

Audit of USAID/Egypt's Direct Contracting Practices

Report No. 6-263-93-01
November 30, 1992





**UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL/AUDIT**

November 30, 1992

MEMORANDUM FOR A/D/USAID/Egypt, Christopher D. Crowley

FROM :

RIG/A/C, *Philippe L. Darcy*

SUBJECT:

Audit of USAID/Egypt's Direct Contracting Practices, Report
No. 6-263-93-01

Enclosed are ten copies of our audit report on USAID/Egypt's Direct Contracting Practices, Report No. 6-263-93-01.

We have reviewed your comments on the draft report and considered them in the preparation of the final report. Your comments are included as Appendix III to the report. The report contains three recommendations, all of which are considered resolved. Recommendation Nos. 2 and 3 are considered closed upon issuance of this report. Recommendation No. 1 can be closed upon the Mission providing this office with evidence of issuance of a bill for collection or the Contracting Officer's final decision.

Please provide a response to this report within 30 days indicating what further actions you have taken to address the open recommendation.

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

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EXECUTIVE SUMMARY

Background

During the last ten years, the Agency for International Development provided \$1 billion in annual assistance to Egypt. As of July 1991, this assistance was funding 33 cost-reimbursable contracts valued at \$202 million which had been awarded directly by USAID/Egypt. USAID/Egypt's policies and procedures require multiple reviews and approvals before contracts are advertised and awarded. However, the contracting officer is ultimately responsible for deciding what type of contract is in the government's best interest and whether the price negotiated is fair.

Audit Objectives

We audited USAID/Egypt's contracting practices in accordance with generally accepted government auditing standards (see Scope and Methodology, Appendix I). Our field work was conducted from July 1991 through January 1992 to answer the following questions:

1. Has USAID/Egypt awarded contracts at a fair price to eligible contractors in accordance with A.I.D. policies and procedures? (see page 4)
2. Has USAID/Egypt closed out A.I.D. direct contracts in accordance with A.I.D. policies and procedures? (see page 8)
3. Has USAID/Egypt performed or contracted for preaward surveys in accordance with A.I.D. policies and procedures? (see page 13)

Summary of Audit

The Director, USAID/Egypt, provided us written representations covering Mission responsibilities, full and accurate disclosure of financial and management information, compliance with contractual agreements and other matters. (The complete representation is contained in Appendix III of this report.) The Director limited his representations with regard to instances of irregularities, noncompliance and/or violations of laws and regulations to those matters which to the best of his knowledge and belief should be contained in the records under audit or to those matters which were elicited by the auditors during the course of the audit. Also, in accordance with A.I.D. Washington guidance, the Mission Policy is that only the Director, not the officials directly responsible for the activities under audit, will provide written representations. (See Scope and Methodology, Appendix I.)

Except for the effects on the audit findings, if any, of not receiving acceptable representations as discussed above, the mission was awarding contracts at a fair price to eligible contractors and was performing preaward surveys in accordance with A.I.D. policies and procedures. However, USAID/Egypt was not taking action to close out contracts as envisioned by its policies and procedures. Also, the mission needs to develop systems that are more complete and accurate to monitor closure. We observed no significant deficiencies in the Mission's use of preaward audits.

Audit Findings

Contracts Were Awarded At A Fair Price

USAID/Egypt generally followed A.I.D. policies and procedures in ensuring that contracts were awarded at a fair price to eligible contractors. These findings can be attributed to the Mission's efforts to (1) strengthen the reporting level of the Director of Contract Services by having him report directly to the Deputy Mission Director instead of through the Associate Director for Management; (2) standardize its system for documenting and maintaining information in contract files relative to contract negotiations, decisions, and cost evaluations; and (3) require procurement officials to certify that they will protect contract information. We did note that overhead rates may have resulted in excessive costs of about \$39,000 on one contract.

Contracts Were Not Being Closed Out in Timely Manner

USAID/Egypt did not close contracts on time or adequately identify contracts needing closure. This was because: the contract office delayed initiating requests for closure information; the contractors, grantees, project and paying officers did not provide information requested; and the contract office did not follow-up when responses were not received. Also, systems need to be developed that are more complete and accurate for monitoring closure. Knowing which contracts need closure and what close out action is needed is basic to an effective closure system.

Preaward Surveys Were Being Performed

USAID/Egypt followed A.I.D. policies and procedures to ensure that preaward surveys were performed. We reviewed 33 contracts and grants and found 4 formal preaward surveys were performed. In the remaining 29 cases the grant or contract officers appeared to have adequate knowledge of the contractors or grantees capabilities as these were usually large reputable firms with a variety of other federal or A.I.D. contracts or grants.

Summary of Recommendations

We Recommend that USAID/Egypt:

- Review the \$39,036.56 in questioned costs related to contract No. 263-0182-C-00-8017 and determine the amount to be disallowed.
- Develop procedures for the monthly review of closure actions to ensure that contract closure is initiated within 90 days of contract termination and that periodic follow-up occurs when there has been no response to requests for data.
- Reconcile the Mission closure tracking system to the Contract Information Management System data and have the closure tracking reports reviewed for accuracy by contracting officers.

Management Comments and Our Evaluation

Management commented that it was in agreement with the three recommendations in the report. In addition, they provided additional comments which we took into consideration in finalizing the report. (See Appendix III.)

Office of the Inspector General

Office of The Inspector General
November 30, 1992

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INTRODUCTION

Background

The Agency for International Development's Mission in Egypt, hereafter referred to as USAID/Egypt, administers a foreign assistance program that in the last ten years has provided Egypt with approximately \$1 billion a year. On July 1, 1991, USAID/Egypt had 33 contracts, cooperative agreements and grants with contractors and nonprofit organizations scheduled to terminate after January 1, 1992. These 33 awards, hereafter called contracts, had a value of \$202 million.

USAID/Egypt's policies and procedures require multiple reviews and approvals before contracts are advertised and awarded. However, the contracting officer is ultimately responsible for deciding what type of contract is in the government's best interest and whether the price negotiated is fair. It is important that the contracting officer maintains his independence in making these decisions and exercises professional judgement as to which contractual terms best represent the interests of the U.S. Government.

Audit Objectives

The Office of the Regional Inspector General for Audit/Cairo (RIG/A/C) conducted a performance audit of USAID/Egypt's direct contracting practices to answer the following audit objectives:

1. Has USAID/Egypt awarded contracts at a fair price to eligible contractors in accordance with A.I.D. policies and procedures? (see page 4)
2. Has USAID/Egypt closed out A.I.D. direct contracts in accordance with A.I.D. policies and procedures? (see page 8)

3. Has USAID/Egypt performed or contracted for preaward surveys in accordance with A.I.D policies and procedures? (see page 13)

In answering these audit objectives, we tested whether USAID/Egypt followed applicable internal control procedures and complied with applicable provisions of laws, regulations, grants and contracts. Our tests were sufficient to provide reasonable - but not absolute - assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. However, we did not continue testing when we found that, for the items tested, USAID/Egypt followed A.I.D. contracting procedures. For those items, we limited our conclusions concerning positive findings to items actually tested. When we found problem areas, we performed additional work to:

- determine whether USAID/Egypt was following procedures or complying with grant requirements;
- identify the cause and effect of the problems; and
- correct the condition and causes of the problems by making recommendations.

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

REPORT OF AUDIT FINDINGS

Based upon discussions with Mission officials, the Director, USAID/Egypt, provided us a written representation that USAID/Egypt is responsible for the internal control system and the fairness and accuracy of the accounting and management information relating to the audited activities and that, to the best of his knowledge and belief, USAID/Egypt had provided us all the financial and management information relating to the audit objectives, USAID/Egypt is unaware of any material instances where the information provided had not been properly and accurately recorded and reported, and USAID/Egypt has complied with all contractual agreements that could materially affect the Mission's direct contracting practices. (The complete representation is contained in Appendix III to this report.)

Although the Director, USAID/Egypt, provided us these essential written representations, he limited his representations with regard to instances of irregularities, noncompliance and/or violations of laws and regulations to those matters which to the best of his knowledge and belief should be contained in the records under audit or to those matters which were elicited by the auditors during the course of the audit. Also, in accordance with A.I.D./Washington guidance of May 13, 1992, the Mission policy is that only the Director will sign a letter of representation. Therefore, other USAID/Egypt officials directly responsible for the audited activities, in this case the Director of Contract Services, did not provide written representations to the Director confirming essential information. As a result, our answers to the audit objectives are qualified to the extent of the effect of not having such representations.

Has USAID/Egypt Awarded Contracts at a Fair Price to Eligible Contractors In Accordance with A.I.D Policies and Procedures?

Except for the effects on the audit findings, if any, of not receiving acceptable representations, as discussed on page 3, USAID/Egypt generally followed A.I.D. policies and procedures in ensuring that contracts were awarded at a fair price to eligible contractors. These findings can be attributed to the Mission's efforts to (1) strengthen the reporting level of the Director of Contract Services by having him report directly to the Deputy Mission Director instead of the Associate Director for Management; (2) standardize documenting and maintaining information in contract files relative to contract negotiations, decisions, and cost evaluations; and (3) require procurement officials to certify that they will protect contract information.

We welcome these efforts because our review of a sample of contracts awarded a few years ago showed the Mission was having problems ensuring that (1) the contract office was not unduly pressured by Mission program personnel, (2) documentation supporting contract decisions was complete, and (3) contract staff protected contract information during negotiations. Our review of three recent contracts showed that these problems were no longer present. Therefore, we have no recommendations with regard to the findings under this audit objective, except to recommend that the Mission review the questioned cost of \$39,000 of an earlier contract and determine the amount to be disallowed.

The Mission has changed the reporting level of the Director of Contract Services by having him report directly to the Deputy Mission Director instead of through the Associate Director for Management thereby allowing him greater flexibility and independence in dealing with the Mission technical offices. This reporting level is necessary because in the past some of the technical offices have unduly pressured the contract office to enter into contracts which were (1) not in the best interest of the U.S. Government and (2) not considered to be the best choice by the contracting officers. Subsequently, contracting officers were found to have been correct but not before some losses were incurred.

USAID/Egypt has standardized its system for documenting and maintaining information in contract files relative to contract negotiations, decisions, and cost evaluations. Our review of contracts awarded two or three years ago showed that it was difficult and sometimes impossible to access and examine particular transactions. For example, cost negotiations records were insufficient for us to determine if the negotiations conducted and the decisions made were in the best interests of the U. S. Government, and whether

adequate analyses of costs had been performed in those negotiations. Our review of these recent contracts showed that the files are now adequately documented.

In addition, USAID/EGYPT is obtaining a procurement integrity certification from staff involved in the procurement process and advising them of their responsibility to protect contract information. This action appears to have corrected instances in the past whereby the confidentiality of independent government cost estimates were not being protected in accordance with A.I.D. policies and procedures resulting in cost estimates being improperly released.

While reviewing contract files, we noted that overhead rates may have been excessive under one contract.

Overhead Rates May Have Been Excessive

The contract records indicate that USAID/Egypt overpaid for overhead and fringe benefits in calendar years 1988 and 1989 under contract No. 263-0182-C-00-8017. The contract stipulated ceilings on the fringe benefits and overhead that could be claimed. However, payments were made in excess of these ceilings because the contracting officer waived the ceilings while establishing further payment limits which were not adhered to. As a result, the Mission may have overpaid \$39,036.56 of overhead costs.

Recommendation No. 1: We recommend that USAID/Egypt review the \$39,036.56 in questioned costs on Contract No. 263-0182-C-00-8017 and determine the amount to be disallowed.

The Request for Proposal for this procurement requested contractors to propose an indirect cost rate or rates to be established for each of the contractor's accounting periods. The contractor was also to identify a ceiling for indirect cost rates for the periods which applied to the contract. The Contractor proposed a combined overhead and fringe benefit ceiling rate of 149 percent of base salaries for the annual accounting periods ending December 31, 1988 and 1989. The awarded contract broke down the 149 percent ceiling as 38 percent for fringe benefits and 111 percent for overhead. The contract provided that the Government would not be obligated to pay any additional amount of indirect costs above the ceiling rates.

The contract also permitted the contractor to claim fringe benefits and overhead at the provisional rates of 36.97 percent and 108.38 percent until final indirect rates for the accounting periods were established. However, the contract noted that if the final indirect rates exceeded the ceiling rates, repayment would be limited to the ceiling rates and the excess would be absorbed by the contractor and considered shared cost.

At the end of the 1988 and 1989 accounting periods, A.I.D. was advised by the contractor that final cost rates had been negotiated. The Contractor submitted revised vouchers (#22 and #39) adjusting the fringe benefits and overhead it had claimed from the provisional rates to final rates. In some cases the final rates exceeded the ceiling rates. The claim should have been limited to the lower of the ceiling or final rates. Because the Contractor used the final rates and not the lower of the two, it claimed \$39,036.56 more than the ceiling rates permitted. The difference is shown in the table that follows.

CALCULATION OF PAYMENTS IN EXCESS OF CEILING						
<u>CY 1988</u>	<i>Ceilings</i>	<i>Final</i>	Payable	\$ Paid	\$ Payable	Overpayment
	Rates*					
Overhead	111	95.59	95.59	\$141,766.36	\$141,766.36	--
Fringe	38	43.22	38.00	\$64,098.15	\$56,356.54	\$7,741.61
Total 88	<u>149</u>	<u>138.81</u>	<u>133.59</u>	<u>\$205,864.51</u>	<u>\$198,122.90</u>	<u>\$7,741.61</u>
<u>CY 1989</u>						
Overhead	111	105.52	105.52	\$216,824.95	\$216,824.95	--
Fringe	38	53.23	38.00	\$109,378.24	\$78,083.29	31,294.95
Total 89	<u>149</u>	<u>158.75</u>	<u>143.52</u>	<u>\$326,203.19</u>	<u>\$294,908.24</u>	<u>\$31,294.95</u>
TOTAL OVERPAYMENT CY 1988 AND 1989						<u>\$39,036.56</u>

* Rates applied to 1988 and 1989 salary bases of \$148,306.68 and \$205,482.33.

The voucher examiner in the Mission's Office of Financial Management advised us that the voucher adjustments submitted by the Contractor were not questioned, in part, because of a handwritten note on the earlier voucher (#22) from the contract officer. The note states the following.

"Ceiling on fringe rate is waived as long as fringe and overhead does not exceed total of both rates (provisional) stated in contract."

The provisional rates in the contract were: fringe benefits (36.97 percent) and overhead (108.38 percent) for a total 145.35 percent. The final rates in 1988 are less (138.81 percent) as shown earlier. However, the 1989 final rates totalled 158.75 percent. A.I.D.'s payment of the 158.75 percent rather than the 145.35 percent provisional rate resulted in an overpayment of \$27,543.62 (\$326,203.19 versus \$298,668.57) assuming that the handwritten waiver of 1988 applied to 1989.

We found that due to the recent departure of the contracting officer handling this contract, it was difficult to establish why or by what authority he voided the contract ceiling rates. Furthermore, contract staff had difficulty determining exactly what had occurred and whether the contract officer had intentionally waived ceilings for one or two fiscal years. The "waiver" itself was only discovered by us during a review of the paid vouchers and no record of the waiver was found in the contract office files.

Thus, we were unable to establish the justification for the contracting officer's action to void the ceiling limits. Moreover, it is unclear whether he intended his action to apply only to 1988. For example, Voucher #22, which contained his note, was processed by the Mission's Office of Financial Management on December 3, 1989 but modification No. 6 to the contract, effective January 1, 1990, continues to retain the ceiling rate of 149 percent for 1989. This would indicate the ceiling rates were still to be effective for 1989.

In our opinion, the Contractor has been overpaid for fringe and benefits. Unless waiver of the fringe and overhead rates for 1988 and 1989 can be justified, we question \$39,036.56 of costs claimed. If the waiver can be justified, we would reduce cost questioned to \$27,534.62.

Has USAID/Egypt Closed Out A.I.D. Direct Contracts In Accordance With A.I.D. Policies And Procedures?

Knowing which contracts need closure and what close out action is needed is basic to an effective closure system. USAID/Egypt did not close contracts on time or adequately identify contracts needing closure. This was because: the contract office delayed initiating requests for closure information; the contractors, grantees project and paying officers failed to provide information requested; and the contract office failed to follow-up when responses were not received. Also, the mission needed to develop a more complete and accurate system to monitor closure.

USAID/Egypt Needs to Improve Contract Closure

A.I.D. Mission Order 14-7 specifies a process for closing contracts and states that closure should be initiated within 90 days of contract termination. Closure is desired within 3 years because contract clauses generally require the contractor to retain records only for that period. The timely completion of this process is contingent on contractors, grantees, technical officers, and paying officers providing various reports and statements to the contract office. Contract closure by USAID/Egypt was not completed on time in 20 of 21 sampled contracts because: the contract office delayed initiating requests for closure information; the contractors, grantees, project and paying officers failed to provide information requested; and the contract office failed to follow-up when responses were not received. As a result, it may be necessary to close contracts over \$500,000 without a close out audit because contractors are required to maintain records for only 3 years.

Recommendation No. 2: We recommend that USAID/Egypt develop procedures for the monthly review of closure actions to ensure that contract closure is initiated within 90 days of contract termination and periodic follow-up occurs when there is no response to requests for data.

Mission Order 14-7 requires closure action be initiated within 90 days of contract termination and such action should be completed within 3 years as contractors are only required to retain records for that period.

The USAID/Egypt contract office prepares a report of contracts that have terminated and require closure action. The reporting system identifies which contracts have terminated, the dates the contract office requested information from the contractor, grantee, technical officer, or paying officer and the dates they responded.

We selected 21 of the 91 contracts, grants, and cooperative agreements to determine the amount of time it took to complete closure steps and what problems were encountered in closure. The Mission records showed the following:

1. The contract office on an average sent its initial request for closure information to the 21 contractors 13 months after the contract terminated.
2. Eleven of the 21 contractors that replied to contract office requests did so within an average of 2.3 months. The remaining 10 did not reply. Accordingly, it appears that if a contractor is to respond, he is likely to do so within 90 days. Follow-up is therefore required if no response is received within 90 days. However, we found that the contract office had sent a follow-up request to only one of the 10 contractors that had failed to reply as of August 30, 1991. An average of 14 months had expired since the initial requests were made to the remaining 9 contractors for information.
3. The Mission does not always request information from contractors and technical officers at the same time. In 21 reviewed cases the Mission sent 5 requests to the contractor and technical officer on the same day but waited, in 16 cases, for the response from the contractor before making a request to the technical officer. Because the contractors failed to respond in 6 of the 16 cases the technical officers were never requested to furnish data.

Contractor's did not respond in 10 of the 21 cases, and in the 11 cases where they responded, the Mission took timely action to request data from the technical offices in 9 cases. For reasons unknown the Mission took 10 months to request data on one case and failed to request data on the other although the contractor had responded 19 months earlier.

In 14 of the 21 cases, the technical officers were requested to provide closure information. Six responded within a month, one within 4 months, one within 7 months, and six did not respond. In four of the latter six cases, the requests to the technical officers had been made 8 to 18 months earlier. Three of the 4 non-responsive cases in question involved the same technical officer.

4. Once a response was received from the technical officer, the contract office would request data from the paying officer (financial management). In 7 of the 8 cases where the technical officer responded, the contract office quickly requested the paying office to provide information. No request was made in one instance. However, in 5 of the 7 cases the paying office never responded to the contract office and the contract office did not follow-up. In 4 of 5 cases, 11 to 18 months had passed since the contract office had requested information. However, the records showed that while the paying officers did not respond to the contract office, they were taking action to deobligate unneeded funds on terminated contracts.

In summary, it took the contract office an average of 13 months to send its first letter to a contractor. Half of the contractors never responded and the process stopped; half responded within 2.3 months. Once a response was received from the contractor, Mission technical officers generally replied within a month although in four cases replies took several months. When the technical officer replied, it was to request data from the contractor paying office, but in 4 of 7 cases the contractors failed to respond within 11 months of the requests. Our sample of 21 contracts in need of closure included cases which had been in the closure process for 1 to 4.5 years.

USAID/Egypt Must Improve Its Inventory of Contracts Needing Closure

If the Mission is to monitor that closure action is initiated within 90 days of contract termination, it must have an accurate system to track contracts in need of closure. Our tests of 77 contracts terminated prior to July 1, 1991 showed that only 33 were reported by the contract office as needing closure action. This occurred because an adequate system was not in place for monitoring contract closure. As a result, the close out of contracts was delayed unnecessarily.

Recommendation No. 3: We recommend that USAID/Egypt reconcile the Mission's closure tracking system to the Contract Information Management System data and have the closure tracking reports reviewed by the respective contracting officers to confirm their accuracy.

In order to monitor that closure action is initiated in a timely fashion, the Mission must have accurate information about which contracts need closure. USAID/Egypt's contract office used three reports to identify contracts needing closure. These reports identified:

1. Expired contracts closed since November 1989.
2. Contracts expiring before FY 89 and being closed out.
3. Contracts expiring in FYs 89, 90, 91 and being closed out.

A separate contract reporting system called the Contract Information Management System (CIMS) is also available to the contract office. The CIMS identifies the termination dates of contracts. The CIMS data base has a data field for the date contracts are closed. But the field contained no dates because USAID/Egypt has never reported the information.

We matched the CIMS data to the three reports used to monitor close outs. The CIMS data revealed 77 contracts, cooperative agreements, or grants that had terminated prior to July 1, 1991. Comparing these 77 to the contract office tracking reports revealed that only 33 were reported as closed or being tracked for closure. No information related to the other 44 contracts was in the tracking system reports.

The records showed that out of the 44 expired contracts, grants and cooperative agreements in CIMS but not included in the tracking reports, 33 were not included because: 1 had been closed prior to November, 1989; 7 were to be amended; 1 was not being closed until certain disputes between the contractor and Mission were resolved; the contract office wasn't certain if 2 were to be closed or amended; and 22 contracts had their termination dates extended. The remaining eleven contracts qualified for closure and should have been in the contract office's tracking system but were not. As a result closure action will not be initiated within 90 days as Mission policy requires.

The Mission believes that many of the problems relating to CIMS data stemmed from the fact that during 1990 and 1991, the Office of Contracts Services was tasked to implement the new Contracts Information Management System (CIMS) for both direct and host country contracts, review and approve host country agency contracting capacity and capability assessments, and review, approve and enter into CIMS all host country contracting data. Since USAID/Egypt is the largest A.I.D. Mission, it became the testing ground for the Agency since CIMS had not been tested before implementation.

Testing required a lot of Contract Services staff time in order to correct systems problems. However, after almost 2 years of de-bugging, the staff believes the system is now operational for both direct and host country contracts.

The mission can improve its performance in this area, by developing a system which provides more complete and accurate information to monitor closure actions.

Has USAID/Egypt Performed or Contracted for Preawards In Accordance With A.I.D.'s Policies and Procedures?

Except for the effects on the audit findings, if any, of not receiving acceptable representations, as discussed on page 3, USAID/Egypt followed A.I.D. policies and procedures to ensure that preaward surveys were performed. We reviewed 33 contracts and grants and found 4 formal preaward surveys were performed. In the remaining 29 cases the grant or contract officers appear to have adequate knowledge of the contractors or grantees capabilities as these were usually large reputable firms with a variety of other federal or A.I.D. contracts or grants.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of internal controls for the audit objectives.

Scope of Our Internal Control Assessment

We performed our audit in accordance with generally accepted government auditing standards, except that the USAID/Egypt Director did not provide us acceptable representations in all essential respects and, in accordance with A.I.D./Washington guidance, Mission officials directly responsible for the audited activities did not provide written representations relating to the activities to support the representation made by the USAID/Egypt Director. (A description of the representations USAID/Egypt made is included in the Scope and Methodology section of this report; and Appendix III contains the audit representation letter along with the Mission's response to this audit report.)

Generally accepted government auditing standards require that we plan and perform the audit to fairly, objectively and reliably answer the audit objectives. Those standards also require that we:

- Assess the applicable internal controls when necessary to satisfy the audit objectives; and
- Report on the controls assessed, the scope of our work, and any significant weaknesses found during the audit.

We focused our assessment of internal controls on those applicable to the audit objectives, not to provide assurance on the overall internal control structure. Furthermore, the limitations in the Mission's representations are sufficient to preclude

an unqualified opinion on the reliability of the internal controls related to the audit objectives. Therefore, our opinions on the adequacy of internal controls are qualified to the extent of the effect such representations may have, if any, on our audit results.

For the purposes of this report, we have classified significant internal control policies and procedures applicable to each audit objective by category. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they had been placed in operation. 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

The management of A.I.D., including USAID/Egypt, is responsible for establishing and maintaining adequate internal controls. Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Manager's Financial Integrity Act (the Integrity Act) in September 1982. This Act, which amends the Accounting and Auditing Act of 1950, makes the heads of executive agencies and other delegated managers legally responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office (GAO) has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

The Office of Management and Budget (OMB) has issued "Guidelines for the Evaluation and Improvement of Reporting on Internal Control Systems in the Federal Government". According to these guidelines, management is required to assess the expected benefits versus related costs of internal control policies and procedures. The objectives of internal controls and procedures for federal foreign assistance are to provide management with reasonable -- but not absolute -- assurance that resource 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 a system 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 if USAID/Egypt had awarded contracts at a fair price to eligible contractors in accordance with its policies and procedures.

Our audit was limited to USAID/Egypt direct cost-reimbursable contracts for technical services. In planning and performing our audit of USAID/Egypt contract awarding procedures, we considered applicable internal control policies and procedures cited in A.I.D. Handbooks, Mission Order 3-34, and in the Federal Acquisition Regulation. For the purposes of the report, we have classified the relevant policies and procedures into the following categories: use of open and full competition to the extent possible; complete and timely preparation of requests for contract services; review and approval of requests for contractual services and waivers by appropriate offices; and adequate documentation of cost negotiations and reasons for selecting particular contract types.

Except for the effect of the limited Mission representations, if any, on the audit findings, our tests showed that the Mission's internal controls relating to this objective, were logically and consistently applied.

Conclusion for Audit Objective Two

The second objective was to determine if USAID/Egypt closed out A.I.D. direct contracts in accordance with A.I.D. policies and procedures. In planning and performing our audit of USAID/Egypt's close out actions, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks and the Federal Acquisition Regulation. For the purpose of this report, we have classified the relevant policies and procedures into the following categories: the identification of contracts requiring close out action and the monitoring of actions taken to close out the contracts.

We noted two reportable conditions relating to the close out of A.I.D. direct contracts.

- USAID/Egypt did not take timely action to complete close out actions that its monitoring system showed were needed.
- USAID/Egypt's system for identifying contracts in need of close out was inaccurate.

These reportable conditions were not included in the Mission's reporting under the Federal Manager's Financial Integrity Act. We are not recommending they be included in a future report, as the Mission has already taken corrective action.

Conclusions for Audit Objective Three

The third objective was to determine if USAID/Egypt performed or contracted for preaward surveys in accordance with A.I.D.'s policies and procedures. In planning and performing our audit of USAID/Egypt's preaward efforts, we considered internal control policies and procedures cited in A.I.D. Handbook 13 and in the Federal Acquisition Regulation. For the purpose of this report, we classified the relevant policies and procedures into the following categories: requirements for formal preaward and implementation requirements.

Except for the effect of the limited Mission representations, if any, on the audit findings, our tests showed that the Mission's internal controls relating to this objective, were logically and consistently applied.

REPORT ON COMPLIANCE

This section addresses USAID/Egypt's compliance with applicable laws.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards. Although the Director, USAID/Egypt provided us with essential written representation, he limited his representations with regard to instances of irregularities to those matters which to the best of his knowledge and belief should be contained in the records under audit or to those matters which were elicited by the auditors during the course of the audit. Also, in accordance with A.I.D./W guidance of May 13, 1992, the Mission policy is that only the Director will sign a letter of representation. Therefore, other USAID/Egypt officials directly responsible for the audited activities, in this case the Director for Contract Services, did not provide written representations to the Director confirming essential information.

The limited representations on compliance and lack of written representations from officials directly responsible for the audited activities constitute a limitation on the scope of the audit and are sufficient to preclude us from giving an unqualified opinion on compliance with applicable laws and regulations. Therefore, we are disclaiming an opinion.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibition, contained in statutes, regulations, contracts, grants, and binding policies and procedures governing an organization's conduct. Non-compliance 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 in the A.I.D. Handbooks generally does not fit into this definition of non-compliance and is included in our report on internal controls. Abuse is distinguished from non-compliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Conclusions on Compliance

We are disclaiming an opinion on compliance.

SCOPE AND METHODOLOGY

Scope

We audited certain aspects of USAID/Egypt's direct contracting practices in accordance with generally accepted government auditing standards, except as discussed below with regard to the extent of representations made by Mission officials.

Government auditing standards require auditors to obtain representation letters when they deem the letters useful. The Office of the Inspector General deems them necessary evidence to support potentially positive findings. We requested USAID/Egypt's management to furnish a written representation regarding this audit assignment. Based on discussions with Mission officials, USAID/Egypt's Director provided us a written representation that USAID/Egypt is responsible for the internal control system and the fairness and accuracy of the accounting and management information relating to the audited activities and that, to the best of his knowledge and belief, USAID/Egypt had provided us all the financial and management information relating to the audit objectives, USAID/Egypt is unaware of any material instances where the information provided had not been properly and accurately recorded and reported, and USAID/Egypt has complied with all contractual agreements that could materially affect the Mission's direct contracting practices. (The Director's representation is contained in Appendix III to this report.)

Although the Director, USAID/Egypt, provided us these essential written representations, he limited his representations with regard to instances of irregularities, noncompliance and/or violations of laws and regulations to those matters which to the best of his knowledge and belief should be contained in the records under audit or to those matters which were elicited by the auditors during the course of the audit. Also, in accordance with A.I.D./Washington guidance of May 13, 1992, the Mission policy is that only the

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Director will sign a letter of representation. Therefore, other USAID/Egypt officials directly responsible for the audited activities, in this case the Director for Contract Services, did not provide written representations to the Director confirming essential information. Therefore our answers to the audit objectives are qualified to the extent of the effect of not having such representations.

We conducted the audit from June 1991 through December 1991. The obligations and expenditures covered by the audit varied with the objectives. The specifics are detailed in the methodology and the findings sections of the report. The audit covered systems and procedures relating to cost-reimbursable contracts awarded directly by USAID/Egypt. The review did not include host country contracts financed by USAID/Egypt nor did it include USAID/Egypt personal service contracts, participating agency support agreements, fixed price contracts, or purchase orders. For audit objectives 1 and 3 the work was limited to USAID/Egypt contracts that had termination dates of January 1, 1992 and beyond. For objective 2, the review was basically limited to contracts that had been terminated and were awaiting close out although some limited testing was done of contracts that had been closed.

Records reviewed were limited to those available in USAID/Egypt's contract office and project offices. We confined our assessment of internal controls to applicable audit objectives. See report on internal controls on page 34.

Methodology

Audit Objective One

The first objective was to determine if USAID/Egypt had awarded contracts at a fair price to eligible contractors in accordance with its policies and procedures.

To accomplish this objective, we reviewed: (a) project papers to determine if the procurement of the contract services had been planned; (b) Project Implementation Orders/Technical Services to determine if they were completed in accordance with USAID/Egypt's Mission Order 3-34; (c) waiver justifications for sole source procurement and salaries above the FS-1 level to determine if they were properly approved and justified; and (d) cost negotiation documentation to determine if it was adequate.

We selected 11 contracts valued at \$145 million. Our selection was made based on the dollar value of the contracts and the fact that they would not terminate until after January 1, 1992. We discussed problem issues observed with the contract and the project officer. To determine the extent to which problems noted on some of the earlier contracts included in our sample were still prevalent, we also selected three recent current contracts valued at \$22.5 Million which were awarded during 1991-92.

Audit Objective Two

The second objective was to determine if USAID/Egypt closed A.I.D. direct contracts in accordance with A.I.D. policies and procedures. We reviewed and tested USAID/Egypt's records of action taken on contracts reported in need of close out. To accomplish this objective, we examined the system that USAID/Egypt had for identifying contracts in need of audit closure and monitoring action being taken to close the contracts. We tested this system with other Mission contract data to verify the termination status of the contracts and the completeness of the monitoring system. Where project officers had failed to respond to the contract office's requests for close out information we interviewed the responsible project officers to determine why they failed to respond properly. We provided details on our findings to the Director of the Office of Contract Services.

Audit Objective Three

The third objective was to determine if USAID/Egypt performed or contracted for preaward contracts in accordance with its policies and procedures. The audit reviewed 33 active contracts and grants worth \$220 million to determine if contractor information and the size of the contract award required a formal preaward audit and if it did, whether it was performed.

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MANAGEMENT COMMENTS AND OUR EVALUATION

USAID/Egypt's response to the draft report is included in its entirety in Appendix III of this report. The Mission has also requested that its letter of audit representations be included as part of its comments. Therefore, this letter is also included in Appendix III. The Mission's response to the draft report and the actions it proposes to implement the recommendations' are discussed below, as well as our response to the Mission's comments.

- The Mission proposed that the summary of the Mission Director's representation letter used on page ii of the report (first paragraph) be rephrased to more adequately state his representation. We have done so on page iii and elsewhere in the report where reference is made to the representation letter.
- The Mission stated that "the reason for not taking appropriate actions for close out contracts as envisioned by its policies and procedures was due to shortage of Mission staffing levels and not due to low priority and supervision provided to this activity." We have changed our text to more accurately reflect what specifically was done or not done relative to the cause rather than attribute it to low priority and lack of supervision provided the activity. While a shortage of Mission staff may have been a factor in the Mission not taking appropriate actions for close out contracts as envisioned by its policies and procedures, our audit shows that in most cases, delays in close out occurred because Mission personnel did not initiate action necessary to enable the contractor to comply with close out procedures. Therefore, a system which could tell or remind Mission staff to initiate these actions, would not in our opinion add a great burden on staff workload. In fact it might lessen it by being less haphazard. Action taken by the Mission on Recommendation Nos. 2 and 3 should achieve this.

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- The Mission also presented additional facts which they felt should be included in the report such as the total number of contracts closed out since 1990, and information relative to the implementation of the new Contracts Information Management System (CIMS). Where we deemed appropriate, we have included this information in the text of the report.
- Recommendation No. 1 - The Mission reported that the Office of Contract Services has reviewed the file and is presently discussing these costs with the contractor. If the Contracts Office cannot settle this matter with the contractor and obtain a refund of the \$39,036.34, a Contracting Officer final decision will be issued. Based on the above we consider the recommendation resolved. We will close the recommendation on issuance of a bill for collection or evidence of the Contracting Officer final decision.
- Recommendation No. 2 - The Mission reported that the Contract Services Staff have been instructed to follow Mission Order 14-7 to the letter. In addition, monthly CIMS runs are being generated which identify all contracts, grants and cooperative agreements that are listed to end within the next 30 days. This listing is reviewed by all contracting officers and close out action initiated on any contract, grant or cooperative agreement not due to continue. Since CIMS does not have the capacity to track close-outs, an internal tracking system has been established for each project to be closed-out. Also, Contract Services will follow-up both internally and externally on each close-out action and report to Mission management quarterly on the status of all pending close-out actions. Based on the reported procedure developed, we consider the recommendation closed.
- Recommendation No. 3 - The Mission reported that the Office of Contract Services has requested AID/W and they have agreed to modify CIMS to expand the system to include the capability to use the system for tracking all close-out actions. However, AID/W has projected that these systems modifications will take up to 18 months to implement. In the meantime, the Mission is using CIMS to identify termination dates to begin the close-out process and track close-out actions on their CS Internal Tracking System. Also, the Director, Contract Services has reconciled the Mission closure tracking system to CIMS data and the closure tracking reports are now being reviewed by contracting officers for accuracy. Based on the above, we consider the recommendation closed.

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UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

NOV 18 1992

MEMORANDUM

NOV 18 1992

TO: Philippe Darcy, RIG/A/C

FROM: Christopher Crowley, A/D/DIR

SUBJECT: Response to Draft Report on the Audit of USAID/Egypt's Direct Contracting Practices

Discussed below are the Mission's comments and response to the three recommendations under subject draft audit report. Mission is in agreement with the three Recommendations and will address them in detail below. However, we believe that the following comments are appropriate in order to adequately reflect USAID/Cairo's overall performance of Direct Contracting Practices:

1. The summary of the Mission Director's representation letter on page iii of the report (first paragraph) does not adequately state his representation. We believe that Attachment I is a more appropriate summary of the Mission's Director's Representation Letter.
2. On page iii of the report, it is stated that "USAID/Egypt was not taking action to close out contracts as envisioned by its policies and procedures was due to the low priority and supervision provided this activity, taking four years or more to close contracts." The reason for not taking appropriate actions for close out contracts as envisioned by its policies and procedures was due to shortage of Mission staffing levels and not due to low priority and supervision provided to this activity. The Mission did not have appropriate staffing levels (as reported in the FY 89, 90, 91 and 92 Internal Control Assessments/Reviews) to take appropriate actions for close out of contracts as required

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under AID regulations.

Also, the audit report does not reflect the fact that since early 1990, the Office of Contracts Services has closed out a total of 453 contracts, grants and cooperative agreements. We have 36 ready to send to the Missions Record Center and have another 127 in the close out process (See Attachment II for details).

3. The Audit Report did not take into account that during 1990 and 1991, the Office of Contracts Services was tasked to implement the New Contracts Information Management System (CIMS) for both Direct and Host Country Contracts, review and approve Host Country Agency Contracting capacity and capability assessments, review, approve and enter into CIMS all Host Country Contracting data.

Since USAID/Egypt is the largest Mission, we became the testing ground for CIMS. USAID/Egypt has the largest portfolio of Host Country Contracts (over 80% of all USAID Host Country Contracts) and a yearly total exceeding \$135 Million in direct contracts. CIMS had numerous problems since it was not tested before implementation. This required large amounts of CS staff time in order to correct systems problems. After almost 2 years of de-bugging, this system is now operational for both direct and Host Country Contracts. The Mission believes that the above information is relevant and should be included in this audit report.

Recommendation No. 1:

We recommend that USAID/Egypt review the \$39,036.56 in questioned costs related to Contract No. 263-0182-C-00-8017 and determine the amount to be disallowed.

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Mission Response:

The Mission's Office of Contract Services has reviewed the file and is presently discussing these costs with the contractor. If the Contracts Office can not settle this matter with the contractor and obtain a refund of the \$39,036.56, a Contracting Officer's final decision will be issued.

Recommendation No. 2:

We recommend that the Director USAID/Egypt develop procedures for the monthly review of closure actions to ensure that contract closure is initiated within 90 days of contract termination and that periodic follow-up occurs when there has been no response to requests for data.

Mission Response:

The Contracts Services Staff have been instructed to follow Mission Order 14-7 to the letter. We are now generating monthly CIMS runs which identifies all contracts, grants and cooperative agreements that are listed to end within the next 30 days. This listing is reviewed by all contracting officers and close out action will be initiated on any contract, grant or cooperative agreement not due to continue.

Since CIMS does not have the capacity to track close-outs, we have established an internal tracking system for each project to be closed-out.

AID/W has been requested and is working on a systems expansion which would cover the close-out process and satisfy this Audit Recommendation.

Contracts Services will follow-up both internally and externally on each close-out action and will report to mission management quarterly on the status of all pending close-out actions.

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Based on the above, the Mission requests that Recommendation No. 2 be closed.

Recommendation No. 3:

We recommend that the Director USAID/Egypt reconcile the Mission closure tracking system to the Contract Information Management System data and have the closure tracking reports reviewed by contracting officers for accuracy.

Mission Response:

The Office of Contract Services has requested AID/W to modify CIMS to expand the system to include the capability to use the system for tracking all close-out actions. AID/W has agreed to expand CIMS to include this very important function. However, AID/W has projected that these systems modifications will take up to 18 months to implement. In the meantime, we are using CIMS to identify termination dates to begin the close-out process and track close-out actions on our CS Internal Tracking System. DIR/CS has also

reconciled the Mission closure tracking system to CIMS data and the closure tracking reports are now being reviewed by contracting officers for accuracy.

Based on the above, the Mission requests that Recommendation No. 3 be closed.

Att: a/s above

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CAIRO, EGYPT

28 OCT 1992

Mr. Philippe L. Darcy
Regional Inspector General
for Audits
Cairo, Egypt

OCT 27 1992

Dear Mr. Darcy:

This Representation Letter is being issued in accordance with Agency guidance in response to the audit of "USAID/Egypt's Direct Contracting Practices" recently conducted by your Staff.

Based upon discussions with Mission Staff, and taking into account identified staffing constraints and vulnerabilities as expressed in Mission ICAs, to the best of my knowledge and belief, I confirm that all appropriate financial records in the possession and under the control of USAID/Cairo relating to the function being audited have been made available to you. To the best of my knowledge and belief, the records made available to you are accurate and complete, and they fairly represent the status of Direct Contracting Practices within the Mission. To the best of my knowledge and belief, in conjunction with the confirmation in A, B, C and D below, those records, and verbal representations of AID employees currently in the Mission, should have identified any instances of non-compliance or irregularities, or violations of laws and regulations as those terms may be defined by or perceived by the Inspector General. Specifically I confirm that:

- (A) USAID/Egypt is responsible for the internal control system, for the fairness and accuracy of accounting and management information for the function under audit. USAID/Egypt to the best of my knowledge and belief exercises its best efforts to ascertain and follow applicable U.S. laws and AID regulations and AID interpretations of those laws and regulations.

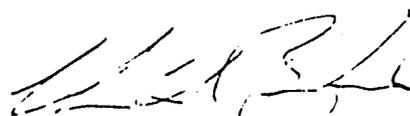
- (B) To the best of my knowledge and belief, and based on discussions and verbal representations by others in the Mission, USAID/Egypt has made available to you or otherwise provided you at your request all financial and management information related to the audit objectives.
- (C) To the best of my knowledge and belief, except for any findings or other matters included in the audit report, USAID/Egypt is unaware of any material instances associated with the function being audited where financial or management information has not been properly and accurately recorded/reported.
- (D) To the best of my knowledge and belief, USAID/Egypt has complied with all contractual agreements, to the extent there are such agreements, which could have any material effect on Mission Direct Contracting Practices.

Upon review of your draft report and following further discussion with my staff, I know of no events subsequent to the date of your draft report, (other than those which were included in our response to that report), which to the best of my knowledge and belief would materially alter the statements in (A) thru (D) above.

All representations made herein by me are made in light of my experience since my arrival at post.

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 therewith as an Annex to the report.

Sincerely yours,



Henry H. Bassford
Director

APPENDIX IV**REPORT DISTRIBUTION**

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