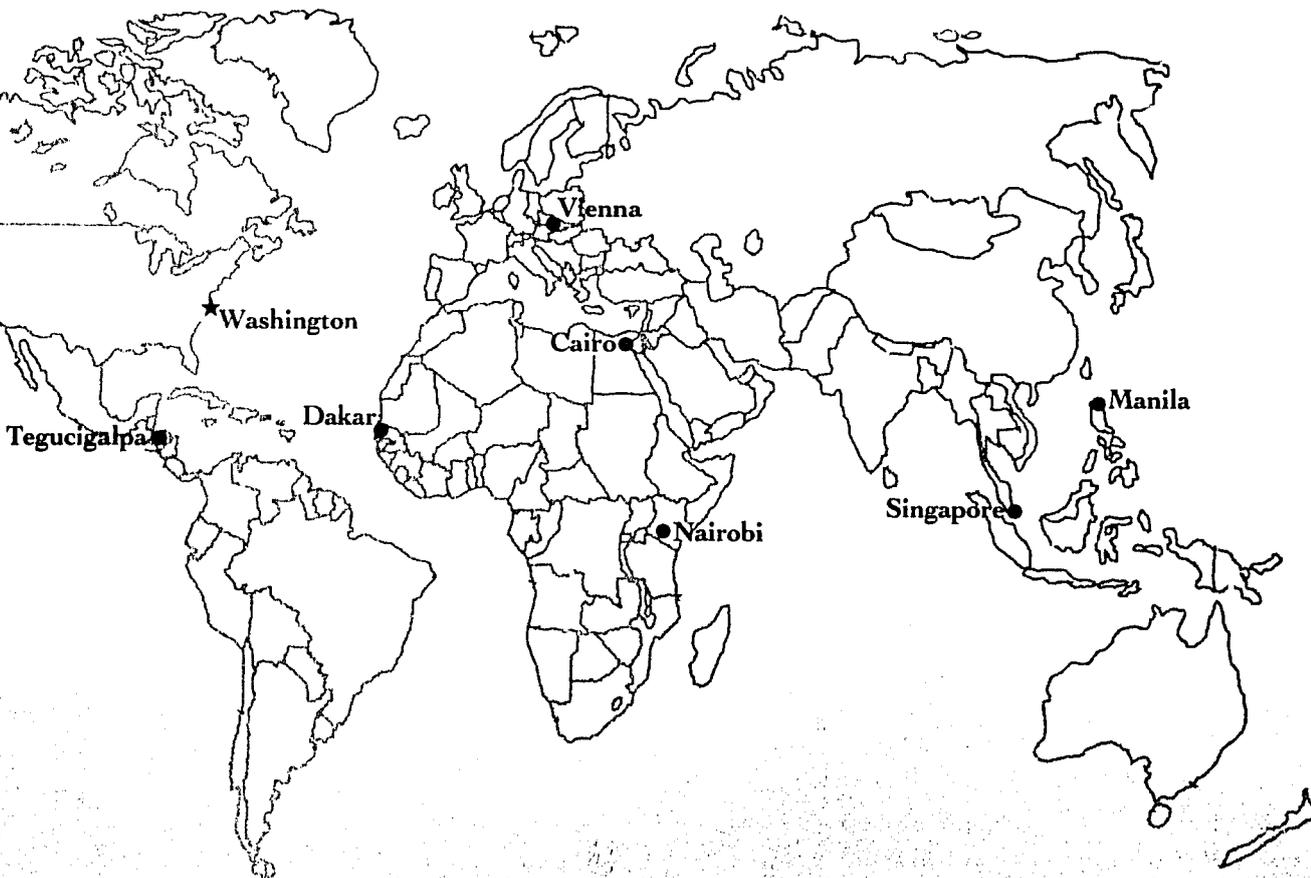

**AUDIT OF USAID/PHILIPPINES'
DIRECT A.I.D. CONTRACTING
FOR TECHNICAL ASSISTANCE**

**Audit Report No. 5-492-93-01
October 30, 1992**



**INSPECTOR
GENERAL**

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

October 30, 1992

MEMORANDUM

TO: Thomas W. Stukel, Jr.
Mission Director, USAID/Philippines

FROM: *James B. Durnil*
James B. Durnil, RIG/A/Singapore

SUBJECT: Audit of USAID/Philippines' Direct A.I.D. Contracting
for Technical Assistance (Audit Report No. 5-492-93-01)

Enclosed are five copies of the subject final report. Except for the effects, if any, of the qualification described below, our audit work found that controls over A.I.D. direct contracts for technical assistance were adequate in many areas. The Mission was generally planning, procuring, and accounting for technical assistance contracts correctly. Some controls, however, could be strengthened. For example, work statements need to be more specific; indirect cost rates need to be properly and timely established; controls over subcontracting, contractors' progress reports, contract closeouts, and reimbursement procedures need to be improved; and monitoring visits need to be better planned and documented.

During the audit, USAID/Philippines was requested to provide a representation letter to confirm in writing certain information considered essential to answering the audit objectives. USAID/Philippines provided some of the written assertions requested. Mission officials, however, would not specifically confirm in writing that to the best of their knowledge they followed A.I.D. policy and procedures in administering technical assistance program and reported to the auditors all known irregularities and material instances of noncompliance. The absence of these representations constitutes a scope limitation on our audit and precludes us from providing an unqualified opinion in answering the audit objectives.

Your comments to the draft report were very responsive. Except for Recommendation Nos. 11.3 and 12.2, all recommendations are resolved and will be closed when the agreed to actions are completed. The two recommendations can be resolved when there is agreement with the dollar amounts involved. Your comments are summarized after each finding and are present in their entirety in Appendix II of this report. Please provide us information within 30 days indicating any actions planned or taken to close the recommendations. I appreciate the cooperation and courtesies extended to my staff during this audit.

Attachments: a/s

EXECUTIVE SUMMARY

Background

USAID/Philippines contracts for technical assistance to provide support for many of its projects. For each contract, USAID/Philippines is responsible for determining the need for technical assistance, procuring the assistance, monitoring and evaluating the utilization of the assistance, and ensuring that the funds are accounted for properly. Its contracting activities are performed by contracting officers, who are located at the Mission.

As of June 30, 1991, USAID/Philippines was administering 60 active direct A.I.D. contracts for technical assistance. Obligations and expenditures for these active contracts amounted to \$48 million and \$10 million, respectively. In addition, as of December 31, 1991, there were 32 expired contracts awaiting closeout. Obligations and expenditures for expired contracts amounted to \$14.4 million and \$13.7 million, respectively (as of March 31, 1992).

Audit Objectives

We audited USAID/Philippines' controls over direct A.I.D. contracting for technical assistance to answer the following objectives:

- Did USAID/Philippines follow A.I.D. procedures in planning for technical assistance? (See pages 3 to 7)
- Did USAID/Philippines follow U.S. Government and A.I.D. regulations, policies, and procedures to ensure that technical assistance was procured at a fair price, in a timely manner, with the appropriate contract type, through full and open competition and from qualified contractors? (See pages 8 to 25)
- Did USAID/Philippines monitor contractor performance to ensure that technical assistance was provided and utilized as prescribed in A.I.D. regulations, policies, and procedures? (See pages 26 to 37)

- Did USAID/Philippines obligate, expend, and account for technical assistance funds in compliance with U.S. Government and A.I.D. regulations and procedures? (See pages 38 to 45)

The field work for this audit was conducted from June 27, 1991 through April 30, 1992, and was performed in accordance with generally accepted government auditing standards except that USAID/Philippines would not provide us with a completely acceptable representation letter. The scope of this review, the methodology used to answer the objectives, and the impact of not receiving an acceptable representation letter are discussed in Appendix I.

Summary of Audit

We requested USAID/Philippines officials to provide written representations which we considered essential to answering the audit objectives. USAID/Philippines provided us with some but not all of these written representations. Our audit conclusions are, therefore, qualified because Mission officials would not confirm in writing that to the best of their knowledge they followed A.I.D. policies and procedures and reported to the auditors all known irregularities and instances of material noncompliance. Considering the effects, if any, of this qualification, the audit did conclude that for the items tested Mission planned for technical assistance; procured technical assistance in a timely manner, through the appropriate contract type and with full and open competition; and obligated and accounted for technical assistance funds.

The following problem areas, however, came to our attention:

- Planning for technical assistance did not always provide work statements that were adequately defined or include performance indicators for measuring contractors' progress and evaluating contractors' performance. (See pages 3 to 7)
- Procurement practices could be improved to ensure that technical assistance is procured at a fair price and from qualified contractors. (See pages 8 to 25)
- Monitoring of technical assistance did not always ensure that contractors prepared work plans and progress reports to objectively measure their performance, contractors established controls over non-expendable property, and USAID/Philippines planned and documented site visits. (See pages 26 to 37)

- Control procedures could be improved for reviewing reimbursable costs paid to contractors and for determining final indirect cost rates. (See pages 38 to 45)

Summary of Recommendations

The report contains 14 recommendations to correct the problems areas. These included the following:

- Work statements in direct A.I.D. contracts should clearly define the objectives of the contract and include indicators for measuring contractor progress and performance (see page 4);
- Provisional indirect cost rates used in direct A.I.D. contracts should be established by cognizant contracting agencies (see page 9);
- Contracting Officer approval should be secured before contractors subcontract for goods and services (see page 19);
- Technical assistance contractors should include measurable targets and time frames in work plans and include in their progress reports a comparison of completed activities against the established targets and time frames (see page 26);
- Contractors should implement programs for the receipt, use, maintenance, protection, care and custody of non-expendable property purchased under direct A.I.D. contracts (see page 30);
- Site visits by Mission staff should be adequately planned and documented (see page 32); and
- Expired technical assistance contracts should be closed out in a timely manner (see page 35).

In addition, we recommended that USAID/Philippines: (1) determine if there is a need to maintain the unliquidated balances and account for and initiate distribution of the non-expendable property for the expired contracts (see page 35), (2) recover any unallowable costs identified in this report (see page 39), and (3) determine whether the internal control weaknesses identified in this report should be included in its next internal control assessment under the Federal Managers' Financial Integrity Act (see page 49).

Management Comments and Our Evaluation

In responding to the draft report, USAID/Philippines officials generally concurred with the findings and listed specific actions which would be taken to implement each of the recommendations. These actions were very responsive to the issues raised and, when completed, would further improve procedures. This demonstrates a clear commitment for strengthening the program and helping ensure efficient and effective operations.

There was agreement on actions which would be taken to resolve and close all recommendations. However, Recommendation Nos. 11.3 and 12.2 can not be resolved until there is an agreement with the monetary amounts involved. All other recommendations are resolved and will be closed when the agreed to actions are completed.

The comments received from USAID/Philippines were carefully considered when preparing this final report. These comments along with our evaluations are summarized after each finding. The comments are also present in their entirety as Appendix II to this report.

Office of the Inspector General

Office of the Inspector General
October 30, 1992

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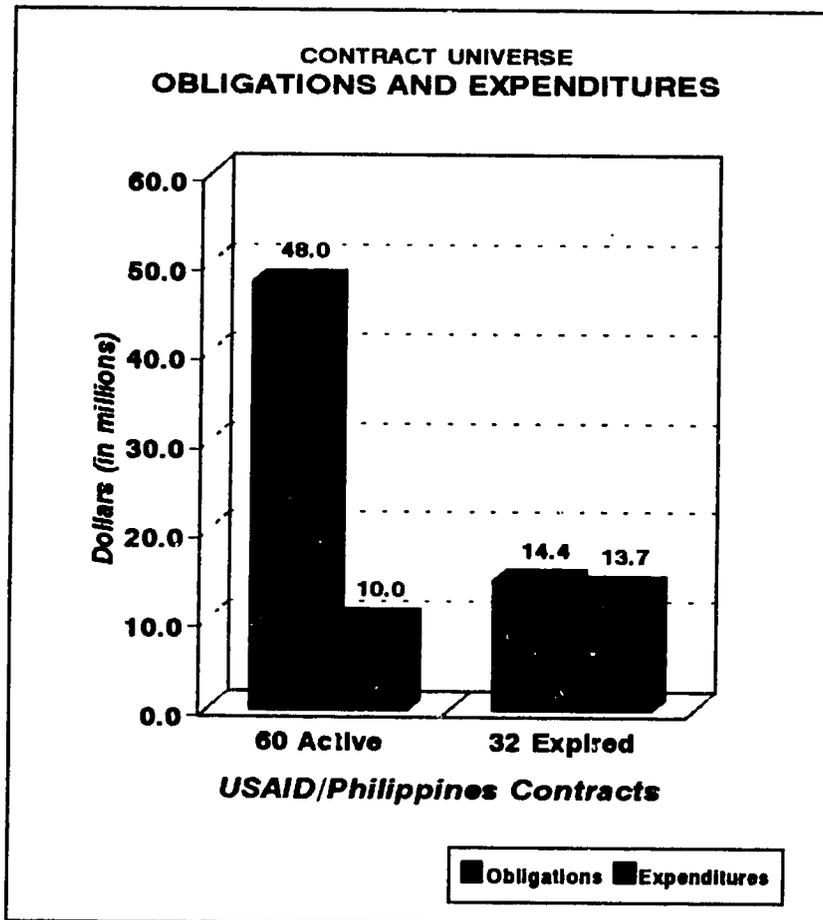
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INTRODUCTION

Background

USAID/Philippines contracts for technical assistance to support many of its projects. As shown below, USAID/Philippines was administering 60 active direct A.I.D. contracts for technical assistance as of June 30, 1991, and 32 expired contracts awaiting closeout as of December 31, 1991. Obligations and expenditures for active contracts amounted to \$48 million and \$10 million, respectively, as of June 30, 1991. Obligations and expenditures for expired contracts amounted to \$14.4 million and \$13.7 million, respectively, for expired contracts as of March 31, 1992.



For each contract, USAID/Philippines is responsible for determining the need for technical assistance, procuring the assistance, monitoring and evaluating the utilization of the assistance, and ensuring that the funds are accounted for properly. Its contracting activities are performed by contracting officers, who are located at the Mission.

Audit Objectives

The Regional Inspector General for Audit/Singapore audited, based on the approved 1992 Audit Plan, USAID/Philippines' controls over direct A.I.D. contracting for technical assistance to answer the following objectives:

- Did USAID/Philippines follow A.I.D. procedures in planning for technical assistance?
- Did USAID/Philippines follow U.S. Government and A.I.D. regulations, policies, and procedures to ensure that technical assistance was procured at a fair price, in a timely manner, with the appropriate contract type, through full and open competition and from qualified contractors?
- Did USAID/Philippines monitor contractor performance to ensure that technical assistance was provided and utilized as prescribed in A.I.D. regulations, policies, and procedures?
- Did USAID/Philippines obligate, expend, and account for technical assistance funds in compliance with U.S. Government and A.I.D. regulations and procedures?

In answering these audit objectives, we tested whether USAID/Philippines followed applicable internal control procedures and complied with certain provisions of laws and regulations and applicable contractual requirements. Our audit tests were designed to provide reasonable assurance in answering the audit objectives. However, due to a lack of a fully acceptable representation letter, we are able to provide only qualified answers to these objectives. In those instances where problems were found, we performed additional work to identify the causes and effects of the problems and make recommendations for correcting the problems.

Appendix I contains a complete discussion of the scope and methodology for this audit.

REPORT OF AUDIT FINDINGS

In accomplishing the audit work, we requested USAID/Philippines to provide a representation letter to confirm information considered essential to answering the audit objectives. USAID/Philippines provided only some of the written representations requested. Mission officials would not confirm in writing that, for those aspects of the technical assistance program being reviewed and to the best of their knowledge and belief, A.I.D. policies and procedures were followed and all known irregularities and instances of noncompliance were reported to the auditors. Instead of confirming that they had reported all known irregularities and instances of noncompliance, Mission officials would only state that they had made available (to the extent available within the Mission) and not knowingly and purposely withheld" information regarding any irregularities and instances of material noncompliance.

Our answers to the following audit objectives and our assessment of related internal controls are therefore qualified because of the lack of these written representations. We are also unable to make firm conclusions on USAID/Philippine's compliance with applicable laws and regulations.

Did USAID/Philippines follow A.I.D. procedures in planning for technical assistance?

Considering the above qualifications, we can report for the items tested that USAID/Philippines planned for technical assistance in accordance with A.I.D. policies and procedures except for not preparing well-defined work statements.

The Mission identified the need for the technical assistance, related the project goals to the need, specified the kinds of goods and services to be procured and their probable sources, and identified the contracting mode and the applicable procedures to be used in accordance with A.I.D. Handbook 3, Chapter 3. For example, in a privatization project, a goal to privatize selected state-owned enterprises was related to the planned technical assistance for the valuation and marketing of these enterprises. In another project, the project paper included a listing specifying the kinds and amounts of goods to be procured with their probable sources. The contracting mode and procedures to be used for procurement were also included.

A.I.D. Handbook 3, Supplement A, states that Mission Directors are required to certify in each Project Paper that the procurement plan for the project was developed with full consideration of economically and socially disadvantaged firms under the Gray Amendment Act and whether the project is appropriate for Gray Amendment organization contracting. Certifications signed by the Mission Director stating that special consideration are given to economically and socially disadvantaged firms were included.

We found, however, that the work statements were not adequately defined and did not include performance indicators for measuring contractor progress or evaluating contractor performance.

**Work Statements Need To Be Better
Defined and Include Performance Indicators**

Work statements for three of the six contracts reviewed were expressed in general terms and lacked specific performance indicators and time requirements--contrary to A.I.D. guidance. Because USAID/Philippines did not require its staff to follow procedures for the preparation of work statements, its ability to monitor and evaluate the effectiveness of contractor performance was limited for contracts valued at about \$13.5 million.

Recommendation No. 1: We recommend that USAID/Philippines implement procedures to ensure that work statements in direct A.I.D. contracts clearly define the objectives of the contract and include performance indicators for measuring contractor progress and for evaluating contractor performance.

According to A.I.D. Handbook 3, Supplement A, Appendix C, the work statement is the most substantive part of the planning document and the most essential part of the corresponding contract. The work statement must define the work to be performed and include specific targets and time frames which will enable A.I.D. and others (evaluators and non-project staff) to objectively monitor and evaluate contractor progress in achieving contract objectives. Whether a completion or level-of-effort contract is utilized, the work statement must be specific and detailed about what A.I.D. wants the contractor to do and when A.I.D. wants it done. For example, work might be divided into phases of accomplishments, each to be completed and approved before the contractor proceeds to the next phase. The work statement constitutes the essence of the agreement between A.I.D. and the contractor on what is to be done and should bind the contractor to specific obligations.

The work statements for three of the six USAID/Philippines contracts reviewed did not clearly define the work to be performed nor include performance indicators. For example:

- A \$4.2 million contract was awarded on March 9, 1990, to assist the Philippines Department of Agriculture in establishing an effective management and service-oriented system for the Accelerated Agricultural Production Project. This 23-month contract has the same work statement, except for an additional training task, as its 24-month predecessor contract with the same firm. The work statements called for the contractor to provide technical services and support in improving the Department of Agriculture's overall management system and to strengthen its capability in providing services to farmers.

The work statements of both contracts were vague and neither included performance indicators for measuring the contractor's progress or performance. For example, one objective was to develop an appropriate management system emphasizing finance, staffing, information and communications by reviewing past studies and the current management system. The project officer stated that the work statement of the second contract was not revised because the contracted work was a continuation of the first contract. However, the work statement of the first contract was vague and did not include performance indicators. As a result, USAID/Philippines limited its ability to assess the contractor's progress or evaluate its performance.

- A \$2.8 million contract was awarded on May 29, 1990, to provide technical assistance and support services to the Philippines Department of Health in the areas of epidemiology-based programs and area health planning, management information systems, social marketing, and financing. Although the contract work statement identified the contractor's duties in each area, such activities were stated in general terms. For example, under the Health Information Management System, the contractor's objectives were to: (1) assist the Department's Health Intelligence Service and Management Advisory Service in the development and nationwide implementation of health management reporting systems and (2) assist the Child Survival Program managers in assessing, analyzing, and utilizing health information in formulating policies and provisions for the improvement of institutional capacity to collect, process, and utilize information. Neither objective identifies the type of assistance the contractor is to provide or when the assistance is to be provided. In addition, there are no measurable indicators to assess the contractor's progress or evaluate its performance.

After one year of implementation, there were problems with the performance of the contractor. Department officials complained that the contractor was not responsive to their technical assistance needs.

Likewise, relationships between Department counterparts and the technical assistance team were strained. These problems appear to have been caused, at least in part, by the vagueness of the work statements and the resultant lack of ability to measure the contractor's performance against what was required in the work statements.

To correct some of these problems, USAID/Philippines conducted a workshop where certain actions were identified to improve the services of the technical assistance team, including the need to revise the work statements of the contract. These actions were scheduled to be completed by April 1992. In effect, defined work statements with performance indicators were still being developed for this contract almost two years after it was awarded.

- Another contract, valued at \$6.5 million, was awarded on May 21, 1990, to provide technical assistance over a 41-month period for (1) improving operations in the areas of management systems, finance, accounting, loan management, electrical distribution engineering, and training; (2) the development of a Rural Electrification Master Plan; and (3) procurement of project commodities. However, the work statement was not specific and did not include performance indicators. For example, one of the contract tasks was to develop accounting policy and procedures manuals for a Government of the Philippines agency and its associated cooperatives and to provide training in the use of these policies and procedures. However, this agency and the cooperatives had been functioning for several years and had existing accounting policy and procedures manuals of their own.

The work statement was not specific as to whether a new system of accounting policies and procedures was to be developed or whether only improvements to the existing accounting policies and procedures were to be made. Furthermore, performance indicators were not included in order to monitor the progress of the contractor and evaluate its performance and no schedule was indicated for the phases of the work. For example, time frames could have been provided for surveys and reviews, analysis and documentation, initial system installation and testing, revisions and streamlining, and personnel orientation and training.

USAID/Philippines did not clearly define the contracts' work statements because applicable planning procedures for the preparation of work statements were not followed. According to the Contracting Officer, work statements are prepared before the office decides on the type of contract, and level-of-effort contracts are used when the statements of work are not sufficiently defined to use a completion type contract.

However, A.I.D. Handbook 3, Supplement A, Appendix C, states that, whichever contract type is ultimately utilized, the work statement must be specific and detailed as to what the Mission wants the contractor to do and when it should be done. Likewise, the Contracting Officer stated that using level of effort contract is not an excuse for a poorly defined statement of work.

Although he agreed that performance indicators are essential for measuring contractor performance, a project official commented that they are not always included in work statements because it is difficult to identify specific performance indicators prior to contract award. In contrast, the Contracting Officer stated that USAID/Philippines emphasizes establishing performance indicators in the work statements of contracts.

A well-defined work statement can assist contracting officers in evaluating the reasonableness of contractor cost proposals and project officials in assessing contractor performance. Because USAID/Philippines did not ensure that work statements were adequately defined and included performance indicators, its ability to monitor the effectiveness of \$13.5 million of technical assistance contracts was limited. Therefore, the Mission needs to ensure that work statements are well-defined and include specific targets and time frames to measure contractor performance as prescribed by A.I.D. guidelines.

Management Comments and Our Evaluation

USAID/Philippines agreed that the work statements in the three contracts mentioned could have been better defined and included better performance indicators. However, officials mentioned that there has been significant improvement since the award of those contracts. In its comment, the Mission stated that work statements are prepared before the type of contract is decided, and level of effort contracts are used when the statements of work are not sufficiently defined to use a completion type contract. This statement has been incorporated in our discussion above.

Mission officials stated that they are aware of the need for performance based statements of work and measurable performance standards and strive to include these in the contracts wherever possible. Nevertheless, the Mission agreed with the recommendation and proposed to issue a notice establishing a requirement that each PIO/T contain a separate section for the inclusion of specific objectives and performance indicators in the statement of work.

Actions planned by USAID/Philippines are responsive to Recommendation No. 1; therefore, it is resolved on issuance of this report. The recommendation can be closed upon establishment of evidence that statements of work of contracts approved after issuance of notice contained specific objectives and measurable performance indicators.

Did USAID/Philippines follow U.S. Government and A.I.D. regulations, policies, and procedures to ensure that technical assistance was procured at a fair price, in a timely manner, with the appropriate contract type, through full and open competition and from qualified contractors?

Considering the effects of the qualification discussed on page 3, we found for the items tested that USAID/Philippines generally followed U.S. Government and A.I.D. regulations, policies, and procedures in procuring technical assistance in a timely manner, through the appropriate contract type and with full and open competition. However, these regulations and procedures were not always followed to ensure that technical assistance was procured at a fair price and from qualified contractors.

The Federal Acquisition Regulation (Subpart 5.203) states that a notice of proposed contract action must be published in the Commerce Business Daily at least 15 days before the issuance of solicitations, and A.I.D. Handbook 3, Supplement A states that an average of 180 calendar days is required to award a competitively bid contract. USAID/Philippines complied with these requirements. The Mission issued solicitations no sooner than 15 days after the notice was published, and all competitively bid contracts were awarded within an average of 180 calendar days.

A.I.D. Handbook 1, Supplement B (Section 12B.2h) and the Federal Acquisition Regulation (Subpart 16.301-2) allow cost reimbursement-type contracts when uncertainties in contract performance do not permit costs to be estimated to the same degree of accuracy as fixed-price contracts. The Contracting Officer determined that the services to be provided in the six contracts reviewed could not be sufficiently defined to form a basis for a fixed-price contract. Accordingly, cost reimbursement-type contracts were utilized in each case.

Contracting officers must promote and provide for full and open competition in soliciting offers from prospective contractors as required by the Federal Acquisition Regulation (Subpart 6.101) and A.I.D. Handbook 1, Supplement B (Section 12B.2c). The Contracting Officer satisfied these requirements for full and open competition. For example, evaluation factors for making selections and their relative importance were provided to prospective contractors in Requests for Proposals, the Contracting Officer utilized the information provided by the technical evaluation committees which assessed each proposal based on the evaluation criteria, and the Contracting Officer prepared the required memoranda of negotiations.

Regulations and procedures to ensure that contracts were awarded at a fair price and to qualified contractors, however, were not fully followed. As discussed below, USAID/Philippines did not (1) coordinate with the proper office to establish

provisional indirect cost rates, (2) support and document the reasonableness of negotiated contract costs, (3) document the process of determining that technical assistance is procured from responsible contractors, (4) approved subcontracts prior to their awards, (5) ensure that technical evaluation committees document reference checks, and (6) review technical evaluation score sheets to ensure the accuracy and completeness of the documents supporting the committees' final ranking of prospective contractors.

**Provisional Indirect Cost Rates
Were Not Properly Established**

USAID/Philippines approved provisional indirect cost rates using contractor-provided information rather than rates established by cognizant contracting agencies, as required by applicable regulations and guidance. This occurred because the Contracting Officer did not follow procedures in establishing provisional indirect cost rates. As a result, USAID/Philippines, for the five of the six contracts reviewed, was paying the contractors \$3.2 million in estimated indirect costs without knowing whether the billing rates for those costs were correct.

Recommendation No. 2: We recommend that USAID/Philippines:

- 2.1 implement procedures for obtaining established provisional indirect cost rates, through A.I.D.'s Procurement Support Division, from cognizant contracting agencies;**
- 2.2 review the provisional indirect cost rates established under direct A.I.D. contracts with U.S.-based contractors and obtain evidence, in coordination with A.I.D.'s Procurement Support Division, that the approved rates are consistent with the current rates established by cognizant contracting agencies; and**
- 2.3 obtain contractor agreement to adjust the approved billing rates for contractor progress payments if these rates are inconsistent with the current rates established by cognizant contracting agencies.**

When the U.S. Government enters into a cost-reimbursement contract with a U.S.-based contractor, the contract normally provides for payment of indirect costs--such as overhead, fringe benefits, and other administrative expenses--through the application of an indirect cost rate. An indirect cost rate is expressed in percentage terms and represents the ratio of indirect costs incurred over a given period to direct labor costs or another appropriate base for the same period. The indirect cost rate applicable to each U.S.-based contractor should be established by a single U.S.

Government agency to ensure (1) uniformity of approach with the contractor when more than one contract or agency is involved and (2) economy of administration. To this end, the Federal Acquisition Regulation (Subpart 42.704) requires the following:

The cognizant contracting officer (usually with the Government agency having the most business with the respective contractor) is responsible for determining the provisional indirect cost rates to be billed under contracts. These rates shall be established on the basis of information resulting from recent review, previous audits or experience, or similar reliable data or experience of other contracting activities.

To implement this U.S. Government regulation, A.I.D. requires--as enumerated in Contract Information Bulletin 90-21--a single office to establish indirect cost rates, when A.I.D. is the cognizance government agency for a contractor. A.I.D.'s Procurement Support Division, Overhead and Special Cost and Contract Close-Out Branch, is the only office in A.I.D. designated responsibility for establishing these rates. The Bulletin also states that Missions may not negotiate a different rate or base of application.

Five of the six contracts reviewed had established indirect cost rates which did not comply with A.I.D.'s requirements. The value of the indirect costs for these contracts was estimated at \$3.2 million. The sixth contract was with a local contractor; therefore, it was not subject to the requirements. For four of the five contracts, A.I.D. is the cognizant agency; therefore, A.I.D.'s Procurement Support Division should have established the rates. The rates for the fifth contractor should have been established by its cognizant agency and provided to A.I.D.'s Procurement Support Division. However, the Contracting Officer established the indirect cost rates for the five contractors using information provided by them--two based on financial statements and three based on previously negotiated Indirect Cost Rate Agreements. The Contracting Officer did not follow procedures in establishing provisional indirect cost rates by requesting the latest available rates from A.I.D.'s Procurement Support Division.

Contracts with rates based on financial statements are discussed below:

- **For one contract, awarded in June 1990, with indirect cost valued at about \$589,000 the Contracting Officer established a provisional overhead rate of 107.9 percent and a fringe benefit rate of 27.1 percent, both based on direct labor costs, for a total of 135 percent. These rates were derived from the June 30, 1989, financial statement of the contractor, which was included in the contractor's proposal. The contractor indicated that the last audit conducted by the cognizant audit agency recommended a provisional overhead rate of 131.7 percent for 1986 and until amended.**

The Contracting Officer did not coordinate with A.I.D.'s Procurement Support Division to determine the current established indirect cost rates. Rather, he approved a rate he believed was reasonable based on the information provided by the contractor. Although the Mission had expended \$800,000 (\$211,000 more than budgeted as of December 31, 1991) for indirect costs, the established indirect cost rates had still not been obtained as of May 1992. As a result, USAID/Philippines is not sure if the amount expended was based on the correct rate.

- Another contract, awarded in June 1990, included about \$967,000 in indirect costs. The negotiated overhead rate for this contract was based on the contractor's financial statement for the period ending December 31, 1989. The Contracting Officer established this overhead rate at 150 percent of direct salary costs. He did not coordinate with A.I.D.'s Procurement Support Division to determine the current established indirect cost rates. However, on June 14, 1991, almost a year after the contract was signed, the Contracting Officer received a cable from A.I.D./Washington stating that both the final and provisional rates for calendar years 1990 and 1991, respectively, were 159.28 percent.

In response to the cable, the Contracting Officer amended the contract on July 29, 1991, to establish the contractor's final indirect cost rate at 150 percent of direct labor for the period June 26, 1990 through December 31, 1990. Likewise, the provisional indirect cost rate established for 1991 and beyond was not amended. According to the contract specialist, the contract could not be adjusted to reflect the current negotiated indirect cost rates because the contract's negotiated rate of 150 percent is stated as a ceiling for overhead purposes. Although the established indirect cost rate is advantageous to the U.S. Government, the procedures used in determining this rate were not in accordance with applicable regulations and resulted in a lower rate for the contractor than was appropriate.

Contracts with rates based on negotiated indirect cost rate agreements had rates established that were not current. For example:

- A contractor used its negotiated 1986 provisional indirect cost rates in its proposal for a contract awarded on March 9, 1990. This contract included indirect costs of about \$579,000. The Contracting Officer established the indirect cost rates--overhead rate of 120 percent and fringe benefit rate of 25 percent--for the period March 9, 1990, through December 31, 1991, without requesting information from A.I.D.'s Procurement Support Division. Furthermore, there was no

documentation, not even a copy of the 1986 negotiated rate agreement, in the contract file to show the basis for establishing the provisional indirect cost rates. As a result, USAID/Philippines has paid this contractor \$350,000 for indirect costs for the period February 1990 through December 1991 without knowing whether these costs were based on the correct rate.

- A contract, awarded in May 1990, included indirect costs of about \$703,000 based on a negotiated provisional overhead rate of 46 percent of total direct salaries and fringe benefits. This rate was based on a negotiated provisional indirect cost rate provided by the contractor, effective January 1, 1989, and until amended, of 46 percent of total direct salaries plus deferred compensation and fringe benefits. No explanation was given for why the bases of these rates were different. Had the Contracting Officer obtained the current provisional indirect cost rate from A.I.D.'s Procurement Support Division, he would have been provided both the current established rate and correct base for applying the rate.

In November 1991, the Contracting Officer received a cable indicating the 1990 final rate of 43.65 percent and 1991 provisional rate until amended of 43.65 percent, both based on total direct salaries plus deferred compensation plus fringe benefits. Five months after the receipt of the cable, the Contracting Officer amended the contract to reflect the current overhead rates. Although the payments to contractor have been adjusted, the way that the indirect cost rates were established was not in accordance with applicable regulations.

The Contracting Officer's practice of establishing overhead rates using contractor information is not in accordance with the Federal Acquisition Regulation or A.I.D. policy. The Contracting Officer stated that he relies on the contractor to inform him about the rates established by cognizant agencies and to provide its most recent financial statement, if it is to be used in establishing the provisional indirect cost rates. If the contractor certifies that there are no applicable negotiated indirect cost rates, he uses the contractor's financial statements as the basis for determining the indirect cost rates of the contracts.

The Contracting Officer added that A.I.D./Washington informs Missions about the latest indirect cost rates of contractors--by cables to the Missions. Once the cables are received, he amends the contracts to reflect the current indirect cost rates. Therefore, the Contracting Officer believes that he does not need to coordinate with A.I.D.'s Procurement Support Division about provisional indirect cost rates.

We disagree. Although the Contracting Officer amends the contracts once he receives the current rates established by cognizant agencies, it is still necessary for the Contracting Officer, during the negotiation process, to consult with A.I.D./Washington in order to apply the most current negotiated rates and verify the contractor's proposed rates.

A major reason why the Contracting Officer has not complied with the Federal Acquisition Regulation and A.I.D. policy is that A.I.D. has not established clear procedures for implementing these requirements. Although A.I.D. Handbook 17, Chapter 18, states that A.I.D.'s Overhead and Special Cost and Contract Close-Out Branch of the Procurement Support Division is responsible for establishing indirect cost rates and Contract Information Bulletin 90-21 clarified this policy in 1990, there still exists considerable confusion about what the policy requires and how to implement it.

We noted this same problem--use of indirect rates different from established rates and lack of coordination with A.I.D.'s Procurement Support Division about contractor proposed indirect cost rates--at other Missions. In our Audit Report No. 5-383-92-04, dated March 1992, we recommended that A.I.D.'s Associate Administrator for Finance and Administration clarify A.I.D.'s policy on provisional indirect costs rates and devise procedures for its clear-cut implementation.

Until this policy is clarified, USAID/Philippines needs to ensure that its Contracting Officer is using provisional indirect cost rates that are consistent with current rates established by the cognizant contracting agencies. Therefore, the Contracting Officer needs to obtain these rates from A.I.D.'s Procurement Support Division, determine whether these rates are consistent with rates approved in existing contracts and obtain contractor agreement to adjust rates that are not consistent with rates established by cognizant contracting agencies.

Management Comments and Our Evaluation

USAID/Philippines officials stated that they agreed with Recommendation No. 2.1. Recent guidance from FA/Office of Procurement in Washington made it clear that only the cognizant U.S. Government agency is responsible for establishing provisional indirect cost rates. Accordingly, the Contracting Officer has started to require that negotiated provisional indirect cost rates be approved by the Procurement Support Division and will confirm this procedure by issuing a notice to his staff.

For Recommendation Nos. 2.2 and 2.3, Mission officials also agreed and stated they will prepare a list of all active contracts without evidence that the overhead rates are consistent with those established by cognizant contracting agencies. This list will be

forwarded to the Procurement Support Division for review and determination of the correct rates. For those contracts that the rates are inconsistent with the rates obtained from the Procurement Support Division, the Contracting Officer planned to obtain contractor agreement for the appropriate adjustment.

Based on these planned actions, all parts of this recommendation are resolved on the issuance of the report and can be closed when the planned actions are completed.

The Reasonableness of Negotiated Costs Needs to be Documented

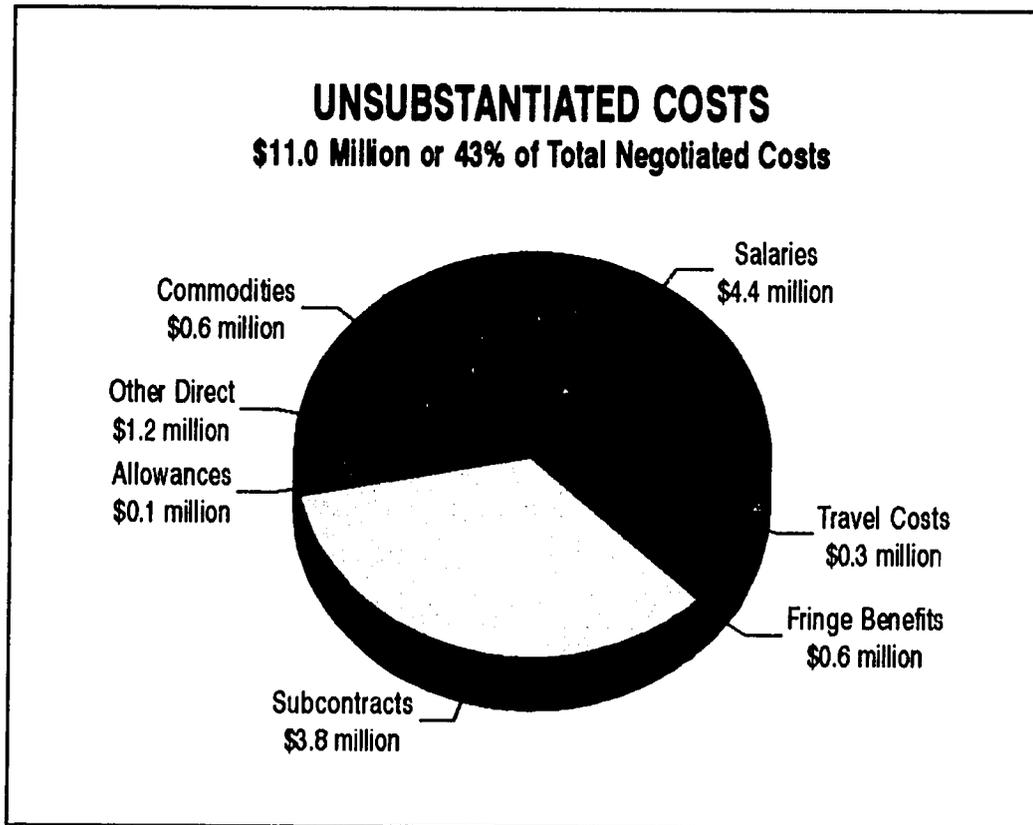
USAID/Philippines awarded technical assistance contracts without fully documenting, as required by U.S. Government regulations, the reasonableness of the negotiated costs. The reasonableness of the contract costs was based on a number of factors including the Contracting Officer's experience and general knowledge, but management stated that due to staff and time constraints, formal cost analyses or other documentation to support these determinations were not always prepared. As a result, USAID/Philippines did not have documentation to substantiate the reasonableness of \$11.0 million of the \$25.6 million negotiated in the six contracts reviewed.

Recommendation No. 3: We recommend that USAID/Philippines establish procedures to ensure that cost analyses, including comparing cost proposals with U.S. Government cost estimates, are performed and documented when determining the reasonableness of negotiated direct A.I.D. contract costs.

The Federal Acquisition Regulation, Subparts 15.805-1 and 15.805-3 requires contracting officers to make cost analyses in evaluating the reasonableness of contractor cost proposals. These analyses should compare the individual cost elements of the prospective contractors' proposals with actual cost histories, previous cost estimates from the offerors, cost estimates received from other prospective contractors, and independent U.S. Government cost estimates. The cost analyses should also verify cost or pricing data provided by the prospective contractors and analyze subcontract costs.

Furthermore, Subparts 4.801 and 4.803 require that documentation in contract files be sufficient to constitute a complete background as the basis for a decision at each step in the acquisition process and to provide information for reviews and investigation. These documents may include pre-award survey reports, references to previous pre-award survey reports, cost and price analyses, and determinations of contractor responsibility.

The Contracting Officer did not fully comply with the above requirements. In fact, documentation was not available in the contract files to substantiate the reasonableness of 43 percent, or about \$11.0 million of \$25.6 million, of negotiated costs for the six contracts reviewed. Most of the unsubstantiated costs were for salaries and subcontracts as illustrated in the following graph.



As illustrated above, unsubstantiated salaries and wages were about \$4.4 million, or 40 percent of the \$11 million budgeted. The cost proposals included biographical data sheets; however, not all of these sheets indicated the salary histories of the employees. Where they did indicate the salary histories, the salary rates in the proposals were not justified by the salary histories. To illustrate, one accounting specialist position had a salary established at \$3,025 per month, but the individual who got the position had a salary history justifying a salary of only about \$1,500 per month. The determinations made were subjective and were based on the Contracting Officers' knowledge of the prevailing rates used in the private sector. As a result, it appears that some salary rates were set at excessively high levels.

As also shown above, unsubstantiated subcontractor costs amounted to \$3.8 million. This represents 66 percent of \$5.8 million of subcontract costs reviewed. According

to the Contracting Officer, reviews of subcontractor costs were not always detailed and documented due to staff and time constraints. Because documentation indicating the performance of detailed cost analyses is not available, the Contracting Officer may have accepted subcontractor cost elements that were overpriced or irrelevant. Our examination disclosed that one subcontractor included fixed fee twice in his proposal. This proposal included a 10 percent fixed fee and another 15 percent for profit in the indirect cost element. As a result, this subcontractor overstated his fee and may have been paid excess profit under the subcontract. A detailed cost analysis of this proposal should have identified this.

Our examination also revealed that some contractors used different indirect cost rates depending on whether they were subcontractors or prime contractors. For example, two contractors used overhead rates for their subcontract proposals that were two to three percent more than those rates used for prime contracts. The Contracting Officer stated that these rates should be consistent whether they are for subcontracts or prime contracts. These inconsistencies were undetected because detailed cost analyses of subcontractor cost proposals were apparently not performed.

The Contracting Officer stated that the determinations of reasonableness were based on many factors, including his own experience and general knowledge, but due to staff and time constraints these determinations were not always documented. As a result, the reasonableness of \$11 million of contract costs was not substantiated by documented evidence of cost analyses or other forms of assurance available to the Contracting Officer.

In conclusion, USAID/Philippines needs to establish procedures to ensure that cost analyses are performed and that documentation is maintained to substantiate the reasonableness of negotiated contract costs as required by the Federal Acquisition Regulation.

Management Comments and Our Evaluation

USAID/Philippines did not fully agree with the auditor's opinion on this finding. Mission officials believed that the finding raised issues that are judgmental in nature particularly in the determination of the adequacy of cost analysis documents for evaluating the reasonableness of cost proposals. Nevertheless, the Mission agreed that there is room for improvement and concurred with the recommendation and stated a notice would be issued providing guidance for documenting cost analyses and setting standards for such documentation. Based on this planned action, the Recommendation No. 3 is resolved on report issuance and can be closed upon issuance of the above notice.

Assessments of Contractor Responsibility Should be Made and Documented

USAID/Philippines did not document determinations of responsibility for prospective contractors as required by U.S. Government regulations and A.I.D. policy. This occurred because the Contracting Officer believed that recent experience with these contractors provided him with knowledge about their abilities plus his signature to the contract was sufficient documentation to show that a determination of responsibility was made. Without conducting a routine verification to determine if a contractor is responsible, A.I.D. is vulnerable to hiring contractors lacking the necessary level of responsibility to perform under the terms and conditions of these contracts.

Recommendation No. 4: We recommend that USAID/Philippines implement procedures for ensuring that determinations of responsibility or non-responsibility of prospective contractors are performed and documented in the contract files.

The Federal Acquisition Regulation, Subpart 9.103(a), requires that contracts be awarded only to responsible contractors. Furthermore, Subpart 9.105-1(c) provides that contracting officers should use the following sources of information to support determinations of contractor responsibility or non-responsibility:

- Lists maintained in accordance with Subpart 9.4 of contractors debarred, suspended, proposed for debarment or declared ineligible;
- Records and experience data, including verifiable knowledge of personnel within the contracting office, other contracting offices, audit offices and contract administration offices;
- The prospective contractor--including bids or proposals, questionnaire replies, financial data, production reports, and personnel files;
- Pre-award survey reports; and
- Other sources such as publications, suppliers, subcontractors, and customers of the prospective contractor, financial institutions, government agencies, and business and trade associations.

A.I.D. Contract Information Bulletin 85-17 states that contracting officers should also use the past performance evaluation summaries (see reference checks discussion on page 21 of this report), in addition to other relevant information, in determining the responsibility of prospective contractors. It provides that the determinations of

responsibility for prospective contractors be documented and maintained in the contract files. Likewise, Subpart 9.105-2(b) of the Federal Acquisition Regulation states that documents and reports supporting determinations of responsibility or non-responsibility must be included in the contract files.

Our review of six contracts disclosed that the Contracting Officer did not include sufficient documentation in the contract files to indicate that determinations of contractor responsibility had been made. For example, for three of the contracts reviewed, the only reference to contractor responsibility in the contract files was a statement in the negotiation memoranda that the contractors were not on the latest list of debarred, suspended or ineligible contractors. Even this statement was not included in the negotiation memoranda for two of the remaining three contracts, and no negotiation memorandum was on file for the sixth contract.

While some of the information needed for assessing contractor responsibility was included in the proposals submitted by the prospective contractors, there was no documentation or evidence to show that A.I.D. reviewed and verified this information. The Contracting Officer commented that most of the contractors included in our review had been conducting business with A.I.D. for several years; thus, he believed there was no need to make additional assessments of contractor responsibility for these contractors. He added that signing the contracts is sufficient evidence to show that he has made determinations as to the responsibility of the contractors.

The absence of assessments and determinations of contractor responsibility for prospective contractors may result in USAID/Philippines hiring contractors who lack the necessary level of responsibility. If there are acceptable justifications for not making new reviews of familiar contractors who are doing or were recently doing business with the Mission, these justifications should be included in the contract files. Otherwise, the Contracting Officer should comply with the requirements of the Federal Acquisition Regulation and A.I.D. policy to make and document the determinations.

Management Comments and Our Evaluation

USAID/Philippines officials concurred with this recommendation and stated they would issue a notice to the Contracts Office Staff providing guidance for documenting determination of contractor responsibility. Since planned action is responsive, Recommendation No. 4 is resolved on issuance of this report and can be closed when the appropriate notice has been issued.

Controls Over Subcontracting Need Improvement

USAID/Philippines did not ensure that contractors both provided the required documentation and obtained the Contracting Officer's approval prior to the award of 14 of the 17 subcontracts reviewed. This occurred because, according to the Contracting Officer, there were staff and time constraints and a lack of notice as to when some subcontracts had been awarded. Therefore, USAID/Philippines does not have adequate assurance that the services and costs of subcontracts valued at about \$7.6 million were reasonable and proper.

Recommendation No. 5: We recommend that USAID/Philippines:

- 5.1 establish procedures for ensuring that contractors provide necessary information and obtain written approval from the Contracting Officer prior to the award of subcontracts, and**
- 5.2 review the subcontracts awarded but not approved by the Contracting Officer and either approve them or take appropriate action to preclude reimbursement to the contractor for non-approved subcontracts.**

A.I.D. Handbook 3, Supplement A, states that the Mission's policies and procedures, which ensure that contractors are in compliance with applicable sections of the Federal Acquisition Regulations, should be adhered to. In accordance with the Federal Acquisition Regulation, Subpart 44.204(b), the Federal Acquisition Regulation clause 52.244-2 was included in five of the six contracts reviewed (the sixth contract did not anticipate the award of subcontracts). This clause requires the contractor to notify the U.S. Government contracting officer in advance of entering into subcontracts if the proposed subcontract is cost-reimbursement, time-and-materials, or labor-hour type; fixed-price and exceeds either \$25,000 or 5 percent of the total estimated cost of the contract; the subcontract has experimental, developmental, or research work as one of its purposes; or the subcontract is not a facilities contract and the proposed subcontract provides for the fabrication, purchase, rental, installation, or other acquisition of special test equipment valued in excess of \$10,000.

When the subcontract exceeds \$10,000, the above required advance notification should include the following information:

- Description of supplies or services to be subcontracted;
- Identification of the type of subcontract to be used;

- **Identification of the proposed subcontractor and an explanation about the manner in which the proposed subcontractor was selected, including the competition obtained;**
- **The proposed subcontract price and the contractor's cost or price analysis; and**
- **The negotiation memorandum reflecting additional but relevant information such as the reasons for any significant difference between the contractor's price objective and the price negotiated and a complete explanation of the incentive fee or profit plan whenever incentives are used.**

Likewise, the cited Federal Acquisition Regulation clause requires the contractor to first obtain the contracting officer's written consent before procuring any subcontract. Otherwise, the contracting officer may ratify--thus constituting consent--in writing any subcontract.

The five contractors reviewed awarded 17 subcontracts totaling \$11.7 million. Evidence of written approval by the Contracting Officer was not available for 14 of the subcontracts, valued at \$7.6 million. Contract files for seven of the subcontracts did not have copies of the subcontracts on file. According to the Contracting Officer, this situation occurred because he had staff and time constraints and was unaware that these subcontracts had been awarded. The contractors that had awarded these subcontracts agreed that Contracting Officer approval had not been obtained prior to the award of the subcontracts. For the seven other subcontracts without approval, the Contracting Officer stated that these should have been approved by him and that the lack of approval was due to administrative error.

Although the contracts included the provisions described above, the contractors did not provide all of the required information about the subcontracts. The contractors' proposals included only descriptions of services or supplies to be subcontracted, lists of key personnel and proposed subcontract costs. None of the contract proposals included subcontractor cost or price analyses, negotiation memoranda, or explanations about why and how the proposed subcontractors were selected. Furthermore, only \$2 million of the \$5.8 million of subcontract costs reviewed (as discussed on page 15 of this report) were substantiated by detailed breakdowns of cost elements. The Contracting Officer stated that cost or price analyses for these subcontract costs were performed together with the contractors' cost proposals.

Although three subcontracts were reviewed and approved, issues resulting from the reviews were not always dealt with. For example, on September 28, 1990, a contractor requested contracting officer approval for the award of a subcontract already awarded on September 17, 1990. A review was conducted, resulting in some

issues that necessitated a revision to the subcontract scope of work. However, the Contracting Officer did not receive a copy of the revised subcontract until 18 months later. The Project Officer commented that this audit prompted the contractor to submit the revised subcontract for approval in March 1992. The expanded scope of work increased the proposed subcontract costs by about 250 percent (from \$226,417 to \$827,745). The Contracting Officer, as of May 1992, had neither reviewed nor approved the subcontract.

As shown above, controls over subcontracting need to be improved in order to comply with the Federal Acquisition Regulation. USAID/Philippines needs to ensure that contractors provide the required information and that the Contracting Officer approves subcontracts prior to their award and that this approval is documented in the contract file. If not approved, assurance that the subcontract services and costs are reasonable is neither obtained nor documented.

Management Comments and Our Evaluation

USAID/Philippines officials agreed with both parts of this recommendation. The Mission planned to issue a notice establishing procedures to require all vouchers containing subcontract costs to break down the costs by subcontract and be accompanied by a letter providing the Contracting Officer approval. In addition, the Contracts Office will review all subcontracts awarded but not approved, and either approve them or deny reimbursement. These planned actions are responsive to this recommendation, which is resolved on issuance of this report and can be closed when the notice has been issued and the review completed.

Technical Evaluation Committees Should Document Reference Checks

USAID/Philippines did not document, for five of the six contracts reviewed, reference checks which were required by U.S. Government regulations and A.I.D. policy and which were reportedly performed during reviews of contractor proposals. This occurred because the Technical Evaluation Committees were not aware of the documentation requirement. Consequently, the Mission did not have assurance that prospective contractors' past performance was considered during the technical evaluation process.

Recommendation No. 6: We recommend that USAID/Philippines implement procedures ensuring that Technical Evaluation Committees document reference checks on the past performance of offerors who have submitted technically acceptable proposals.

A.I.D. Contract Information Bulletin 85-17 sets forth procedures for determining the responsibility of prospective contractors and for assuring that past contractor performance is given systematic consideration in the award of new direct A.I.D. contracts. The Technical Evaluation Committee should obtain past performance information from offerors' references and provide this information to contracting officers for consideration in the selection process.

In order to obtain factual comment on the past performance of contractors, the A.I.D. Instructions for Technical Evaluation Committees require them to obtain references from at least three cognizant technical representatives (commercial or government) and/or A.I.D. project officers concerning offerors' past performance with regard to the following factors:

- **Planning to achieve the project objectives;**
- **Providing technically qualified staff, including key personnel on a timely basis;**
- **Responding to technical directions;**
- **Adhering to the work schedule; and**
- **Developing working relations with the cooperating country's nationals.**

Furthermore, the Federal Acquisition Regulation, Subparts 4.801 and 4.803, state that this documentation forms the basis for decisions in the contract procurement process and provides information for reviews and investigations.

Our review of six contracts disclosed that Technical Evaluation Committees documented reference checks for only one of the prospective contractors. Moreover, reference checks for this contractor showed comments from only one technical representative, rather than the three required by A.I.D.'s instructions to the Committees. Discussions with project officers, who are usually the chairpersons of the Committees, revealed that reference checks are made based on their own knowledge of the offerors or on comments from other project officers at the Mission. These officers may have known or may have been dealing with the offerors through contracts administered by them at USAID/Philippines or other Missions. However, neither of these methods were documented in the contract files because project officers were unaware of the documentation requirement.

Without conducting and documenting reference checks on prospective contractors, USAID/Philippines may be hiring contractors who can not meet the expected level of performance required of them. Also, contracting officers can use this information, in addition to other relevant factors, in determining the responsibility of prospective

contractors (see discussion on pages 17 and 18). Therefore, USAID/Philippines needs to ensure that reference checks are performed and that they are documented in the contract files.

Management Comments and Our Evaluation

USAID/Philippines agreed with the recommendation. The Contracting Officer will revise the memorandum to project officers to make clear that reference check needs to be documented. A notice will be issued to the Contracts Office staff not to accept the results of the evaluation without the required documentation of reference checks. These actions are responsive to Recommendation No. 6, which is resolved on issuance of the report and can be closed when revision to the memorandum has been completed and the notice has been issued.

Technical Evaluation Score Sheets Should Be Reviewed for Correctness

USAID/Philippines's Technical Evaluation Committee composite scores for contractor technical proposals contained mathematical errors, contrary to prudent management practices. This happened because neither the project officers nor the contracting officers reviewed the accuracy of the technical evaluation score sheets, which were the bases for determining the technical ranking of offerors. Consequently, A.I.D. could have chosen less technically qualified offerors in the competitive range.

Recommendation No. 7: We recommend that USAID/Philippines establish procedures to ensure the review and verification of the correctness of Technical Evaluation Committee score sheets prior to their submission to the Contracting Officer.

The Federal Acquisition Regulation, Subpart 15.605, provides that, in awarding cost reimbursement contracts, the U.S. Government may choose quality factors--proposals with the greatest value in terms of performance, technical excellence, management capability, and personnel qualifications--as the deciding factors in the procurement process.

Contract Information Bulletin 90-25 provides that an equal weighing of cost and technical evaluation factors is not appropriate for A.I.D. procurement of technical assistance that is done on a cost reimbursement basis. Technical evaluations are considered approximately three times more important than cost evaluations in determining the total evaluation scores. Thus, A.I.D.'s Instructions for Technical

Evaluation Committees require that each member provide evaluation scores sheets and narrative comments describing the strengths and weaknesses of each proposal. Upon completion of the technical evaluation, the chairperson of the Committee sends a memorandum to the Contracting Officer showing the Committee's composite scores and narrative findings for each offeror. This information guides the Contracting Officer in determining who, among the offerors, is technically capable and responsible to perform the contract. Thus, prudent management practices require that these evaluation score sheets be accurate--free from any mathematical or transposition errors--and be completely documented.

Our review of six contracts showed that technical evaluation score sheets for four contracts contained mathematical errors. The score sheets for the other two contracts were missing from the file. Errors on score sheets for two of the contracts impacted on the technical ranking of the proposals. Contracts were awarded to two contractors from among 11 offerors that responded to a request for proposal under the Philippines Assistance Program Support Project. The Technical Evaluation Committee evaluated the proposals by using the evaluation criteria contained in the request for proposal and ranked the two winning contractors as second and third based on the results of the individual score sheets. The Contracting Officer awarded the contracts, valued at \$5.7 million and \$6.3 million, respectively, to the second and third ranking offerors because the cost of the first-ranked offeror's proposal was very high.

Our review of the score sheets disclosed mathematical and transposition errors which affected the technical ranking of the two winning contractors. If corrected, a difference of six points would have made the third contractor rank fourth instead of third. However, although there was an error in the technical ranking, the winning contractor was still within the competitive range. Also, the winning contractor's cost proposal was \$500,000 less than the contractor who would have been ranked third rather than fourth. Considering these factors, the Contracting Officer stated that the contract would still have been awarded to the winning contractor even though its technical ranking would have been lower.

The mathematical and transposition errors in the technical evaluation score sheets for two other contracts did not affect the technical ranking of the offerors. However, the recurring presence of errors in the Technical Evaluation Committee score sheets indicates a need for corrective action. Also, the missing score sheets for two contracts indicates a need to improve the documentation of the technical evaluation review process.

The project and contracting officers did not verify the correctness of the technical evaluation score sheets--identified as the most critical factor in the contractor selection process--before selecting an offeror for contract award. The Contracting Officer stated that he relied on the diligence of the Technical Evaluation Committee

and did not check the accuracy of the score sheets. The Project Officers said that the Committee chairperson should be responsible for ensuring the accuracy of the Committee's evaluation results.

Being of critical value to the contractor selection process, the technical evaluation rankings should be accurate and properly documented. USAID/Philippines should require both the project officers and the chairpersons of the Technical Evaluation Committees to verify the accuracy of the score sheets to ensure the accuracy of the resultant technical rankings.

Management Comments and Our Evaluation

The Mission concurred with the audit finding and recommendation. The Contracting Officer will include in the memorandum to the Technical Evaluation Committee instructions for the Chairman to review and verify the correctness of the score sheets and to document this review in the evaluation memorandum to the Contracts Office. The Contracting Officer will also issue a notice to the staff not to accept the evaluation memorandum unless it contains such statement. These actions are responsive to Recommendation No. 7, which is resolved on issuance of this report and can be closed when the memorandum has been revised and the notice issued.

Did USAID/Philippines monitor contractor performance to ensure that technical assistance was provided and utilized as prescribed in A.I.D. regulations, policies, and procedures?

USAID/Philippines did not routinely follow A.I.D. regulations, policies and procedures in monitoring contractor performance to ensure that technical assistance was provided and utilized. The Mission did not ensure that (1) work plans and progress reports were prepared to objectively measure contractor performance, (2) controls over non-expendable property were adequate, (3) site visits were effectively planned and documented, and (4) expired contracts were closed out in a timely manner.

Contractor Annual Work Plans and Progress Reports Need Improvement

The work plans and progress reports submitted by the contractors lacked the data necessary to measure contractor performance. This occurred because, contrary to A.I.D. regulations, policies and procedures, USAID/Philippines did not monitor contractors' reports to ensure measurable performance standards were included in work plans and progress against these standards reported. As a result, the Mission's ability to objectively assess the effectiveness of \$14 million spent for technical assistance was limited.

Recommendation No. 8: We recommend that USAID/Philippines establish procedures to ensure that technical assistance contractors include measurable targets and time frames in work plans and a comparison of completed activities against the measurable targets and time frames in progress reports in order to objectively assess contractor performance.

A.I.D. Handbook 3, Supplement A, emphasizes that project officers are responsible for monitoring contract implementation and contractor performance. The project officers are to review progress reports and comment on their adequacy and responsiveness, particularly those portions of the reports that discuss progress toward established bench marks or targets and identify problems and recommend solutions or actions to be taken. Likewise, the project officers are to bring any deficiencies in the reports to the contractors' and contracting officers' attention.

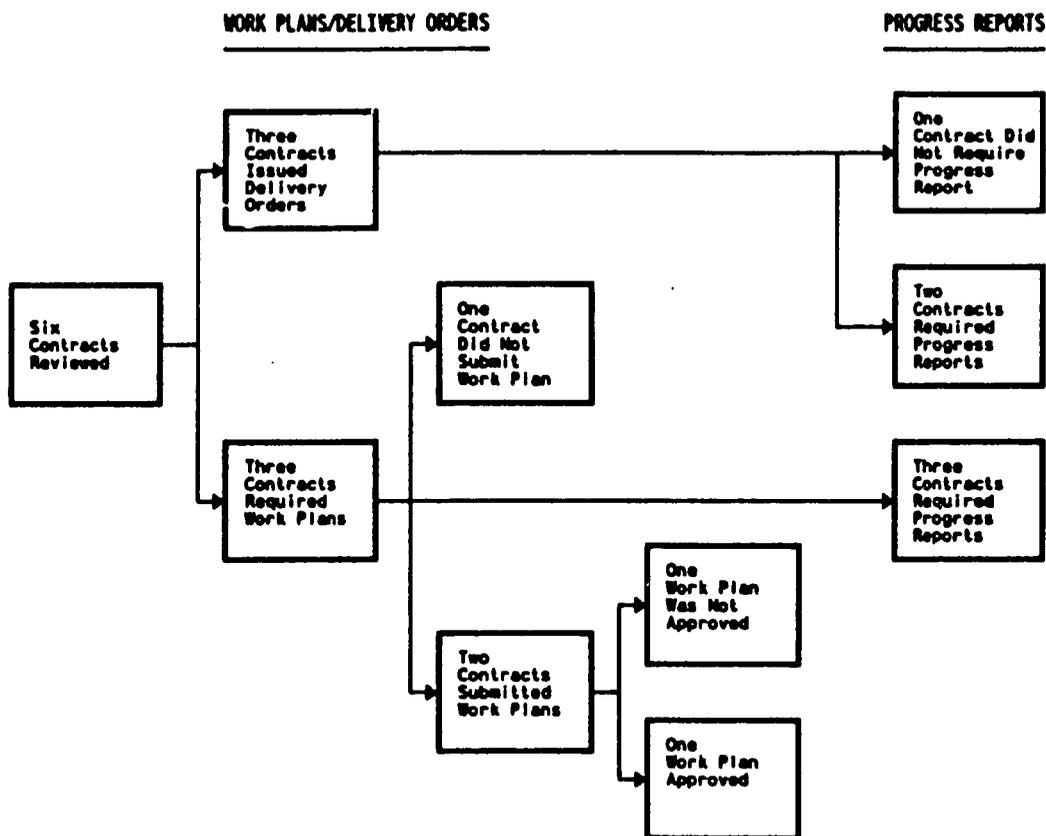
Moreover, Contract Information Bulletin 85-17 indicates that project officers are to monitor contractor performance under contracts assigned to them for technical cognizance and to record written comments on that performance. The Bulletin also

requires project officers to bring instances of poor performance immediately to the attention of both contractors and contracting officers.

A.I.D. Acquisition Regulation, Subpart 752.7026, requires contractors to prepare quarterly or yearly work plans setting forth strategies for meeting contract objectives and to prepare periodic substantive reports indicating progress toward and recommendations for meeting the objectives. The substance of this regulation is incorporated as a standard clause in A.I.D. contracts.

The audit covered six technical assistance contracts with estimated costs of about \$25.6 million (\$14 million spent as of December 31, 1991). As shown in the chart below, USAID/Philippines required three of the contractors to prepare work plans and issued delivery orders to the other three contractors for the services needed. Five of the six contractors were required to submit progress reports. One contractor was not required to submit progress reports because the contract required periodic meetings with the Mission on project progress.

REQUIRED WORK PLANS AND PROGRESS REPORTS



Of the three contractors required to submit work plans, two submitted work plans which included some time frames but only one had work plans approved by the Mission, as follows:

- The approved work plan for a \$6.5 million contract covering 3.4 years included time frames for some activities for the first year; it did not include a plan of activities or time frames for the whole contract period. Therefore, it did not help USAID/Philippines gauge the contractor's performance for some activities during the first year or the overall contract objectives.
- Although the second contractor submitted three work plans, as required by this \$2.8 million contract, none of these work plans was approved by the Mission. According to the project officer, the Mission did not approve the work plans because the implementing agency had complained that the contractor was not responsive to the agency's technical assistance needs. In view of the implementing agency's concerns, USAID/Philippines was in the process of redefining the technical assistance roles and revising the work plans for this contractor.
- The third contractor, with a \$4.2 million contract, did not comply with the requirement to submit a work plan. The project officer commented that, in lieu of a contractor work plan, the technical assistance activities of the contractor were being monitored based on the work plans of the implementing agencies. Our review of these work plans revealed that the technical assistance activities of the contractor were not specifically identified. As a result, these work plans did not contribute to an objective assessment of the contractor's performance.

The three contractors discussed above submitted progress reports as required by their contracts. However, these reports were merely listings of activities completed during the reporting period. They did not compare progress to date with performance indicators so that the progress of the contractors could be measured against contract objectives. As a result, these reports were not as useful as they could have been as monitoring tools, either to the contractors or the Mission.

Of the three contracts using delivery orders to identify the services to be provided, only two required the submission of progress reports. Although the delivery orders included performance indicators, the contractors did not utilize these performance indicators in the progress reports submitted. Comments by the contractors were as follows:

- A contractor with a \$5.7 million contract indicated that established targets are ignored for progress reporting purposes because they are often unrealistic and are usually adjusted later to correspond with actual accomplishments.
- The other contractor with a \$6.3 million contract submitted progress reports on time but did not use the targets or milestones established. The contractor agreed that these reports do not compare project progress against established targets.

The project officers we interviewed commented that they are fully aware of the status of contractor performance because of their daily contacts with them even though the progress reports do not show comparisons between targets and actual accomplishments. This may be true, but good project monitoring requires effective reporting and proper documentation that will enable not only project officers but others--external evaluators and other A.I.D. officials--to independently measure contractor performance and assess problems and actions taken to resolve them.

In our opinion, a contributing factor for the lack of detailed work plans and useful progress reports was the vague work statements developed for the technical assistance contracts (see discussion on pages 4 to 7). If USAID/Philippines does not clearly define the contract objectives and include specific performance indicators in the work statements, there is little basis for contractors to prepare useful work plans and corresponding periodic progress reports.

In conclusion, USAID/Philippines needs to require work plans to be better defined and to include specific indicators to measure contractor progress. The Mission should also require contractors to report progress toward meeting these performance indicators and take corrective actions to improve contractor reporting as needed.

Management Comments and Our Evaluation

The Mission agreed with Recommendation No. 8 and planned to issue a notice to its staff requiring the inclusion of measurable targets and time frames in work plans and a comparison to these standards in the progress reports. In addition, the Contracts Office will develop and include a standard provision covering this requirement in all appropriate contracts. These actions are responsive to the recommendation which is resolved on report issuance and can be closed when the notice is issued and the standard provisions for contracts completed.

Controls Over Non-Expendable Property Need Improvement

Although USAID/Philippines required technical assistance contractors to establish programs for controlling non-expendable property, none did. Likewise, while the Mission received non-expendable property reports from some of the contractors, these reports were incomplete and inaccurate. This occurred because project officers were neither aware of the requirement nor willing to accept responsibility for monitoring contractor commodities. As a result, USAID/Philippines did not have adequate control over A.I.D.-funded property (\$757,000 for the contracts in our sample), thus increasing the vulnerability of the property to waste, fraud, and abuse.

Recommendation No. 9: We recommend that USAID/Philippines ensure that contractors establish programs for the receipt, use, maintenance, protection, care and custody of non-expendable property purchased under direct A.I.D. contracts.

To ensure that contractors are in compliance with applicable sections of the Federal Acquisition Regulations and A.I.D. Acquisition Regulations, the Mission's policies and procedures should be adhered to. Five of the six contracts reviewed contained the A.I.D. Acquisition Regulation Clause 752.245-71, which states that it is A.I.D. policy to vest title with the cooperating country for contractor-acquired, non-expendable property costing \$500 or more. The sixth contract did not provide for commodity procurement. The contracts required the contractors to:

... prepare and establish a program to be approved by the Mission, for the receipt, use, maintenance, protection, custody, and care of non-expendable property for which it has custodial responsibility, including the establishment of reasonable controls to enforce such program.

Likewise, each contract had a provision requiring the contractors to submit annual non-expendable property reports for property purchased under the contracts. The contracts required the contractors to certify that: (1) physical inventories of non-expendable property are taken at least annually, (2) the accountability records maintained for non-expendable property in their possession are in agreement with such inventories, and (3) the total of the detailed accountability records maintained agrees with the property value. Non-expendable property to be purchased under the five contracts reviewed totaled \$757,000.

Submission of property reports varied: two contractors included non-expendable property reports in their monthly progress reports, one submitted reports on an annual basis while the other two did not submit any property reports. Our review disclosed that all of the reports contained discrepancies, inaccuracies, and incomplete

data. Moreover, these reports did not contain the required certifications. To illustrate:

- One contract had a budget of \$243,997 for non-expendable property. The contractor's reimbursement voucher as of September 1991 showed that \$88,127 had been spent for non-expendable property. However, the monthly non-expendable property report submitted to the Mission, dated September 1991, showed that the contractor had only \$56,457 of property on hand. Thus, there was a discrepancy of \$31,670, or 36 percent of the amount reportedly purchased and reimbursed by A.I.D. In addition, the required certifications were not provided.
- A second contract had a budget of \$231,460 but the contractor had been reimbursed \$390,701 for non-expendable property as of September 1991. The contractor submitted non-expendable property listings but without the required certification. Also, the listing of property acquired from July 1990 to September 1991 showed the cost of equipment in local currency--making a comparison with the reimbursed amount, which is expressed in dollars, difficult.
- Another contract had a budget of \$53,807 for equipment and furniture. The financial vouchers did not show how much had been spent for this line item. At our request, the contractor submitted a listing showing that it had purchased and been reimbursed for commodities valued at about \$59,465, or \$5,658 more than budgeted for this contract.

Virtually all of the contractor property reports reviewed contained errors or otherwise did not meet the Mission's needs. The contractors stated that they were not aware of the requirement to establish a program for the receipt, use, maintenance, protection, care, and custody of non-expendable property. Instead, they were applying their company policies in purchasing and accounting for commodities.

Likewise, discussions with project officers showed that they were neither aware of the requirement nor willing to accept responsibility for monitoring contractor commodities. Although the Mission received property reports from the contractors, the project officers did not verify the accuracy of these reports. One Project Officer added that verification of commodity listings is the responsibility of the Office of Financial Management or the auditors. He further stated that, because of the voluminous work load and limited staff, the project office could not perform this function.

In conclusion, although the cost of the contractor-purchased commodities may not be significant in relation to the total cost of technical assistance, the above cases illustrate control deficiencies which warrant attention. USAID/Philippines needs to

implement procedures to ensure that technical assistance contractors establish effective controls over the receipt, use, maintenance, protection, care, and custody of non-expendable property.

Management Comments and Our Evaluation

For Recommendation No. 9, the Mission agreed with the recommendation and planned to require any voucher containing non-expendable property costs be accompanied by a letter showing the Contracting Officer approval of the contractor's program for the receipt, use, maintenance, protection, care and custody of such property. Without such a letter, the property cost will not be reimbursed. In addition, the Contracts Office will issue a Contracts Office Staff Notice requiring this provision be included in all appropriate contracts. These actions are responsive to the recommendation; therefore it is resolved upon issuance of this report and can be closed when the notices are issued and we received evidence that the provision is included in the next contract.

Site Visits Need Better Planning and Documentation

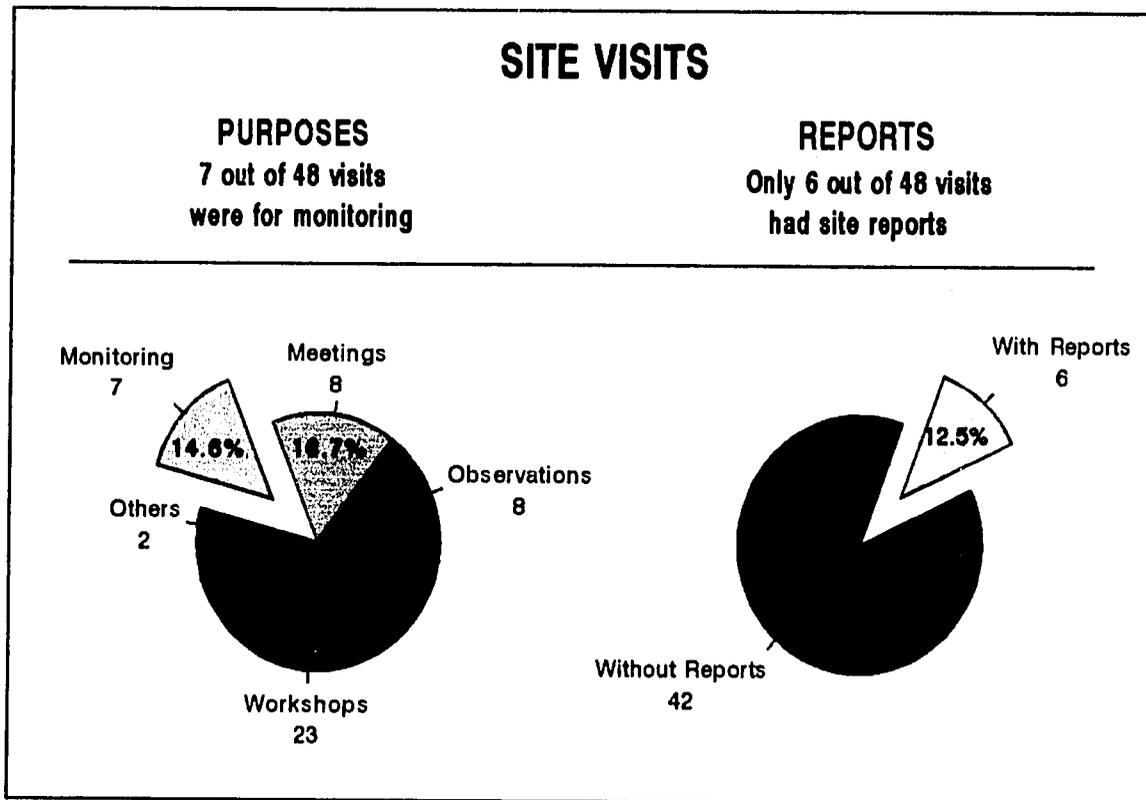
USAID/Philippines' project officers and staff were neither planning for site visits nor preparing site visit reports for all visits made to technical assistance contractors as required by A.I.D. guidance. This occurred because Mission management had not emphasized the importance of site visits as a monitoring tool. As a result, the Mission was limiting its ability to assess project progress and to determine if problem areas had been identified and corrected.

Recommendation No. 10: We recommend that USAID/Philippines ensure that guidelines are implemented for planning, performing, and documenting site visits by Mission staff.

A.I.D. Handbook 3 states that one of the most important and useful monitoring tools is the periodic visit to project sites to enable the project officer to gauge the status of work and identify actual and potential problems. A.I.D. Handbook 3, Supplement A, Chapter II, Part C, Section 2K, further states that the frequency of site visits will depend upon a number of factors, such as the size of the project, complexity of activities, urgency of unresolved problems, availability of funds and staff and other priorities of project officers and staff. Therefore, prudent management requires proper planning of site visits in order to maximize limited resources.

A.I.D. Handbook 3, Chapter 11, Section 11E, states that the purpose and coverage of site inspection is best illustrated by preparing a report after conducting a site visit. Likewise, A.I.D. Handbook 3, Supplement A, Chapter II, Part C, provides that a project officer or staff should prepare a report highlighting observations and findings as soon as possible after each visit. The report should document the purpose and accomplishments of the visit and discuss progress made relative to planned results.

We reviewed the 48 site visits involved in our sample of six technical assistance contracts. As shown in the chart below, only 7 of 48 visits were for monitoring and only 6 of the 48 trips were documented by reports. The stated purposes of these 48 site visits varied. For example, 23 trips were to attend workshops and training, 8 trips were to attend meetings, and as mentioned only 7 trips were principally to monitor project activities. This shows that the Mission places a low priority on site visits for the purpose of monitoring contractor performance and an even lower priority on the need to document site visits.



The Mission did not require site visits to be documented or emphasize their importance as a monitoring tool. One Project Officer stated that documentation usually results when there are problems, outstanding issues, or major decisions to be

made. He added that management principles state that managers should maximize their resources and time; therefore, he documents only issues that need to be recorded. Although he indicated that most site visits involve monitoring to some extent, the stated purpose for only two of 19 trips conducted during calendar year 1991 for his project were for the purpose of monitoring project progress. Site visit reports were not prepared for any of the 19 trips.

Another Project Officer commented that it has been the practice in his office to verbally report the results of site visits to the office chief rather than prepare a written site visit report. He reasoned that no one has the time to read a written report but that it would add to the documentation of project implementation if written site visits reports were required.

Due to the practice of not documenting site visits, there is little evidence available to support the extent that monitoring by Mission staff has taken place. At the same time, there is less information to assess the projects' progress and address actual or potential problems. Mission officials stated that they conduct periodic review meetings and believe there is thorough knowledge of project activities by all involved project officers. However, most of these meetings were also undocumented.

The opportunity to visit sites is limited and subject to varying factors and constraints. Therefore, an adequately planned, effectively executed and well documented site visit is a useful project management tool for measuring and documenting project progress and for identifying actual and potential problems. Without a more structured approach to planning and documenting site visits, the Mission has missed the opportunity to maximize the usefulness of the site visit.

Management Comments and Our Evaluation

In response to Recommendation No. 10, the Mission stated that a notice will be issued requiring each office to prepare a quarterly plan for site visits to be performed and, include in each Quarterly Project Status Report, the number of site visits conducted and information obtained during these site visits. Moreover, the notice will require a written site visit report be prepared soon after the visit to show any significant variations from planned schedules or other problems. These actions are responsive to the recommendation which is resolved on issuance of this report and can be closed when the planned actions have been completed.

**Contract Closeout
Needs Improvement**

USAID/Philippines did not close out expired technical assistance contracts within 36 months, as required by U.S. Government regulations and A.I.D. policy. The Contracting Officer considered contract closeout a low priority and training had not provided in this area. Only 2 of the 11 expired contracts reviewed had closeout initiated as of March 25, 1992. The 11 expired contracts reviewed had approximately \$647,000 in unliquidated obligations that potentially could be deobligated as of March 31, 1992, and \$719,000 budgeted for non-expendable property that had not been accounted for properly.

Recommendation No. 11: We recommend that USAID/Philippines:

- 11.1 Implement procedures for ensuring that expired technical assistance contracts are closed out in accordance with the provisions of the Federal Acquisition Regulation, Subpart 4.804, and A.I.D.'s Contract Information Bulletin 90-12 in a timely manner;**
- 11.2 Take the necessary steps to initiate the closeout of all expired technical assistance contracts;**
- 11.3 Determine if there is a need to maintain the \$647,000 of unliquidated balances for the expired contracts; and**
- 11.4 Account for and initiate the distribution of non-expendable property in accordance with the contract provisions.**

The Federal Acquisition Regulation, Subpart 4.804, requires that contracting officers take actions to close out expired contracts in a timely manner. Files for contracts requiring settlement of indirect cost rates should be closed within 36 months of the month in which the contracting officer receives evidence of physical completion.

In addition, A.I.D.'s Contract Information Bulletin 90-12 requires contracting officers, prior to retiring a contract file, to perform the following actions:

- Obtain clearance from the technical office that the contractual requirements have been satisfied,
- Account for non-expendable property,
- Settle interim or disallowed costs,

- Obtain the final contractor invoice,
- Finalize provisional indirect cost rates,
- Request final audits for contracts above \$500,000, and
- Deobligate or decommit excess funds.

While the 36-month period has not elapsed for all of the 11 expired contracts reviewed, the USAID/Philippines Contracting Officer did not initiate the process in a timely manner to ensure that closeout will be completed within 36 months. For example, one \$1.1 million contract expired in March 1989 but closeout actions had not been initiated as of March 1992. Two other contracts expired later in 1989, four in 1990 and four in 1991 without timely closeout action. These expired contracts had approximately \$647,000 in unliquidated obligations that could potentially be deobligated as of March 31, 1992, and \$719,000 budgeted for non-expendable property that had not been accounted for properly.

The Contracting Office does not have procedures established indicating within what time frame the individual closeout actions should be initiated. For example, the person who is in charge of initiating the closeout process said that it is being done only once or twice a year whenever the cabinets for expired contracts are full. The Contracting Officer indicated that this occurred because his office is understaffed and the closeout process has a low priority.

The Bulletin states that, if the final voucher has not been submitted, the contracting office needs to send a letter to the contractor requesting submission of the final voucher to the paying office. However, the person in charge of closeout said that, if she started the closeout process and found that the final voucher had not been submitted, she would return the contract file to the cabinets until the next time. The closeout process for this contract would start again when the cabinets were full. This occurred because there were no closeout procedures and no formal training had been provided to this individual--whose principal duties were secretarial.

Some actions, such as requesting technical office clearance, should be undertaken as soon as possible after a contract expires--while staff who are knowledgeable about the contractor's performance are still available. For example, requests for technical office clearance, audit of direct costs and an inventory of non-expendable property had not been sent as of March 1992 for a \$1.1 million contract that expired in March 1989. Time-consuming tasks, such as requesting final audits and finalizing provisional indirect cost rates (discussed in more detail on pages 9 to 13 of this report), should be initiated as early as possible so that the 36-month time requirement for closeout can be met. For other actions, such as obtaining a final inventory of non-expendable property, USAID/Philippines needs to act quickly while contractors are still in-

country to ensure that all property is accounted for and to reduce the potential for fraud and misuse of the property. Finally, unliquidated obligations for expired contracts should be examined for deobligation purposes.

USAID/Philippines needs to establish formal procedures to ensure that all expired technical assistance contracts are closed out in a timely manner. The Mission should take action to initiate the closeout process as soon as feasible for all expired technical assistance contracts. For the 11 contracts discussed above, the Mission needs to determine the validity of the unliquidated balances for deobligation purposes and to account for and initiate the distribution of the non-expendable property in accordance with the contract provisions.

Management Comments and Our Evaluation

While USAID/Philippines officials agreed with this recommendation, they stated that there was a system in operation to close out expired contracts and that, except for contracts over \$500,000, hundreds have in fact been closed out. These larger contracts were not closed because closeout takes substantial time and a low priority was assigned to such work. Nevertheless, the Mission agreed to issue a notice to the Contracts Office Staff alerting them to the closeout requirements. Also, the Contracts Office will develop an inventory of contracts requiring closeout and will prepare documentation to initiate required actions. Based on these actions, Recommendations No. 11.1, 11.2 and 11.4 are resolved on report issuance and can be closed when the planned actions are completed.

For Recommendation No. 11.3, the Mission will review the particular contracts to ascertain the required actions and documentation to make a final determination. Based on the results of this review, the Contracting Officer will determine whether there is a need to maintain the unliquidated balances of \$647,000. This recommendation will be resolved when the Mission determined the unneeded unliquidated balance and will be closed when the identified amount is deobligated or reprogrammed.

Did USAID/Philippines obligate, expend, and account for technical assistance funds in compliance with U.S. Government and A.I.D. regulations and procedures?

Considering the qualification discussed on page 3, we found that for the items tested USAID/Philippines, generally obligated, spent, and accounted for technical assistance funds in compliance with U.S. Government and A.I.D. regulations and procedures, except that control procedures for reviewing reimbursable costs paid to contractors and for determining final indirect cost rates need improvement.

We reviewed six contracts with total expenditures of \$9.4 million, as of June 30, 1991, and we examined 12 vouchers totaling \$2.3 million. USAID/Philippines used valid, authorized and appropriate documents--such as project agreements, project implementation orders, contracts and payment vouchers--for recording transactions. USAID/Philippines also maintained a voucher log to monitor the timely processing of contractor invoices in compliance with the Prompt Payment Act. Our tests showed that payment vouchers and contractor invoices were reviewed and approved by project officers prior to being processed for payment, and payments were accounted for using the commitment liquidation records generated by the Mission Accounting Control System. However, USAID/Philippines did not obtain periodic audits of U.S.-based contractors and verify whether claimed costs were in accordance with the term of the contracts.

Control Procedures Over Payments of Reimbursable Costs Need to be Improved

Obtaining audits for A.I.D.-funded cost reimbursement contracts is necessary to ensure compliance with the Federal Acquisition Regulation requirement that payments be made only for allowable costs. USAID/Philippines did not obtain periodic audits because A.I.D. has not established procedures and requirements for obtaining audits of U.S.-based contractors. In addition, USAID/Philippines did not always verify whether claimed costs were in accordance with the terms of the contracts because written contract review procedures had not been established for the voucher examiners to follow. As a result, questionable costs of \$83,500 are being reimbursed to contractors.

Recommendation No. 12: We recommend that USAID/Philippines:

- 12.1 Establish review procedures for voucher examiners to ensure that the provisions of contracts are considered before contractor invoices are approved for payment;**

- 12.2 Determine whether the questionable reimbursement of about \$83,500 of contract costs should be disallowed and recovered; and**
- 12.3 If the questioned costs related to consultant salaries are disallowed, review the balance of contractor invoices for disallowance of these costs because the questioned costs are recurring and are from a small sample of contractor invoices.**

The Federal Acquisition Regulation requires that the allowability of contract costs be determined (Subpart 31.201) and that a notice of intent to disallow costs be provided to the contractor as early as practicable during contract performance. The purpose of the notice is to inform the contractor that certain billed costs are considered unallowable under the terms of the contract and to provide for a timely resolution of any resulting disagreement (Subpart 42.801). To ensure compliance with the Regulation, USAID/Philippines needs to obtain periodic audits of claimed costs. Also, a review of billed costs for compliance with the terms and conditions of the contracts is necessary to determine cost allowability.

Periodic Audits - USAID/Philippines did not obtain periodic audits of cost reimbursement contracts and allowed the reimbursement of some costs claimed by the contractors that were not in accordance with the terms of the contracts. As a result, the reimbursement of some of the \$6.6 million of costs paid to the six contractors we reviewed, as of June 30, 1991, are questionable. Also, since a timely determination of cost allowability was not made, contractors have not received notice of intent to disallow costs as early as practicable during contract performance.

Periodic audit is a key internal control technique to ensure that claimed costs are reasonable, allowable and allocable as required by the Federal Acquisition Regulation. Periodic audits of contract costs strengthen controls over the disbursement of and accountability for A.I.D. funds. It provides assurance that A.I.D. funds are used only for intended purposes in accordance with laws and regulations.

The Federal Manager's Financial Integrity Act report of A.I.D. management to the President, dated December 20, 1991, addressed the need for periodic audits to determine whether costs claimed for reimbursement, which are based on contractors' good faith assertions, are allowable and proper. A.I.D. management considered the lack of audit coverage to be a material weakness and planned to establish an inventory of required audits of contractors for all field missions and central offices. In March 1992, A.I.D. management issued a general notice on an audit management and resolution program, which assigned specific responsibilities to the A.I.D./Washington Office of Procurement and field Missions for tracking the audit status of all contractors and grantees.

Under the present payment system for cost reimbursable contracts, the certifying officer certifies vouchers for payment without routinely requiring contractors to submit supporting documentation for the invoices. Voucher examiners check the invoices by reviewing cost details, verifying the mathematical accuracy, posting cost categories to summary worksheets and confirming the project officers' approval. Since the requirements and procedures for obtaining periodic audits of cost reimbursable contracts have yet to be established, audits of reimbursed costs are not always obtained. Hence, USAID/Philippines is not assured that claimed costs paid to contractors are allowable, as required by the Federal Acquisition Regulation.

Questionable costs were noted during our review of six technical assistance contracts as follows:

- Contractor reimbursements for consultant salaries were not in accordance with employment contracts. Our review of salary records for 14 of 67 consultants, employed during the months of February 1990 and April and May 1991, disclosed that the salaries were computed on a monthly basis, which included legal holidays. However, the employment contracts stipulated that salaries be computed on a work-day basis. The overstatement of salaries for the three months approximated \$8,700. The work-day rate method of paying consultants was based on the contractor's head office employment contracts with its employees. Accordingly, the salaries claimed were not consistent with the terms of the contracts. As a result, a portion of the \$1.1 million of contractor salary payments, as of June 30, 1991, were questionable.
- Commodities and services purchased by two contractors included identifiable value-added taxes amounting to about \$700. The voucher examiner assigned to these contracts said that value-added taxes were not detected because the Mission did not request or receive supporting documentation from the contractor.
- Two contractors claimed \$624 in excess of the allowable amounts stipulated in their contracts for lodging, meals and rest-stop per diem.

While the amounts of the questionable costs are relatively small (about \$10,000), they are drawn from a small sample of vouchers (12). Should the questionable costs identified in this small sample prove indicative of the payments made by USAID/Philippines, the total of questionable costs being reimbursed could be quite large.

The need for periodic audits of A.I.D.-funded cost reimbursement contracts was noted in our work at another Mission. In this report (Audit Report No. 5-383-92-04,

dated March 19, 1992), we recommended that the Associate Administrator for Finance and Administration implement procedures for obtaining periodic audits of contractors with A.I.D.-funded cost reimbursement contracts. Since this is an Agency-wide issue, which has already been addressed with the appropriate agency officials, no additional recommendation is warranted at this time. However, USAID/Philippines needs to adopt the applicable guidance when issued and ensure that periodic audits are requested.

Voucher Reviews - To ensure compliance with the Federal Acquisition Regulation, voucher examiners should be familiar with the terms of the contract. A.I.D. Handbook 19, Chapter 3 states that the authorized certifying officer is responsible for checking vouchers for consistency with the contract before making payment. Also, one of the major duties and responsibilities of the voucher examiner, as stated in The Interagency Position Classification Standard, is to ensure that requests for payment are in accordance with the provisions, terms, and conditions of the contracts.

Voucher examiners review and check vouchers after the project officers administratively approve them. However, our examination of paid vouchers disclosed that voucher examiners did not always determine whether costs claimed were in accordance with the terms of the contracts. This occurred because voucher examiners did not have written instructions for ensuring that claimed costs were in accordance with the terms of the contracts and placed too much reliance on project officer reviews of vouchers. As discussed below, our examination of the vouchers disclosed the possible reimbursement of questionable costs as follows:

- Accumulated costs in excess of 15 percent of the budgeted line item for commodities were not disallowed in a timely manner. The contract provided that the contractor may not exceed any individual line item by more than 15 percent without prior written approval from the Contracting Officer. Although the costs paid for commodities were already 19 percent over the budgeted amount by March 1991, April and May billings for commodities were still paid in full. Thus, commodity costs exceeding the budgeted amounts by about 35 percent (\$45,000) in April and by about 72 percent (\$94,000) in May were reimbursed. Although the June 1991 invoice was not paid in full and the \$74,000 in excess of the 15 percent variance allowed for commodities was recovered at that time, the two previous payments should not have been made.
- Contract costs were paid for costs incurred before the effective date of one contract. The contract provides that the effective date of the contract is the date signed by the Contracting Officer. However, USAID/Philippines paid contract costs, amounting to \$65,000, incurred prior to the effective date of the contract.

- Cost categories used in a contractor's billing were different from budgeted line items established in the contract. Even though the cost categories were different, the vouchers were paid because the voucher examiner did not check the budgeted cost elements in the contract. As a result, there was no assurance that cost categories, totaling about \$3.0 million, were within the budgeted line items allowed by the contract.
- Fringe benefits and indirect costs of about \$8,500 were overstated in a contractor's billing and paid, as of December 31, 1991, because local staff salaries were included in the labor base computation. According to the contract, the budgeted fringe benefits and allowable indirect costs were to include only U.S. staff salaries in the labor base.

In conclusion, our limited examination disclosed that USAID/Philippines had not obtained periodic audits of contract costs because A.I.D. had not established procedures and requirements for obtaining such audits. Our audit also disclosed that voucher examiners did not always verify whether claimed costs were in accordance with contract provisions. This occurred because the voucher examiners place too much reliance on the project officers' administrative approval and do not always review the contract provisions. Accordingly, voucher review of contractor invoices should be improved.

USAID/Philippines should establish voucher review procedures that require a comparison of contractor invoices to the terms and conditions of the contracts. The Mission should also verify the validity of the questionable cost reimbursements totaling about \$83,500 (\$8,700 for salaries, \$700 for value added taxes, \$624 for subsistence, \$8,500 for fringe benefits and indirect costs, and \$65,000 for costs incurred before the effective date of the contract).

Management Comments and Our Evaluation

USAID/Philippines officials did not agree with our statements that voucher examiners placed too much reliance on project officers reviews and did not always determine whether costs claimed were proper. Officials also stated that they thought the voucher examiners were properly trained, that current written instructions were sufficient for ensuring claimed costs were proper, and that no system would prevent all errors.

Concerning Recommendation No. 12.1, Mission officials stated that re-emphasizing the instructions through written procedures will neither absolutely prevent all errors nor motivate a recalcitrant employee. In lieu of preparing written instructions as recommended, officials stated they hold a workshop to reiterate required procedures

for cost reimbursements contracts. This action is responsive to the recommendation; therefore, it is resolved on report issuance and can be closed when the workshop has been completed.

For Recommendation No. 12.2, the Mission will review the items questioned to determine whether they should be disallowed and recovered from the contractor. While this action is appropriate, an agreement on the amount to be recovered is necessary before the recommendations can be resolved. It can be closed when actions to collect any disallowed costs have been completed.

For Recommendation No. 12.3 the Mission officials agreed to review the documentation supporting costs for consultant salaries for the entire contract period if the amount in Recommendation No. 12.2 is disallowed. According, this recommendation is resolved upon issuance of this report and can closed when the review has been completed and collection action, if necessary, has been taken.

Final Indirect Cost Rates Were Not Negotiated in a Timely Manner

USAID/Philippines was not requesting established indirect cost rates from A.I.D.'s Procurement Support Division in order to finalize provisional rates in accordance with A.I.D. guidance. This occurred because there is no procedure established to ensure that contractors submit proposed final indirect cost rates along with supporting cost data, as required, so that final indirect cost rates can be established in a timely manner. As a result, USAID/Philippines has paid contractors about \$800,000 for indirect costs without reasonable assurance that the rates used were proper.

Recommendation No. 13: We recommend that USAID/Philippines:

- 13.1 establish procedures, in coordination with A.I.D.'s Procurement Support Division, to ensure that established final indirect cost rates are obtained in a timely manner, and**
- 13.2 request final indirect cost rates for all direct A.I.D. contracts with U.S.-based contractors from A.I.D.'s Procurement Support Division so that payments to contractors can be adjusted.**

The Federal Acquisition Regulation and the five contracts with U.S.-based contractors reviewed require that the contractor shall, within 90 days after the expiration of each of its fiscal years or a later date approved by the cognizant contracting officer, submit to the cognizant contracting office (usually with the U.S.

Government agency having the most business with the respective contractor) proposed final indirect cost rates for that period and supporting cost data specifying the contract and/or subcontract to which the rates apply. The cognizant contracting office and the contractor shall establish final indirect cost rates as promptly as practical after receipt of the contractor's proposal (Subpart 52.216-7). When A.I.D. is the cognizant contracting office, A.I.D.'s Procurement Support Division, Overhead and Special Cost and Contract Close-Out Branch is the office designated responsibility for establishing final indirect cost rates.

The Contracting Officer determines final indirect cost rates for contracts awarded by him based on cables and negotiated indirect cost rate agreements received from U.S. Government contracting offices. The Contracting Officer stated that A.I.D.'s Procurement Support Division provides negotiated final indirect cost rates to field Missions.

Our review disclosed that provisional indirect cost rates for two of the five contractors included in our review have yet to be finalized. The two contracts, with reimbursed indirect costs totaling \$800,000 as of June 30, 1991, were awarded in March and June 1990. The Contracting Officer does not know if the contractors have provided proposed final indirect cost rate data to the cognizant contracting office. Also, the Contracting Officer has not requested final indirect cost rates for these contractors from A.I.D.'s Procurement Support Division. The Contracting Officer indicated that his office does not coordinate with A.I.D./Washington to obtain final indirect cost rates because of staff and time constraints and the low priority given to contract closeout.

Our work at another Mission (Audit Report No. 5-383-92-04, dated March 19, 1992) also disclosed that provisional indirect cost rates were not finalized in a timely manner. In that report, we recommended that the Associate Administrator for Finance and Administration establish procedures to: (1) emphasize the need for contractors to provide timely documentation of proposed final indirect cost rates; (2) track contractor submissions of proposed final rates and cost data; and (3) provide for suspension of provisional billing payments if required documentation is not submitted.

In conclusion, USAID/Philippines has paid the contractors included in our review about \$800,000 for indirect costs without adequate assurance that the claims were proper. USAID/Philippines needs to coordinate with A.I.D./Washington to ensure that the two contractors discussed above have provided up-to-date documentation to the cognizant contracting office and that the applicable indirect cost rates are finalized. The Mission also needs to adopt A.I.D./Washington guidance, when issued, on procedures to track the submission of contractors' proposed final indirect cost rates.

Management Comments and Our Evaluation

USAID/Philippines agreed with Recommendation Nos. 13.1 and 13.2. The Contracting Officer will issue a notice reminding the Contract Office staff that final indirect cost rates must be established in a timely manner. Also, he will initiate action to obtain final indirect cost rates for all direct A.I.D. contracts with U.S.-based contractors. These actions are responsive to both parts of this recommendation which is resolve on issuance of this report. The recommendation can be closed when agreed to action is completed.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of internal controls for the audit objectives as well as a recommendation to improve reporting under the Federal Managers' Financial Integrity Act. The results of our assessment, as described below, are qualified because we did not receive an acceptable written representation on irregularities in the internal control structure (see page 3).

Scope of Our Internal Control Assessment

Our audit was made in accordance with generally accepted government auditing standards except that USAID/Philippines management would not provide us with an acceptable representation letter. The lack of such written representations constitutes a scope limitation sufficient to preclude an unqualified opinion about the internal control structure.

For the purposes of this report, we have classified the significant internal control policies and procedures applicable to each audit objective by categories. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether the policies and procedures had been placed in operation--and we assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable section heading for each audit objective.

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act and Office of Management and Budget implementing policies, A.I.D. management is responsible for establishing and maintaining adequate internal controls. The General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining internal controls.

The objectives of internal controls for U.S. foreign assistance are to provide management with reasonable--but not absolute--assurance that resources use is consistent with laws, regulations, and policies; resources are safeguarded against

waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether internal controls will work in the future is risky because (1) changes in conditions may require additional procedures or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusion for Audit Objective One

The first audit objective was to determine whether USAID/Philippines planned for technical assistance in accordance with A.I.D. procedures. In planning and performing our audit, we considered the applicable internal control procedures cited in A.I.D. Handbook 3 (Chapter 3 and Supplement A). For the purposes of this report, we have classified the relevant procedures into the following categories: identifying technical assistance needs, relating project goals to these needs, specifying the kinds of goods and services to be procured and their probable sources, identifying the contract mode and applicable procedures and preparing work statements.

Our tests of the applicable controls revealed that USAID/Philippines did not define work statements in sufficient detail or include performance indicators to enable Mission officials and others to monitor contractor progress and evaluate contractor performance.

Conclusions for Audit Objective Two

The second audit objective was to determine whether USAID/Philippines followed U.S. Government and A.I.D. regulations, policies and procedures in procuring technical assistance. In planning and performing our audit, we considered applicable U.S. Government regulations contained in the Federal Acquisition Regulation (Subparts 4, 5, 6, 9, 15, 16, 42 and 44), internal control policies cited in A.I.D. Handbook 1 (Supplement B) and internal control procedures cited in A.I.D. Handbooks 3 (Supplement A) and 17 and Contract Information Bulletins 85-17, 90-21 and 90-25. For the purposes of this report, we have classified the relevant regulations, policies and procedures into the following categories: procuring technical assistance at a fair price and in a timely manner, selecting the appropriate contract type, providing for full and open competition, establishing provisional indirect cost rates, selecting responsible contractors, controlling the award of subcontracts, documenting reference checks, and reviewing technical evaluation score sheets.

Our tests of the applicable controls revealed that USAID/Philippines:

- **approved provisional indirect cost rates based on contractor-provided information rather than rates established by cognizant U.S. Government contracting agencies.**
- **awarded contracts without fully documenting the reasonableness of the negotiated costs.**
- **did not document determinations of contractor responsibility prior to the award of contracts.**
- **did not always require necessary documentation or approve subcontracts prior to their award by contractors.**
- **did not ensure that its Technical Evaluation Committees documented the performance of reference checks on prospective contractors.**
- **did not ensure the correctness of the Technical Evaluation Committee score sheets prior to their submission to the Contracting Officer.**

Conclusions for Audit Objective Three

The third audit objective was to determine whether USAID/Philippines monitored contractor performance in accordance with A.I.D. regulations, policies and procedures. In planning and performing our audit, we considered the applicable regulations contained in the A.I.D. Acquisition Regulation (Subpart 752) and internal control policies and procedures cited in A.I.D. Handbook 3, including its Supplement A, and Contract Information Bulletins 85-17 and 90-12. In addition, we considered the applicable provisions of the Federal Acquisition Regulation (Subpart 4) for determining whether expired contracts were closed out in a timely manner. For the purposes of this report, we have classified the relevant requirements into the following categories: contractor work plans and reporting, controls over A.I.D.-funded property, site visits and reporting and closeout of expired contracts.

We noted the following significant internal control weaknesses in the monitoring of technical assistance contracts. USAID/Philippines did not ensure that:

- **technical assistance contractors prepared adequate work plans and progress reports to enable Mission officials and others to objectively measure project progress and evaluate contractor performance.**

- technical assistance contractors established adequate controls over A.I.D.-funded property.
- site visits were planned or that the results of visits were documented.
- expired technical assistance contracts were closed out in a timely manner.

Conclusions for Audit Objective Four

The fourth audit objective was to determine whether USAID/Philippines followed U.S. Government and A.I.D. regulations and procedures in obligating, expending and accounting for technical assistance funds. In planning and performing our audit, we considered applicable regulations cited in the Federal Acquisition Regulation (Subparts 31, 42 and 52) and procedures cited in A.I.D. Handbook 19. For the purposes of this report, we have classified the relevant regulations and procedures into the following categories: recording of valid obligations, reviewing contractor claims for reimbursement, timely payment of contractor invoices and finalizing indirect cost rates.

Our tests of the applicable controls revealed the following significant internal control weaknesses:

- USAID/Philippines did not request periodic audits and establish contract review procedures for voucher examiners to ensure that payments made to contractors were only for allowable costs.
- USAID/Philippines did not obtain final indirect cost rates so that payments to contractors could be adjusted accordingly.

Reporting Under the Federal Managers' Financial Integrity Act

Except for controls over A.I.D.-funded non-expendable property, USAID/Philippines has not reported any of the internal control weaknesses identified in this report in its internal control assessments. Therefore, to improve reporting under the Federal Managers' Financial Integrity Act, we are making the following recommendation.

Recommendation No. 14: We recommend that USAID/Philippines determine whether the internal control weaknesses identified in this report should be included in its next internal control assessment to ensure compliance with the Federal Manager's Financial Integrity Act.

Management Comments and Our Evaluation

USAID/Philippines officials concurred with Recommendation No. 14. They stated that the Mission Management Control Review Committee will review from this report during the next internal control assessment. If the findings are deemed to be material weaknesses, they will be included in the assessment. Mission comments are responsive to the recommendation which is resolved on report issuance and will be closed after completion of agreed to action.

REPORT ON COMPLIANCE

This section summarizes our conclusions on USAID/Philippines' compliance with applicable laws and regulations.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards except that USAID/Philippines management would not provide us with a written representation letter confirming, to the best of their knowledge and belief, that they reported all known irregularities and instances of material noncompliance. In light of this qualification, the objectives of our review were to:

- Assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives); and
- Report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

We tested USAID/Philippines' and its Contracting Office's compliance with the Federal Acquisition Regulation, A.I.D. Acquisition Regulations, and A.I.D. Handbook 1, Supplement B, Procurement Policy, as the regulations could affect our audit objectives.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions contained in statutes, regulations, contracts, grants and binding policies and procedures governing entity conduct. Noncompliance constitutes an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures generally does not fit into this

definition of noncompliance, and is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with laws and regulations applicable to direct A.I.D. contracting for technical assistance is the overall responsibility of USAID/Philippines' management and its Contracting Officer.

Conclusions on Compliance

Since Mission officials would not confirm in writing (see page 3) that all known irregularities and material instances of noncompliance were reported to the auditors, we cannot express an opinion that USAID/Philippines complied in all significant respects with the provision referred to above. However, the following specific areas of noncompliance did come to our attention during the audit:

Audit Objective Two: USAID/Philippines did not:

- Obtain or prepare sufficient documentation to support that negotiated contract prices were reasonable as required by the Federal Acquisition Regulation, Subparts 4 and 15;
- Obtain or prepare documentation to support determinations that contractors were responsible as required by the Federal Acquisition Regulation, Subpart 9; and
- Document reference checks on the past performance of prospective contractors who submitted technically acceptable proposals as required by the Federal Acquisition Regulation, Subpart 4.

Audit Objective Three: USAID/Philippines did not ensure that action to close out technical assistance contracts were taken in a timely manner as required by the Federal Acquisition Regulation, Subpart 4.

Audit Objective Four: USAID/Philippines did not secure periodic audits of contract costs to determine their allowability and to ensure timely resolution of any resulting disagreement as required by the Federal Acquisition Regulation, Subparts 31 and 42.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Philippines' controls over Direct A.I.D. Contracting for Technical Assistance in accordance with generally accepted government auditing standards except that USAID/Philippines did not provide a completely acceptable representation letter. Mission officials would not confirm in writing that the Mission had followed A.I.D. policies and procedures, and reported to the auditors all known irregularities and instances of material noncompliance. Instead, Mission officials would only state that they had made available all information related to known irregularities and instances of noncompliance.

Without the above written representations from Mission officials, we cannot fully answer the audit objectives and conclude whether the Mission maintained adequate internal controls or complied with applicable laws and regulations. However, based on the representation letter we did receive, we can report some positive conclusions. The problems areas that came to our attention can also be reported.

We conducted the audit from June 27, 1991, through April 30, 1992, and covered the systems and procedures relating to direct A.I.D. contracts that were active as of June 30, 1991. We conducted our field work in the offices of USAID/Philippines and six technical assistance contractors located in Manila.

Documents provided by USAID/Philippines and the contractors were the project papers, contracts, correspondence, progress reports, work plans, site visit reports, non-expendable reports, feasibility studies, and payment vouchers. The audit team conducted commodity inspections; reviewed progress reports, work plans, project papers, and site visit reports; compared actual accomplishments against planned targets; validated documents supporting payment vouchers; and interviewed Mission and contractor officials to verify the evidence provided. We also reviewed the Mission's internal controls. There was no prior audit of this function.

Methodology

USAID/Philippines had 60 direct A.I.D. contracts active as of June 30, 1991. Six were chosen for review because of their high dollar value and they represented the four technical offices of the Mission. Obligations for this sample amounted to \$22.3 million, or about 46 percent of the total \$48 million obligations for 60 active contracts.

The methodology for each audit objective follows:

Audit Objective One

The first audit objective was to determine whether USAID/Philippines followed the procedures of A.I.D. Handbook 3 in planning for technical assistance. To accomplish this objective, we analyzed the project papers applicable to the six contracts to determine if the project designs identified the technical assistance needs; related the project goals to those needs; and identified information such as the kinds of goods and services to be procured and their probable sources, the contracting modes and related procedures to be used. We also reviewed planning documents (Project Implementation Order/Technical Services) to determine if USAID/Philippines prepared work statements as required by A.I.D. Handbook 3 (Chapter 3 and Supplement A). We interviewed Mission officials to obtain their views on the adequacy of the planning process.

Audit Objective Two

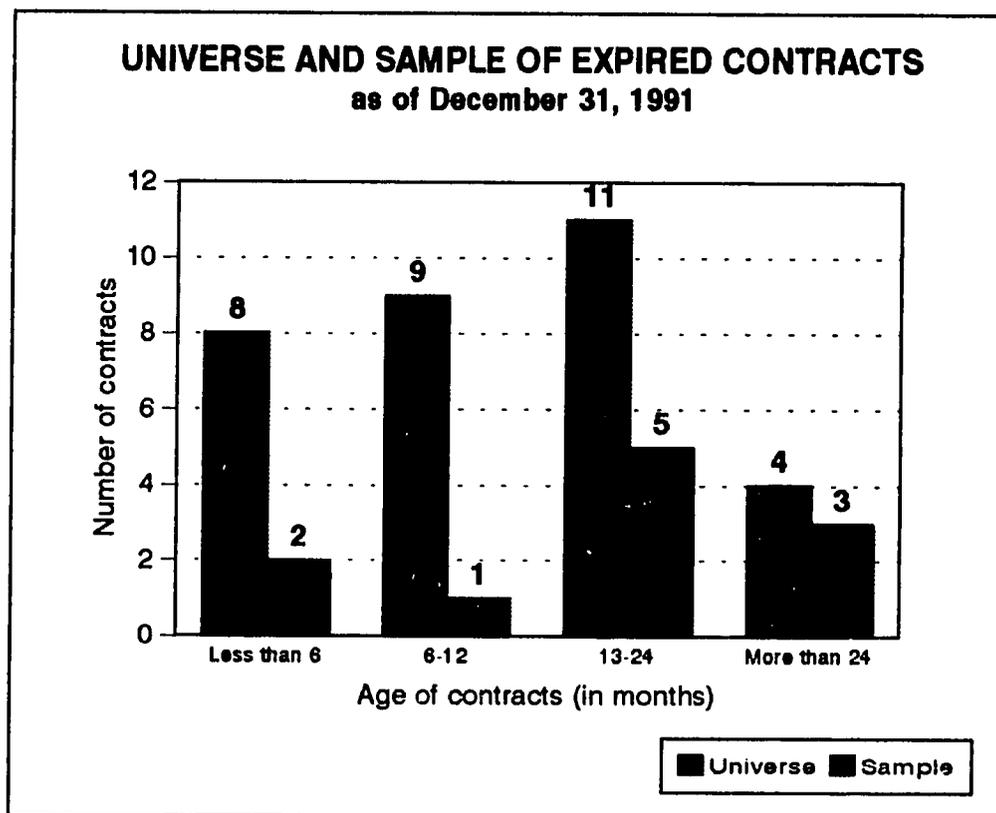
The second objective was to determine whether USAID/Philippines followed U.S. Government and A.I.D. regulations, policies and procedures in procuring technical assistance. To accomplish this objective, the same six contracts selected in Audit Objective One were used. We determined whether the Contracting Officer followed the Federal Acquisition Regulation (Subparts 4, 5, 6, 9, 15, 16, and 42); A.I.D. Handbooks 1 (Supplement B), 3 (Supplement A) and 17; and Contract Information Bulletins 85-17, 90-21 and 90-25 to: (1) ensure the fairness of negotiated prices, including provisional indirect cost rates, and the timeliness of the procurement; (2) select the appropriate contract type; (3) provide for full and open competition; (4) select qualified contractors; and (5) control the award of subcontracts.

We reviewed the respective contract files and documents maintained by USAID/Philippines' Contracting Officer. Examples of documents reviewed include

notices to prospective offerors, lists of qualified offerors, requests for technical and cost proposals, technical selection panel results, prospective contractor cost proposals, biographical data sheets of key contractor personnel, memoranda from cognizant U.S. Government contracting offices concerning indirect cost rates, and memoranda of negotiations. We interviewed the Contracting Officer and Mission officials.

Audit Objective Three

The third audit objective was to determine whether USAID/Philippines monitored contractor performance in accordance with A.I.D. regulations, policies and procedures. The same six contracts selected for Audit Objective One were used for this objective and were compared with the provisions of the A.I.D. Acquisition Regulations (Subpart 752), A.I.D. Handbook 3 (including Supplement A) and Contract Information Bulletins 85-17 and 90-12. We determined whether: (1) contractor work plans and progress reporting complied with contract requirements and were adequate for measuring contractor progress and evaluating contractor performance, (2) controls over A.I.D.-funded property were adequate, and (3) site visits were planned and documented.



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We also determined whether the Contracting Officer followed the Federal Acquisition Regulation (Subpart 4) in closing out expired technical assistance contracts in a timely manner. As shown above, for closeout, we selected 11 of 32 direct A.I.D. technical assistance contracts which expired during the period January 1, 1989, to December 31, 1991, according to Mission Accounting and Control System and Contract Management System reports. The 11 contracts selected represent \$13.3 million of commitments--92.3 percent of the \$14.4 million in commitments, as of March 31, 1992, for the 32 expired contracts.

We interviewed Mission officials and reviewed applicable files and records including project papers, contract files and related documents, work plans and progress reports submitted to USAID/Philippines by contractors, site visit reports, and reports generated by the Mission Accounting and Control System.

Audit Objective Four

The fourth audit objective was to determine whether USAID/Philippines followed U.S. Government and A.I.D. regulations and procedures in obligating, expending, and accounting for technical assistance funds. We used the same six contracts selected in Audit Objective One. As of June 30, 1991, payments totaling \$9.4 million were made on these six contracts. We determined whether USAID/Philippines followed the controls cited in the Federal Acquisition Regulation (Subparts 31, 42 and 52) and A.I.D. Handbook 19 procedures for recording obligations, reviewing contractor claims for reimbursement, processing contractor payments and obtaining final indirect cost rates so that payments to contractors could be adjusted.

We judgmentally selected 12 vouchers with total payments of \$2.3 million. We performed limited tests of supporting documents available at USAID/Philippines and contractor offices in Manila, Philippines. The primary purpose of our tests was to identify USAID/Philippines' vulnerability to making payments for unallowable costs and the need for better controls (e.g. periodic audits) to ensure the propriety of A.I.D. payments--not to determine the extent of questionable payments. The selected vouchers were primarily for travel and transportation, equipment, indirect costs and fringe benefits (verified to rates approved in the contracts), subcontract costs, and consultant salaries (verified to the required approval by the Contracting Officer). We determined whether contractors submitted indirect cost data and whether indirect cost rates were negotiated in a timely manner (e.g. within one year after the end of the contractor's fiscal year) as required by the Federal Acquisition Regulation and whether payments were made in accordance with the provisions of the Prompt Payment Act.

We interviewed officials and reviewed project, contract and financial files maintained at USAID/Philippines and contractor offices in Manila, Philippines. We also requested information from A.I.D.'s Procurement Support Division to determine whether the proper indirect cost rates were used and if those rates were finalized as required by the Federal Acquisition Regulation.

UNITED STATES GOVERNMENT

Memorandum

SEP 11 1992

TO: Mr. James B. Durnil, RIG/A, Singapore

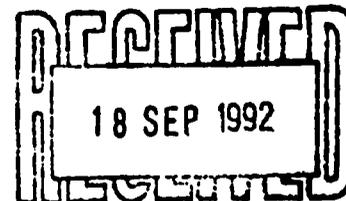
FROM:  Richard A. Johnson, Acting Director, USAID/Philippines

SUBJECT: Mission Comments on Draft Audit Report -
"Direct A.I.D. Contracting for Technical Assistance"

Enclosed are the Mission comments on the subject draft report, a summary of proposed actions detailing requests for resolution or closure of the recommendations, and a Representation Letter signed by me covering the subject audit.

You will note that we are requesting resolution of all 14 recommendations based upon our current planned actions, and have indicated the actions which we believe are sufficient for closure. The Mission is concerned that certain of the actions in response to Recommendation No. 2 may require an extended period to complete. These actions are based upon receipt of data from the Procurement Support Division in Washington, and involve negotiating with contractors to change existing cost rates. Should these actions require an extended period, we may request closure based upon the premise that actions may extend beyond one year. The same situation may exist regarding Recommendation No. 11.3. This recommendation requires a determination of the requirement to maintain existing unliquidated commitments. This determination may require the completion of audits at the contractors home sites in the United States. We will request information from the Procurement Support Division, but should the required actions require more than one year to complete, we will request closure on that basis.

We ask that these comments, this letter, and the Representation Letter be considered in finalizing the report, and be included in the final report as Annexes.



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AUDIT OF TECHNICAL ASSISTANCE CONTRACTING
SUMMARY OF PLANNED ACTIONS ON RECOMMENDATIONS
AND REQUESTS FOR RESOLUTION/CLOSURE

Recommendation 1.

The Mission will issue a notice establishing a requirement that each PIO/T contain a separate section for the inclusion of specific objectives and performance indicators in the statement of work.

The Mission asks that this recommendation be considered resolved based upon the above planned action, and will request closure upon issuance of the Mission notice.

Recommendation 2.

2.1 The contracts officer has already started requiring that negotiated provisional indirect cost rates be approved by the Procurement Support Division, and will confirm this in a notice to his staff.

2.2 The Contract Services Office will review all active contracts with U.S.-based contractors. A list will be prepared of those contracts for which there is no evidence that the rates are consistent with those established by cognizant contracting agencies. This list will be forwarded to the Procurement Support Division for review and determination of the correct rates.

2.3 Upon receipt of the data from the Procurement Services Division in response to Recommendation 2.2, the Contracting Officer will take whatever action is possible to obtain contractor agreement for adjustment of rates where those rates are inconsistent with the established rates.

The Mission asks that 2.1 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the Contracts Office Staff Notice.

The Mission asks that 2.2 be considered resolved based upon the above planned action, and will request closure based upon the receipt of data from the Procurement Support Division.

The Mission asks that 2.3 be considered resolved based upon the above planned action, and will request closure based upon documented attempts to obtain contractor approval of adjusted rates.

Recommendation No. 3.

The Contracts Office will issue a Contracts Office Staff Notice providing guidance for documentation of cost analyses, and setting standards for such documentation.

The Mission asks that Recommendation No. 3 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notice.

Recommendation No. 4.

The Contracts Office will issue a Contracts Office Staff Notice providing guidance for documentation of determination of contractor responsibility, and setting standards for appropriate documentation.

The Mission asks that Recommendation No. 4 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notice.

Recommendation No. 5.

5.1 The Mission will issue a Notice establishing a procedure that all vouchers containing subcontract costs break down the costs by subcontract and be accompanied by a letter providing Contract Officer approval of the subcontracts. Subcontract costs will be disallowed from vouchers which do not meet this criteria. The Contract Office will issue a Contracts Office Staff Notice requiring a provision covering this issue be included in all appropriate USAID contracts.

5.2 The Contracts Office will review all subcontracts awarded but not approved, and either approve them or deny reimbursement.

The Mission asks that 5.1 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notices. We ask that 5.2 be considered resolved based upon the planned actions, and will request closure based upon the completion of the review.

Recommendation No. 6.

The Contracts Office will issue a Contracts Office Staff Notice advising staff not to accept the Technical Evaluation Committee Memorandum without the results of a reference check.

The Mission asks that Recommendation No. 6 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notice.

Recommendation No. 7.

The Contracts Office will include in the guidance memorandum to the Technical Evaluation Committee (TEC) an instruction for the TEC Chairman to review and verify score sheets and to state in the evaluation memorandum to the Contracts Office that this has been done. The Contracts Office will also issue a Contracts Office Staff Notice advising staff not to accept the TEC's evaluation memorandum unless it contains this statement.

The Mission asks that Recommendation No. 7 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notices.

Recommendation No. 8.

The Mission will issue a Notice advising staff of the requirement for the inclusion of measurable targets and time frames in work plans and a comparison to these standards in progress reports. The Contracts Officer will develop a standard provision covering this requirement which will be included in all appropriate contracts.

The Mission asks that Recommendation No. 8 be considered resolved based upon the above planned actions, and will request closure based upon the issuance of the appropriate notice, and the completion of the standard provision for contracts.

Recommendation No. 9.

The Mission will issue a Notice establishing a procedure that all vouchers containing non-expendable property costs be accompanied by a letter providing Contract Officer approval of the contractor's property plan. Non-expendable property costs will be disallowed from vouchers which do not meet this criteria. The Contract Office will issue a Contracts Office Staff Notice requiring a provision covering this issue be included in all appropriate USAID contracts.

The Mission asks that Recommendation No. 9 be considered resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notices.

Recommendation No. 10.

The Mission will issue a notice requiring each Office to prepare a quarterly site visit plan. The Notice will also specify that significant variations from schedules or other significant problems will be documented through a site visit report to be prepared soon after the visit. Information pertaining to site visits will be required in the Quarterly Project Status Reports.

The Mission asks that Recommendation No. 10 be considered resolved based upon the above planned action, and will request

resolved based upon the above planned action, and will request closure based upon the issuance of the appropriate notices.

Recommendation No. 11.

The Contracts Office will issue a Contracts Office Staff Notice reminding them of the close out requirements. Contracts Office will develop an inventory of contracts requiring close out and will prepare documentation to initiate required actions under Recommendations No. 11.2 and 11.4. Based upon the results of this review, the Contracts Officer will make a determination of the necessity of maintaining the \$647,000 in unliquidated balances.

The Mission asks that Recommendations No. 11.1, 11.2, 11.3 and 11.4 be resolved based upon the above planned actions. We will request closure based upon the preparation of the inventory, initiation of required documentation, and determination of requirement for unliquidated balances.

Recommendation No. 12.

12.1 The Office of Financial Management will hold a workshop for voucher examiners covering the requirements for examination of vouchers under cost reimbursement contracts.

12.2 The Office of Financial Management will review the questioned costs, either through a review of existing data or through review of data at the contractor site. We will make a determination of questioned costs, and, if disallowed, will initiate recovery action from the contractors. In the case of the contract which is neither accounted for at the Mission, nor processed for payment at the Mission, we will advise the contractor of the questioned cost, obtain a response, and, if not allowable, will require that the contractor provide the Mission with a copy of an invoice in which the questioned costs are deducted.

12.3 The Office of Financial Management will, if the costs for consultant salaries are disallowed, conduct a review on site to determine the magnitude of the total disallowance, and make disallowances covering all involved costs.

The Mission asks that Recommendations No. 12.1, 12.2 and 12.3 be resolved based upon the above planned actions. We will request closure of 12.1 based upon completion of the workshop, closure of 12.2 and 12.3 based upon a report of the results of the review, along with appropriate collection actions, if necessary.

Recommendation No. 13.

The Contract Office will issue a Contract Office Staff Notice

cost rates in a timely manner, and of the need for coordination with the Procurement Support Division, and will request final indirect cost rate determinations from the AID/W Procurement Support Division for all U.S. based contractors.

The Mission asks that Recommendations No. 13.1 and 13.2 be resolved based upon the above planned actions. We will request closure based upon completion of the Staff Notice and submission of the request to the Procurement Support Division for final indirect rates.

Recommendation No. 14.

The Mission Management Control Review Committee (MCRC) will review this audit and its recommendations during the preparation of the 1992 Internal Control Assessment. If any of the findings are deemed to be material weaknesses, they will be included in the 1992 Assessment report. The Committee will advise the Regional Office of its actions in this matter.

The Mission asks that Recommendation No. 14 be considered resolved based upon the above planned actions. We will request closure based upon the advice from the Committee to the RIG Regional Office.

MISSION COMMENTS ON TECHNICAL ASSISTANCE CONTRACTS AUDIT

Recommendation No. 1: We recommend that USAID/Philippines adopt procedures to ensure that work statements in direct A.I.D. contracts clearly define the objectives of the contract and include performance indicators for measuring contractor progress and for evaluating contractor performance.

Mission comments on text.

Page 8.

The Mission takes issue with one of the statements attributed to the Contract Officer. On page 8, it says "USAID/Philippines did not clearly define the work statements for all contracts, according to the Contracting Officer, because level-of-effort contracts do not require as specific or detailed work statements as do completion-type contracts". This is not exactly what the Contract Officer said. Work statements are prepared before we decide on the type of contract, and level of effort rather than completion type contracts are used when the statements of work are not sufficiently defined to use a completion type contract. However, using a level of effort contract is not an excuse for a poorly defined statement of work.

#1 Mission Response

Although the Mission agrees that the work statements in the three contracts mentioned could have been better defined and included better performance indicators, we believe that this is an area where there has been significant improvement since the award of those contracts. We are very aware of the need for performance based statements of work and measurable performance standards and strive for their inclusion in our contracts wherever possible. Nevertheless, this is an area where further improvement is always possible, and we therefore agree with the auditor's recommendation.

The mission plans to issue a notice reminding its staff of this requirement and providing appropriate guidance. The notice will establish a requirement that each PIOT contain a separate section for the inclusion of specific objectives and performance indicators in the statement of work.

Recommendation No. 2: We recommend that USAID/Philippines:

- 2.1 Adopt procedures for obtaining established provisional indirect cost rates, through A.I.D.'s Procurement Support

Division, from cognizant contracting agencies;

- 2.2 Review the provisional indirect cost rates established under direct A.I.D. contracts with U.S.-based contractors and obtain evidence, in coordination with A.I.D.'s Procurement Support Division, that the approved rates are consistent with the current rates established by cognizant contracting agencies.
- 2.3 Obtain contractor agreement to adjust the approved billing rates for contractor progress payments if these rates are inconsistent with the current rates established by cognizant contracting agencies.

#2 Mission Response:

As the report mentions, there is considerable confusion about the role of AID's Overhead and Special Cost Branch in Washington and the role of Contract Officers in the field concerning the establishment of provisional indirect cost rates. The USAID/Philippines Contract Officer has always believed that only the final indirect cost rates had to be established by the cognizant U.S. Government Agency. For this reason and the reason that the last provisional rates established by the cognizant U.S. Government agency are often out of date, the Contract Officer believes that it is more equitable to both the contractor and USAID to establish provisional rates based on current financial data. This results in contract funding and contractor reimbursement at a more realistic level. Recent guidance from FA/Office of Procurement in Washington makes it clear, however, that provisional indirect cost rates have to be established by the cognizant U.S. Government agency, and USAID/Philippines therefore agrees with this recommendation. The Contract Officer has already started requiring that negotiated provisional indirect cost rates be approved by AID's Procurement Support Division, and he will confirm this in a notice to his staff. He also plans to take the actions recommended under parts 2.2 and 2.3 of the recommendation.

Recommendation No. 3: We recommend that USAID/Philippines establish procedures to ensure that cost analyses, including comparing cost proposals with U.S. Government cost estimates, are documented when determining the reasonableness of negotiated direct A.I.D. contract costs.

#3 Mission Response:

USAID/Philippines believes that the cost analyses done on the contractor proposals for the contracts reviewed were adequate to evaluate the reasonableness of the proposed costs. For each contract, individual cost elements of the contractor proposals

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were compared with one another as well as the USAID estimate. Spread sheets were prepared to facilitate the analyses and ensuing negotiations, and memoranda of negotiation were prepared to document the analyses and support the price negotiated. While the documentation may not have clearly shown the full analyses done, we are confident that such analyses were sufficient to result in fair and reasonable prices to the U.S. Government. While the determination as to whether these analyses were sufficiently documented is judgmental in nature, we agree that there could be improvement in our documentation and therefore agree to this recommendation. The Contract Officer will issue a notice to his staff reminding them of the requirement for adequate documentation and providing appropriate guidance.

With regard to the examples given for salary and subcontract costs that allegedly are unsubstantiated, we do not agree fully with the audit conclusions. The cost that was negotiated for salaries is merely an estimate which is based on prevailing rates in the market as well as salary histories. It is compared with our own estimate and the estimates of other proposers and reviewed for reasonableness by both the Contract and Project Officers. We believe that this analysis is sufficient to substantiate the total salary cost negotiated. For large contracts (such as those reviewed), we do not insist on complete biographic data sheets for every potential employee and consultant, especially the short-term ones, because their salaries are approved after the contract is awarded. To negotiate and agree on every salary prior to execution, as the audit report implies should be done, would take an inordinate amount of time. With respect to subcontract costs this too is merely an estimate. These costs, whenever the amount is significant, are broken down in the prime contractor's proposal and analyzed to the same extent as prime contractor costs. Perhaps the documentation did not fully explain the analyses but we believe it is unfair and incorrect to say the subcontract costs were not substantiated.

Recommendation No. 4: We recommend that USAID/Philippines adopt procedures for ensuring that determinations of responsibility or non-responsibility of prospective contractors are performed and documented in the contract files.

#4 Mission Response:

USAID/Philippines agrees with this recommendation. Although assessments of contractor responsibility are being performed, they are not always as thorough as FAR 9.103(a) requires. Further, even though FAR 9.105-2 states that the Contract Officer's signing of the contract constitutes a determination of Contractor responsibility, formal determinations of contractor responsibility are not always prepared. The Contract Officer

plans to issue a notice to his staff reminding them of these requirements and providing appropriate guidance.

Recommendation No. 5: We recommend that USAID/Philippines:

- 5.1 establish procedures for ensuring that contractors provide necessary information and obtain written approval from the Contracting Officer prior to the award of subcontracts, and
- 5.2 review the subcontracts awarded but not approved by the Contracting Officer and either approve them or take appropriate action to preclude reimbursement to the contractor for non-approved subcontracts.

#5 Mission Response:

USAID/Philippines agrees with this recommendation and plans to take the following actions:

5.1 Issue a Mission notice to establish a procedure requiring that all vouchers containing subcontract costs break down the costs by subcontract and be accompanied by a letter providing Contract Officer approval. Subcontract costs without an approval letter will not be reimbursed. In addition, the Contract Officer will issue a notice to his staff requiring that a provision covering the above be included in all USAID contracts where subcontracting is anticipated.

5.2 Review all subcontracts awarded but not approved and either approve them or deny reimbursement.

Recommendation No. 6: We recommend that USAID/Philippines adopt procedures ensuring that Technical Evaluation Committees document reference checks on the past performance of offerors who have submitted technically acceptable proposals.

#6 Mission Response:

USAID/Philippines agrees with the recommendation. For each competitive procurement, the Contract Officer customarily sends the Project Officer a standard memorandum providing guidance for the Technical Evaluation Committee (TEC). This memo addresses the requirement for the reference check but does not say explicitly that the reference check needs to be documented. The Contract officer will revise the memo to make it clear that the reference check needs to be documented. He will also issue a notice to the Contracts Staff advising them not to accept the TEC's memorandum reporting the results of the evaluation without the results of the reference check.

Recommendation No. 7: We recommend that USAID/Philippines establish procedures to ensure the review and verification of the correctness of Technical Evaluation Committee score sheets prior to their submission to the Contracting Officer.

#7 Mission Response:

USAID/Philippines agrees with this recommendation. In the standard memo mentioned above, the Contract Officer will include an instruction for the TEC Chairman (i) to review and verify the correctness of the TEC score sheets prior to their submission and (ii) to state in the evaluation memorandum to the Contract Officer that this has been done. In addition, the Contract Officer will issue a notice to his staff advising them not to accept the TEC's evaluation memo without this statement.

Recommendation No. 8: We recommend that USAID/Philippines establish procedures to ensure that technical assistance contractors include measurable targets and time frames in work plans and a comparison of completed activities against the measurable targets and time frames in progress reports in order to objectively assess contractor performance.

#8 Mission Response:

USAID/Philippines agrees with this recommendation. The Mission plans to issue a notice to its staff advising them of this requirement. In addition, the Contract Officer will develop a standard provision covering this requirement which will be put in all contracts under which work plans and/or progress reports are to be submitted.

Recommendation No. 9: We recommend that USAID/Philippines ensure that contractors establish programs for the receipt, use, maintenance, protection, care and custody of non-expendable property purchased under direct A.I.D. contracts.

#9 Mission Response:

USAID/Philippines agrees with this recommendation and plans to take the following actions:

- (1.) Issue a Mission notice to establish a procedure requiring any voucher containing non-expendable property costs be accompanied by a letter providing Contract Officer approval of contractor's program for the receipt, use, maintenance, protection, care and custody of such property. Property costs without an approval letter will not be reimbursed.
- (2.) Have the Contract Officer issue a notice to his staff requiring that a provision covering the above be included in

all contracts where non-expendable property will be purchased.

Recommendation No. 10: We recommend that USAID/Philippines ensure that guidelines are implemented for planning, performing and documenting site visits for Mission staff.

#10 Mission Response:

USAID/Philippines agrees with this recommendation and plans to take the following actions:

(1.) Issue a Mission notice to require each office to prepare a quarterly plan covering site visits to be performed.

(2.) Require that numbers of site visits, and information obtained during site visits be included in the Quarterly Project Status Reports (QPSRs). In addition, require that data pertaining to significant variations from planned schedules or other problems be documented through a written site visit report, to be prepared soon after the visit.

Recommendation No. 11: We recommend that USAID/Philippines:

11.1 Adopt procedures for ensuring that expired technical assistance contracts are closed out in accordance with the provisions of the Federal Acquisition Regulation, Subpart 4.804, and A.I.D.'s Contract Information Bulletin 90-12 in a timely manner;

11.2 Take the necessary steps to initiate the closeout of all expired technical assistance contracts;

11.3 Determine if there is a need to maintain the \$647,000 of unliquidated balances for the expired contracts; and

11.4 Account for and initiate the distribution of non-expendable property in accordance with the contract provisions.

#11 Mission Response:

Although USAID/Philippines agrees with this recommendation, we do want to mention that the Mission has a system in operation to close out expired contracts, and hundreds have in fact been closed out. However, the ones that are over \$500,000 in value and require an audit and negotiation of final overhead rates have not been closed out because their closeout takes substantially more time and has had a low priority.

11.1 The Contract Officer will issue a notice to his staff alerting them to this close-out requirement and instructing them

to initiate close out action on their respective contracts.

11.2 The Contracts Office will prepare an inventory of contracts which require close out actions, and prepare any required documentation to initiate close out action.

11.3 The particular contracts will be reviewed to determine required actions and documentation to make a final determination. Based upon the results of this review, the Contracts Officer will make a determination of the need to maintain the unliquidated balances of expired contracts.

11.4 Required documentation will be prepared to account for and initiate action to distribute non-expendable property based upon the results of the inventory and review.

Mission Comment on text of Report.

Page 39. First Paragraph:

It is true that certification of vouchers is made without routinely requiring the submission of supporting documentation. This process is the standard process followed by AID Missions and is consistent with the requirements of the FAR and AIDAR. The requirements for documentation to support requests for payment are based upon the terms and conditions of the contract, and the contracts are prepared in accordance with the FAR and AIDAR. Since this is the standard process followed by AID Missions and is consistent with the terms of the regulations, we do not intend to routinely require supporting documentation in excess of the contract requirements. Recent guidance from Washington indicates that the Office of Procurement/Finance and Administration Directorate will take responsibility for audits of U. S. based contractors and grantees, whereas the Missions will take responsibility for non-U. S. based firms. Based upon this guidance, the Mission has established a Mission Management Control Review Committee which will determine policies regarding audits of non-U. S. based firms. Since these policies will include cost reimbursement contracts, there will be procedures for determining the required audit coverage of such contracts.

Page 39. Questioned costs under the three listed items:

All of these questioned costs were determined based upon a review of contractor records, and were based upon supporting documentation in excess of that required for voucher processing. Therefore a review of contractor invoices as suggested in Recommendation no. 12.3 (Page 38) would not reveal the basis for disallowance. This would require on-site review of contractor records which is outside the scope of reviews carried out by the voucher examination staff. Once the audit policies have been

established by the Mission MCRC, this is the type of activity we would expect to be covered by audit. Since these policies are not yet established, the Mission will have this review carried out on site by the Office of Financial Management.

Page 40. Third Paragraph.

The Mission disagrees with the statement that "voucher examiners did not always determine whether costs claimed were in accordance with the terms of the contracts". Voucher examiners are trained to compare requests for payment with the terms of the contracts, and generally make this comparison as a part of voucher processing. The voucher workload at this Mission is extremely heavy. There is no system which can be put into place which will absolutely prevent error. For every ten project vouchers processed, three have disallowances. This is an indication that there are review procedures in place, and that they are generally followed. If it is discovered that an examiner is making errors, the reason for the errors is analyzed. If this reason is a lack of understanding of the required examination procedures and techniques, additional on the job training is provided to the employee. If the reason is an unwillingness to perform the required procedures, the employee is counselled, and repeated instances of substandard performance are noted in employee evaluations. In extreme cases, administrative action is taken.

The Mission also disagrees with the statement that "This occurred because voucher examiners placed too much reliance on project officer reviews of vouchers and did not have written instructions for ensuring that claimed costs were in accordance with the terms of the contracts". The voucher examiners have been trained that the project officer approval of vouchers is a requirement for the process but that it does not substitute for appropriate voucher examination. Therefore, if they are placing too much reliance on this step, it is directly contrary to the training they have received. We can, of course, re-emphasize this instruction, but in and of itself, that re-emphasis will neither absolutely prevent error nor motivate a recalcitrant employee. Further, the number and types of vouchers handled by each examiner vary widely. Cost reimbursement contracts are but one type. It is this very diversity which has caused the voucher examination process to be learned through on the job training rather than through reference to written instructions. Therefore, again, the existence of written instructions will neither absolutely prevent error nor motivate a recalcitrant employee. In lieu of preparing written instructions for such vouchers, we will reinforce the training already received by holding a workshop to reiterate required procedures for cost reimbursement contracts.

Page 40 and 41. Listed items:

The first item is a disallowance which has already been made.

The second item involves a contract in which the effective date stated on the cover page is February 1 while one of the conditions within the contract states that the effective date is the date of signature of the Contracting Officer, which was March 3. This created confusion which led to a mistake in allowing the costs for the month of February.

The third item deals with a mismatch of budget line items from the summary invoice to the contract. The detailed attachments to the summary invoice provided information which allowed the examiner to track expenditures against contract budget items. This tracking was done through a spreadsheet and provided a basis for comparison to the contract. Although we can agree that the examiner should have raised this issue, and required that the contractor bill in accordance with the contract line items, control was maintained in the examination process. Therefore, there was assurance that cost categories, totalling \$3.0 million were within the budget line items. The final billings from the contractor are in accordance with the line items in the contract.

The fourth item deals with calculation of overhead. The item stipulates that the overhead rate should have applied only to the U. S. salaries and excluded the local staff salaries. However, the contract itself simply states that overhead should be based upon direct salaries and fringe benefits, and does not specify limitation to U. S. salaries. Ancillary documents in the files do indicate that the contractor does not include local staff salaries in the overhead calculation. The contract itself, however, does not make that clear. This created a situation which led to a mistake being made in the calculation process. The costs involved will be reviewed and, if not considered allowable, will be recovered from the contractor.

The above items are indicative of errors made during processing. Given the number of vouchers processed by this Mission, it is impractical to assume that all transactions will be free of error. No system of control is extensive enough to be totally error free. As stated earlier, we will reinforce training already received by the voucher examiners to ensure that they have complete understanding of their responsibility in the examination of cost reimbursement contract vouchers. We do not believe, however, that these errors are indicative of a major failure of the system.

Recommendation 12: We recommend that USAID/Philippines:

12.1 Establish review procedures for voucher examiners to ensure that the provisions of contracts are considered before contractor invoices are approved for payment;

12.2 Determine whether the questionable reimbursement of about \$83,500 of contract costs should be disallowed and recovered, and

12.3 If the questioned costs related to consultant salaries are disallowed, review the balance of contractor invoices for disallowance of these costs because the questioned costs are recurring and are from a small sample of contractor invoices.

12 Mission Response:

12.1 As explained earlier, review procedures have been established and these procedures have been explained to the voucher examiners during training. These procedures do include a requirement that requests for payment be verified for consistency with the contract prior to payment. We will reinforce this requirement with the voucher examiners, by holding a workshop which will emphasize the requirements for cost reimbursement contracts.

12.2 We will review the items questioned to determine whether they should be disallowed and recovered. Specifically,

Consultant salaries \$8700 (Page 39). We will send personnel from the Office of Financial Management to the contractor's office to review documentation supporting consultant salaries. If not substantiated, we will disallow these amounts and recover them from the contractor. (Also see Recommendation 12.3 below).

Value Added Tax \$700 (Page 39). Of this amount, \$130 is applicable to a local contract under a project accounted for by the Mission. We will advise the contractor of this amount and, if not substantiated, the Mission will recover the amount from the contractor. The balance, approximately \$570, is under a contract which is financed through non-project assistance, and therefore accounted for in Washington. The invoices are reviewed and approved in Washington and since they are charged to Washington accounts, are never reflected in the official records of the Mission. For this item, we will advise the contractor of the amount and, if not substantiated, we will advise the contractor to deduct this amount from the next invoice.

Lodging, Meals and Per Diem \$624 (Page 39). We will advise the contractor of these questioned costs and obtain documentation from the contractor. If not substantiated, we will disallow these amounts and recover them from the contractor.

Contractor Costs Before Effective Date \$65000 (Page 40-41). We will determine whether these costs are acceptable. If they are deemed to be unallowable, they will be disallowed and recovered from the contractor.

Fringe Benefit/Indirect Costs \$8500 (Page 41). We will analyze the costs and make comparison to the contract terms. If they are deemed to be unacceptable, they will be disallowed and recovered from the contractor.

12.3 As noted in our response to recommendation 12.2, we will send personnel to the contractor's office to analyze documentation supporting consultant's salaries. If it is determined that the \$8700 in salaries are not allowable, we will review the documentation supporting costs for consultant salaries for the entire contract period to date, and, if appropriate, make additional disallowances.

Recommendation NO. 13: We recommend that USAID/Philippines

13.1 adopt procedures, in coordination with A.I.D.'s Procurement Support Division, to ensure that established final indirect cost rates are obtained in a timely manner and

13.2 request final indirect cost rates for all direct A.I.D. contracts with U.S.-based contractors so that payments to contractors can be adjusted.

#13 Mission Response:

USAID/Philippines agrees with this recommendation. The Contract Officer will issue a notice to his staff reminding them that final indirect cost rates must be established in a timely manner. He will also initiate action to obtain final indirect cost rates for all direct A.I.D. contracts with U.S.-based contractors.

Recommendation No. 14: We recommend that USAID/Philippines determine whether the internal control weaknesses identified in this report should be included in its next internal control assessment to ensure compliance with the Federal Manager's Financial Integrity Act,

#14 Mission Response:

The Mission Management Control Review Committee (MCRC) will monitor and review the preparation of the internal control assessment. This same body is now reviewing the findings of each audit completed. The MCRC will consider the findings in this report and if they are deemed to be material weaknesses will ensure that they are included in the assessment.

USAID/Philippines
APO AP 96440



OCT 16 1992

Fax No.: 632-521-5241
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REPRESENTATION LETTER

AUDIT OF TECHNICAL ASSISTANCE CONTRACTING

Mr. James B. Durnil
Regional Inspector General for Audit/Singapore
U. S. Agency for International Development

Dear Mr. Durnil:

Your office has made an audit of the technical assistance contracts of USAID/Philippines that were active on September 30, 1991. The audit was made to answer the following audit objectives:

Did USAID/Philippines follow A.I.D.'s procedures in planning for technical assistance?

Did USAID/Philippines follow A.I.D.'s procedures to ensure that technical services were procured at a fair price, in a timely manner, from qualified contractors, and with clear scopes of work and measurable performance?

Did USAID/Philippines adequately monitor contractor performance to ensure that technical services were provided and used as prescribed in A.I.D. policies and procedures?

Did USAID/Philippines obligate, spend and account for technical services funds in compliance with A.I.D. policies and procedures and applicable laws and regulations?

I have asked the offices concerned with the audit, particularly the Office of Financial Management and the Contracts Services Office, to make available to you all records in our possession for the purpose of the audit. Based upon their representations to me in connection with the audit of technical assistance contracts, I believe those records are reasonably accurate and complete, and that they give a fair representation as to the status of technical assistance contracting.

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Representation Letter
Mr. James B. Durnil.

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I confirm that for the technical assistance contracts under audit (or active during the audit period), USAID/Philippines is responsible for:

maintaining a system of internal controls,
complying with applicable laws and regulations, and
ensuring the fairness and accuracy of the mission's accounting and management information relating to the technical assistance contracts.

Among other techniques we rely extensively on the audit reports of contracted private independent audit firms and A.I.D.'s Office of the Inspector General as a primary element of internal control, to determine compliance with applicable laws and regulations, and to ensure the accuracy of accounting and management information.

Based upon this reliance upon audits, representations made to me by concerned officials and consultations with my staff, to the best of my knowledge and belief, as a layman and not as a lawyer, I confirm that USAID/Philippines has made available (to the extent available within the Mission) and not knowingly and purposely withheld:

all the financial and management information associated with the audit objectives,

information regarding any irregularities, which we consider substantive, involving employees who have roles in the internal control structure related to the technical assistance contracts under audit,

information involving any instances of material error in the recording of financial or management information related to the technical assistance contracts under audit, and

has provided information about any material noncompliance with AID policies and procedure or violations of U.S. laws or regulations, which would substantially impact upon the technical assistance contracts under audit.

Following our review of your draft audit report and further consultation with my staff, I know of no other facts as of the date of this letter (other than those expressed in our enclosed management comments to the draft report) which, to the best of my knowledge and belief, would materially alter the conclusions reached in the draft report.

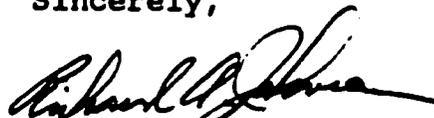
Representation Letter
Mr. James B. Durnil

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Officials of the offices concerned with the audit, particularly the Office of Financial Management and the Contract Services Office have represented to me that they are aware that USAID/Philippines management is relying on their knowledge and that of their staffs as the basis for the representations in this letter and that they have read this letter and concur with the representations. A copy of this letter with appropriate clearances evidencing this concurrence is available within the Mission.

I request that this Representation Letter be included as a part of the official management comments on the draft report and that it be published herewith as an Annex to the report.

Sincerely,


Richard A. Johnson
Deputy Director

APPENDIX III

REPORT DISTRIBUTION

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