative Affairs were responsible for obtaining contract information from the Missions. As of October 1982, the Office of Financial Management, in the Bureau for Management, has been assigned responsibility for developing and maintaining the inventory.

The Office of Financial Management has made progress in obtaining more complete data on contracts valued at \$100,000 or more. Missions were requested to report this data semi-annually and follow-up requests are made to Missions not reporting. Beginning in April 1984 the missions were requested to report throughout the year on the award of contracts and on amendments to existing host country contracts. Currently the inventory is maintained manually but is expected to be computerized by September 1984. 1/

As of October 1, 1983, the inventory included 448 active host country contracts of \$100,000 or more with a total value of \$2.2 billion. In 1982 AID estimated that the value of host country contracts under \$100,000 was \$200 million to \$300 million.

Inventory Understated

The inventory data reported for the Missions visited was significantly understated. We identified almost \$80 million in active host country contracts valued at \$100,000 or more as of October 1, 1983 that were not included in the inventory. This information is shown in greater detail in the following schedule.

<u>Mission</u>	<u>Number of Contracts Reported</u>	<u>Reported Value (in \$ Millions)</u>	<u>No.</u>	<u>Additional Numbers and Values Disclosed Values (in \$ Millions)</u>
Egypt	150	\$ 1,492.5	55	\$ 32.0
Philippines	7	5.7	83	25.9
Indonesia	5	13.2	5	12.3
Thailand	15	10.8	10	2.2
Panama	1	10.4	1	.4
Kenya	<u>15</u>	<u>49.6</u>	<u>3</u>	<u>6.8</u>
	<u>193</u>	<u>\$ 1,582.2</u>	<u>157</u>	<u>\$ 79.6</u>

The above table is merely illustrative of the inaccuracy of the inventory. We did not attempt to develop the full extent of the inventory reporting problem. The actual number and value of contracts at most of the missions were probably significantly more than reported.

1/ In response to the draft report the Assistant to the Administrator for Management stated that an automated system has been developed and the Office of Financial Management will commence inputting data in September 1984.

Need for Guidelines and Internal Controls

Although AID has made progress in the last couple of years in developing a centralized inventory of host country contracts, little action has been taken to establish internal controls either within the Missions or by the Office of Financial Management to assure that all contracts were reported and the accuracy of the data. Some of the same problems reported by the General Accounting Office two years ago existed at the time of our review. For example, adequate guidelines still had not been developed on what types of contracts and data should be reported. Some missions were not reporting local construction contracts, personal service contracts, contractual agreements between host government agencies, and project contracts financed with Commodity Import Program funds.

The General Accounting Office report also stated that a basic problem in obtaining accurate information from the Missions was that project officers were not convinced that the information could contribute to better operations or serve public relations purposes. The report noted that this belief was reinforced by the lack of Mission, regional bureau, or Bureau for Management follow-up to ensure accurate reporting.

Expired Host Country Contracts

Another problem not previously identified concerns expired host country contracts. Handbook 3, Supplement B, requires Project Officers to assure that all host country contracts are properly closed out. This is the last phase of the contracting process. Officials at each of the Missions said they did not know whether or not expired host country contracts had been properly closed out. Accordingly, these officials did not have assurances that (1) the host government and AID had accepted the contractor's work, (2) all AID-financed property involved during performance of the work was accounted for, and (3) charges for work performed were properly made. The current attempt to develop an inventory only deals with active contracts--no effort has been made to identify expired host country contracts that have not been properly closed out.

Reports to the Office of Legislative Affairs

Since July 1982 the Missions also were required to report each host country contract of \$100,000 or more expected to be awarded to an American contractor to the Office of Legislative Affairs. This reporting requirement also has been inaccurate. For example, a comparison of contracts awarded by one host country between January 1 and September 30, 1983 that were reported to the Office of Financial Management with those recorded by Office of Legislative Affairs disclosed a difference of at least 13 contracts valued at \$99 million.

Use of Inventory

We believe that a centralized inventory of host country contracts would be useful to AID. This inventory is needed to enable AID to carry out its statutory and administrative responsibilities. For example, this information is needed in order for (1) AID management to assure compliance with Federal

and AID regulations, (2) the Office of Inspector General to ensure adequate audit and inspection coverage, and (3) the Office of Legislative Affairs to report necessary data to the Congress.

Conclusions and Recommendations

AID has not developed the required inventory on host country contracts and contractors. A basic problem precluding the development of the inventory is a general lack of concern or inadequate monitoring procedures to assure accurate reporting. An accurate inventory is needed to enable AID offices to effectively and efficiently perform their statutory and administrative responsibilities.

Accordingly, we recommend that:

Recommendation No. 4

The office assigned responsibility for monitoring the area of host country contracting develop procedures for ensuring that an accurate inventory system is maintained on host country contracts.

Recommendation No. 5

The office develop guidelines on the types of contracts and related data that should be reported by Missions. The guidelines also should address (a) the information needs of users of the data to be reported, (b) reporting of active contracts valued at less than \$100,000, and (c) inactive and expired contracts.

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON, D.C. 20523

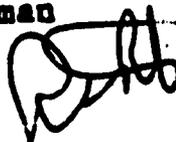
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ASSISTANT TO THE ADMINISTRATOR
FOR MANAGEMENT

20 SEP 1984

MEMORANDUM

TO: RIG/A/W, Mr. E. John Eckman

FROM: AA/M, R. T. Rollis, Jr. 

SUBJECT: Office of Inspector General Draft Report, Host Country Contracting: Assessing Host Country Capabilities and Practices and Reporting Host Country Contracts

This response only includes the comments of the Bureau for Management (i.e., M/FM and M/SER/CM). The short time established for review in your covering memo dated August 31 does not allow for coordination with the Regional Bureaus and Missions as you requested.

There are some fine points in the draft report we would like to bring to your attention.

1. On page 9, the draft report says that Handbook 17 assigns M/SER/CM responsibility to review host country contracting capabilities. As a practical matter, M/SER/CM has done very little in this area. All operational responsibility for host country contracts flows to the regional Assistant Administrators and then to Mission Directors (under Delegations of Authority 5 and 38 and redelegations thereunder). The Deputy Administrator directed on March 10, 1977, that "As circumstances require, Regional Bureaus will be responsible for seeking the advice and guidance of SER/CM in . . . evaluating . . . cooperating country procuring agencies." Handbook 17 is not accurate in assigning review responsibility, and M/SER/CM will take the appropriate action to have it changed.
2. Page 13-14. While we agree that the Departments of Defense and Energy have useful methodologies for assessing procurement (mainly domestically-based U. S. Government procurement systems) which certainly merit detailed review, we point out that the A.I.D. assessments would be looking at the operations of sovereign foreign governments, and the methodology would need to be modified accordingly.

3. Page 18. It should be noted that SER/CM and ENGR were requested by NE/PD to review the contract for the grain silos project prior to A.I.D. approval. Part of the delay resulted because NE/PD, SER/CM, and ENGR felt the prices in that contract were inflated. As a result, several months later, the contract was awarded at a price approximately \$8 million less than originally negotiated.
4. Page 27. The Agency has recently revised and tightened its policy on advances to host country contractors. This new policy is contained in Chapter 15 of Handbook 1, Supplement B. Revisions to Handbook 11, Chapters 1, 2, and 3 to incorporate and implement the policy are in process.
5. Page 37. The comment, "For example, adequate guidelines still had not been developed on what types of contracts and data should be reported," is somewhat misleading. In April 1984, M/FM issued detailed instructions which requested the field missions to report all host country contracts over \$100,000 active as of April 1, 1984. The instructions included a detailed revised data sheet with instructions concerning what information or data is required for each item of the data sheet. Also included was a format and instructions for a semi-annual summary inventory of active host country contracts. In the instructions, Missions were also asked to submit a data sheet for each new host country contract signed after April 1, 1984 and also a data sheet "whenever a Host Country Contract is amended, terminated, or expired."

In response to Recommendation No. 4, an automated system has been developed and tested by M/SER/IRM. M/FM will commence inputting data this month. The April 1, 1984 host country contract data sheets received from Missions have been reviewed for accuracy and consistency and edited. Follow-ups were sent to Missions wherever clarification and/or additional data was required. This procedure will be followed in the future. In addition, a control system has been established to keep track of all the award notification cables sent to the Office of Legislative Affairs and to match these against the data sheets for each country contract. Any discrepancy will be followed-up. From the data base of the automated system, sixteen standard reports will be generated for various users. Some reports will be sent to Missions and Regional Bureaus listing their inventory of active host country contracts. The Missions/Regional Bureaus will be asked to review and confirm the inventory. The semi-annual summary inventory of active country contracts submitted by Missions will also be reconciled with the data in the automated system.

In response to Recommendation No. 5, guidelines were issued prior to the completed automation. The automation process has raised the need for further clarification which will be addressed in M/FM's next revision. Sixteen reports have been developed which have been accepted by the known users. We expect the number of reports to expand as the capability of the inventory system becomes more established; existing reports will be refined as the needs become clearer. In response to the Gray Amendment, Missions may be asked to report active contracts of less than \$100,000 if the contractor is minority-owned. Missions will also be required to delete inactive or expired contracts on a routine basis.

SEP - 71 1984

MEMORANDUM

TO: AA/M, R. T. Rollis, Jr.

FROM: DAA/ASIA, Eugene S. Staples **ESS**

SUBJECT: Office of Inspector General Draft Report, Host Country Contracting: Assessing Host Country Capabilities and Practices, and Reporting Host Country Contracts

REF: Eckman/Rollis memorandum dated August 31, 1984

We agree that host country contracting is a significant factor, among a number of others, that can cause serious delays in project implementation. Improved assessments, carried out as an integral part of project design, can uncover some of the weaknesses in host country contracting capability and lead to proposed solutions to ensure better management of the contracting process. Having said that, there will still be delays that are inherent in a complicated process marrying host country and AID procurement requirements. We might note that while we continue to try and improve the AID direct contracting process, this too, at times, can be a significant element in delaying project start-up. Direct contracting would by no means be a panacea by itself as an alternative to host country contracting, in getting at root causes of delays in project implementation.

We believe that Recommendation No. 2 for the development of an improved methodology for performing realistic assessments and procedures for ensuring that assessments are performed in the design stages is sound and would provide better guidance to Missions to carry out this responsibility. An appropriate task force with Regional Bureau participation would be able to develop these guidelines.

Carrying out this assessment responsibility, however, will be best done within the context of Mission Directors' and Regional Bureaus' responsibility to assure sound analyses for design and implementation of all project aspects including procurement responsibility. Thus we don't agree, and feel it impractical, to establish one office (per Recommendation No. 1) with this accountability and with authority over and independent of Missions and Regional Bureaus. We feel this would undermine the delegations, responsibilities and types of accountability provided to Missions and Regional Bureaus. Steps can be taken by the Bureaus to better ensure that the appropriate assessments are carried out by the Missions, in part through the improved methodological approach and refined procedures recommended in the audit report. We believe that increasing support to Missions for design and implementation (including procurement planning and

pre-implementation) and measures to improve and reward Mission implementation personnel are more likely to alleviate the real problems. (See Auditor's Note)

Concerning Recommendation No. 3, each Regional and Central Bureau involved, together could develop the necessary approach for monitoring the key concerns and information needs in the area of host country contracting.

Recommendation No. 4 and 5 are reasonable and appropriate for an existing Central Bureau, possibly SER/CM or M/FM. To keep the requirements and workload to a minimum, considerable thought should be given to priority informational needs and types of contracts that need to be reported through any established system.

cc: ASIA/EMS, MTumblin
ASIA/PD, RPratt
ASIA/EA, DMerrill

Auditor's Note: The recommendation included in the draft report was revised. The final report does not recommend that the designated office have authority over the regional bureaus or be accountable for selecting the appropriate contracting mode. The final report recommends that the designated office be responsible for ensuring implementation of AID's policy on host country contracting.

**HOST COUNTRY CONTRACTING:
ASSESSING HOST COUNTRY CAPABILITIES AND PRACTICES,
AND REPORTING HOST COUNTRY CONTRACTS**

List of Report Recommendations

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<u>Recommendation No. 1</u>	18
<p>The Administrator make one office specifically responsible for the area of host country contracting. This office should (a) be independent of organizations already assigned responsibilities to perform assessments and assure that the assessments are performed, (b) have the authority and staff resources to ensure implementation of AID's policy on the use of host country contracting, and (c) report semi-annually to the Administrator on the compliance with AID's policy on host country contracting, accomplishments toward the policy's objectives, and problem areas requiring attention.</p>	
<u>Recommendation No. 2</u>	19
<p>The Administrator should establish a task force to develop (a) a methodology for performing realistic assessments and (b) procedures for ensuring that assessments are performed in the design stages for future projects and timely scheduled for current projects.</p>	
<u>Recommendation No. 3</u>	19
<p>The accountable office should develop a program and procedures for monitoring the overall areas of host country contracting.</p>	
<u>Recommendation No. 4</u>	22
<p>The office assigned responsibility for monitoring the area of host country contracting develop procedures for ensuring that an accurate inventory system is maintained on host country contracts.</p>	

**HOST COUNTRY CONTRACTING:
ASSESSING HOST COUNTRY CAPABILITIES AND PRACTICES,
AND REPORTING HOST COUNTRY CONTRACTS**

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Recommendation No. 5

22

The office develop guidelines on the types of contracts and related data that should be reported by Missions. The guidelines also should address (a) the information needs of users of the data to be reported, (b) reporting of active contracts valued at less than \$100,000, and (c) inactive and expired contracts.

**HOST COUNTRY CONTRACTING:
ASSESSING HOST COUNTRY CAPABILITIES AND PRACTICES,
AND REPORTING HOST COUNTRY CONTRACTS****List of Report Recipients**

Assistant to the Administrator for Management, AA/M	2
Associate Assistant to the Administrator for Management Services, M/AAA/SER	5
Assistant Administrator, Bureau for Asia, AA/ASIA	5
Assistant Administrator, Bureau for Near East, AA/NE	5
Assistant Administrator, Bureau for Latin America and the Caribbean, AA/LAC	5
Assistant Administrator, Bureau for Africa, AA/AFR	5
Assistant to the Administrator for External Affairs, AA/XA	1
Office of Media, Bureau for External Affairs, XA/PA/M	2
Bureau For Program and Policy Coordination, PPC/EA	1
Center for Development Information and Evaluation, PPC/CDIE	2
Office of Financial Management, M/FM	5
Office of Legislative Affairs, LEG	1
Office of the General Counsel, GC	1
AID Overseas Offices	69
Office of Inspector General, IG	1
RIG/A/Nairobi	1
RIG/A/Manila	1
RIG/A/Cairo	1
RIG/A/Karachi	1
RIG/A/Dakar	1
RIG/A/LA/W	1
AIG/A	1
IG/PPP	1
IG/II	1
IG/EMS/C&R	16