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Regional Inspector General for Audit
Nairobi, Kenya

Audit of OAR/Oman's Management of Construction Services

Report No. 3-272-93-06
March 17, 1993

INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID

U.S. Agency For
International
Development

March 17, 1993

MEMORANDUM

*Regional
Inspector General
for Audit/Nairobi*

TO: A.I.D. Representative/Oman, Mark S. Matthews

FROM: For RIG/A/Nairobi, Everette B. Orr Joseph Farinella

SUBJECT: Audit of OAR/Oman's Management of Construction Services

Enclosed are five copies of our audit report on OAR/Oman's Management of Construction Services, Report No. 3-272-93-06. We reviewed your comments on a draft of this report and have included them as Appendix III. At your request, we included your audit representation letter as an appendix to the report. See Appendix III.

The report contains four recommendations. Based on your comments and action taken by the Mission, Recommendation Nos. 1.1, 1.2, and 1.3 are closed upon issuance of this report. Recommendation Nos. 2, 3, and 4 are unresolved pending an agreement between our offices on the necessary corrective action. Please advise me within 30 days of any further actions planned or taken to implement the recommendations.

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

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EXECUTIVE SUMMARY

Background

Construction services are the actions performed by construction and architectural and engineering contractors in erecting, altering, or repairing buildings, structures, and other physical works. It also includes the procurement of commodities.

The Office of the A.I.D. Representative in Oman (OAR/Oman) executes its development activities through a binational organization, the Omani-American Joint Commission (OAJC). OAJC was established in 1980 to manage U.S. Government economic assistance programs in Oman. The Commission is funded and guided by both governments. Day-to-day activities are handled by A.I.D. and Omani employees and contractors under the supervision of the A.I.D. Representative, and projects are designed and implemented in accordance with standard A.I.D. policies and procedures. Although all project activities are undertaken in the name of the Commission, only the Office of the A.I.D. Representative is responsible for ensuring that A.I.D. funds are used in accordance with A.I.D. policies and guidance. As a result, this report evaluates the management of A.I.D.-funded construction services in terms of OAR/Oman's responsibilities, and recommendations for corrective action are addressed to OAR/Oman.

As of September 30, 1992, OAJC's project portfolio included only one active project involving the procurement of construction services -- the Water Resources Development Project. No other projects involving such services had been completed within the preceding three years. The Water Resources Development Project funded construction services through two host country contracts and two fixed amount reimbursement agreements. Obligations and expenditures for the two contracts and two agreements totaled $21.02 million and $8.36 million respectively. We audited all four. (See page 1.)

Audit Objectives

We audited OAR/Oman's management of construction services in accordance with generally accepted government auditing standards. This audit was included in the Inspector General's Fiscal Year 1992 Audit Plan because host country contracting, upon which construction services contracting depends heavily, has been long-recognized as a vulnerable method of

delivering development assistance. In addition, funding for construction services represented a significant percentage of OAR/Oman's budget. (See page 2.)

Our field work was conducted from September 26 to November 23, 1992, and was designed to answer the following questions:

1. Did OAR/Oman follow A.I.D. procedures and Agency-wide guidance for monitoring host country construction and architectural and engineering contracts to give reasonable assurance that:

   (a) the host country followed acceptable competitive or noncompetitive procedures when awarding the contract;

   (b) the host country executed a contract that had been reviewed and approved by the mission; and

   (c) the host country contract award process complied with other A.I.D. requirements? (See page 5.)

2. Did OAR/Oman follow A.I.D. procedures and Agency-wide guidance to give reasonable assurance that payments of A.I.D. funds for construction services were made only for services rendered and acceptably performed in accordance with the terms of the contracts and project agreements? (See page 17.)

Summary of Audit

OAJC monitored the award of the two host country contracts we reviewed during this audit and provided formal approval for most host country contracting actions as required by A.I.D. procedures. In addition, we found that payments for construction services were made on the basis of appropriate supporting documentation and were in accordance with contract or agreement terms. OAJC also monitored contractor performance under the two host country contracts and two fixed amount reimbursement agreements for construction services. Notwithstanding these efforts, OAJC conducted limited rather than comprehensive assessments of host country agency contracting capabilities, did not formally approve all required host country contracting actions, and did not fully document its monitoring of contractor performance. OAJC staff attributed these weaknesses primarily to staffing constraints which have subsequently been resolved.

Audit Findings

Host Country Contracting
Capabilities and Actions

OAJC followed A.I.D. procedures and Agency-wide guidance for monitoring host country construction and architectural and engineering contracts to give reasonable assurance that the host country (1) followed acceptable competitive or noncompetitive procedures when awarding A.I.D.-funded contracts and (2) executed contracts that had been reviewed and approved by the mission. However, our audit indicated several areas in which OAR/Oman did not fully comply with other A.I.D. procedures and Agency-wide guidance related to host country contracting. Specifically, we noted that OAR/Oman (1) conducted limited rather than comprehensive assessments of the contracting capabilities of two host country agencies on whose management capabilities project success depended, (2) did not formally approve some required host country contracting actions, and (3) lacked procedures to address questions of conflicts of interests that were likely to arise because of local business practices. We also noted that OAJC did not have written procedures for these problem areas and had not reported the weakness that we noted regarding host country contracting capability assessments in its most recent report under the Federal Managers' Financial Integrity Act.

On a positive note, the audit found that, in accordance with A.I.D. procedures, the two host country contracts for construction services reviewed during this audit were awarded by the host government on the basis of formal competitive bidding procedures. This included public advertisement of the proposed award and the issuance of solicitations for proposals to all pre-qualified firms. In addition, the A.I.D. Representative issued Project Implementation Letters to formally approve both draft contracts.

OAJC staff could not state why A.I.D. procedures were not always followed in the past, but attributed more recent problems to staffing constraints and higher priority tasks. Because OAJC decided to use host country contracting mechanisms on the basis of limited rather than comprehensive contracting capability assessments (see page 6), did not formally approve all critical host country contracting actions (see page 11), and did not have policies and procedures for addressing conflicts of interest that were likely to arise during the host country contract award process (see page 13), it risked the successful and timely achievement of project objectives.

Payment for Construction Services

OAR/Oman followed A.I.D. procedures and Agency-wide guidance to give reasonable assurance that payments of A.I.D. funds for construction services were made only for services rendered and acceptably performed in accordance with the terms of the contracts and project agreements, except that it did not always document monitoring actions and the documentation that was prepared was not readily accessible. (See page 18.)

We noted that the mission lacked procedures establishing minimum requirements for the preparation and distribution of timely, complete, and useful reports on project monitoring activities. OAJC staff attributed these problems to staffing constraints and higher priority tasks.

Because monitoring actions were not fully documented, the project's files provided an incomplete historical record of project progress and any corrective actions recommended and undertaken, and there was no assurance that mission management was fully informed of the project's progress or problems.

Summary of Recommendations

The audit report makes four recommendations to the Office of the A.I.D. Representative/Oman to correct problems noted during the audit. Specifically, we recommended that procedures be developed to ensure that

- comprehensive assessments of host country contracting capabilities are conducted before contracting responsibilities are delegated to host country agencies (see page 7);
- formal A.I.D. approval is provided for all required host country contract award actions (see page 11);
- actual or potential conflicts of interests or the appearance of conflicts of interests are identified and resolved during the host country contract award process and that decisions are documented (see page 14); and
- OAR/Oman's contract monitoring actions are documented (see page 18).

In addition, we recommended that, as part of its next internal controls assessment process under the Federal Managers' Financial Integrity Act, OAR/Oman report the weaknesses in

its processes for assessing host country contracting capabilities if they have not been corrected by that date (see page 7).

Management Comments and Our Evaluation

OAR/Oman's management reviewed the draft report and its comments, which we considered in preparing the final report, are summarized on page 26 and are included in their entirety as Appendix III. Briefly, OAR/Oman generally agreed with the report's findings and accepted its recommendations, but took exception to some of the report's conclusions. For example, although OAR/Oman agreed that its systems for assessing host country contracting capabilities needed improvement, it believed that its 1986 assessment of the Ministry of Electricity and Water generally complied with the limited agency requirements in effect at that time. Also, although OAR/Oman acknowledged that it had not documented its approval of specific host country contracting actions, it believed that we overstated the potential risk resulting from this deficiency because no monetary losses or contracting irregularities were identified. We do not believe that the assessments which were done met Agency requirements for a "systematic review" or a reasonably detailed examination of the host country agency's contracting system and policies. Neither do we believe that informal, undocumented approval actions meet the standards of either the Agency or the General Accounting Office.

At the time that OAR/Oman commented on our draft report, it had presented us with a representation letter that we found to be unacceptable in two respects. The A.I.D. Representative refers to the negotiations leading to that letter in his comments to the draft report (see Appendix III). OAR/Oman subsequently submitted a revised representation letter that fully met the needs of both offices and we were able to issue this report, citing OAR/Oman's general compliance with A.I.D. policies and procedures, without disclaimers or qualifications.

At OAR/Oman's request, we included its audit representation letter with its comments to our draft report (see Appendix III). In this letter, the A.I.D. Representative states that, as a counterweight to our request that he provide us with a representation letter, he requested us to provide him with an "engagement letter", such as that used in the private sector. We have advised the A.I.D. Representative that, in our opinion, the IG's annual work plan and RIG/A/Nairobi's notification cables, both of which describe the scope and objectives of planned audits, serve the purpose of engagement letters.

Our Report on Internal Controls and Report on Compliance are found on pages 21 and 24, respectively.

Office of the Inspector General

Office of the Inspector General
March 17, 1993

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INTRODUCTION

Background

Construction services are the actions performed by construction and architectural and engineering firms in erecting, altering, or repairing buildings, structures, and other physical works. It may also include the procurement of commodities required to accomplish the construction activity. In terms of this audit, which covers the Water Resources Development Project, construction services included construction engineering and design, construction supervision, and the actual construction of waste water treatment ponds, water supply pipelines, a reservoir, and other facilities for a major desalination facility in Muscat, Oman. The Water Resources Development Project was authorized in 1986. An amendment extended its completion date to 1996.

The Omani-American Joint Commission

A.I.D. executes its development activities in Oman through a unique binational organization, the Omani-American Joint Commission for Economic and Technical Cooperation (OAJC). OAJC was established in 1980 by the Governments of the United States and Oman to assist the economic development of Oman through cooperative and jointly-financed development projects. The Commission receives policy guidance from the Undersecretary for Political Affairs of the Ministry of Foreign Affairs and the U.S. Ambassador to Oman. The executive managers of the Commission are the Managing Director, the Undersecretary for Economic Affairs of the Ministry of Finance and Economy, and the A.I.D. Representative to Oman. Day-to-day operations are handled by A.I.D. and Omani Government employees and contractors under the supervision of the A.I.D. Representative and projects are designed and implemented in accordance with standard A.I.D. policies and procedures.

Although all project activities are undertaken in the name of the Commission, only the Office of the A.I.D. Representative (OAR/Oman) is responsible for ensuring A.I.D. funds are used in accordance with A.I.D. policies and guidance. As a result, this report evaluates the management of A.I.D.-funded construction services in terms of OAR/Oman's responsibilities, and recommendations for corrective action are addressed to OAR/Oman.

Acquisition of Construction Services

A.I.D. can obtain construction services by contracting for them directly; by delegating contracting responsibilities to host country contracting agencies, subject to A.I.D. oversight and approval of specific contracting actions; or through use of fixed amount reimbursement agreements. Under a fixed amount reimbursement agreement, A.I.D. does not oversee the host country's procurement process, but reimburses the host government for all or part of the cost of specified services upon receipt of evidence that the services have been completed in accordance with pre-agreed specifications. Regardless of the procurement mechanism, A.I.D. is responsible for monitoring contractor performance to ensure that the desired results are accomplished.

As of September 30, 1992, OAJC's project portfolio included only one active project involving the procurement of construction services -- the Water Resources Development Project. No other projects involving such services had been completed within the preceding three years. The Water Resources Development Project funded construction services through two host country contracts and two fixed amount reimbursement agreements. Obligations and expenditures for the two contracts and two agreements totaled $21.02 million and $8.36 million respectively. (See Appendix II.) We audited both contracts and both fixed amount reimbursement agreements.

Audit Objectives

This audit was included in the Inspector General's Fiscal Year 1992 Audit Plan because host country contracting, upon which construction services contracting depends heavily, has been long-recognized as a vulnerable method of delivering development assistance. In addition, funding for construction services represented a significant percentage of OAR/Oman's budget.

The audit was designed to answer the following questions.

1. Did OAR/Oman follow A.I.D. procedures and Agency-wide guidance for monitoring host country construction and architectural and engineering contracts to give reasonable assurance that:

   (a) the host country followed acceptable competitive or noncompetitive procedures when awarding the contract;

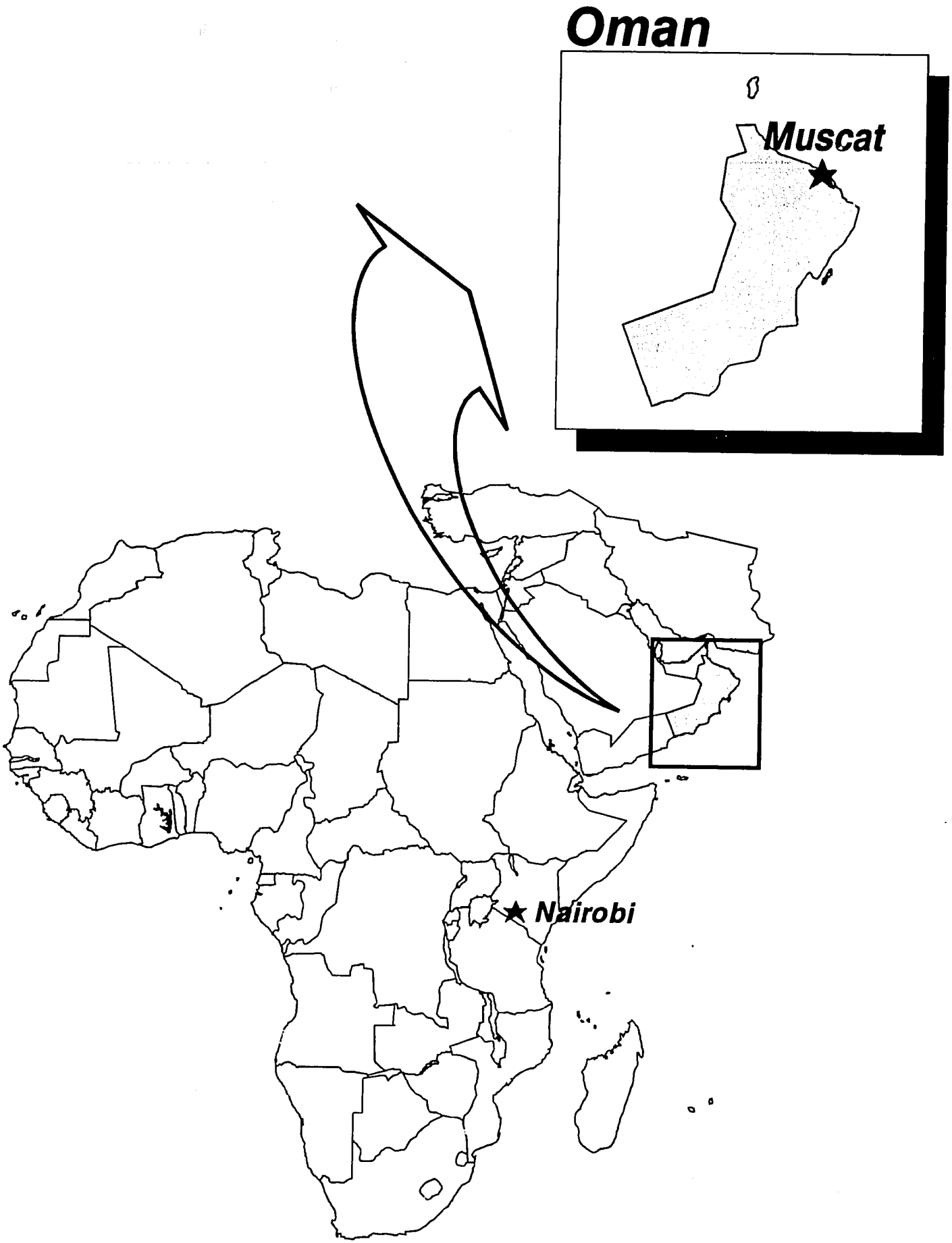
   (b) the host country executed a contract that had been reviewed and approved by the mission; and

(c) the host country contract award process complied with other A.I.D. requirements?

2. Did OAR/Oman follow A.I.D. procedures and Agency-wide guidance to give reasonable assurance that payments of A.I.D. funds for construction services were made only for services rendered and acceptably performed in accordance with the terms of the contracts and project agreements?

In answering these questions, we tested whether OAR/Oman (1) followed applicable internal controls and (2) complied with certain provisions of its loan and grant agreements with the Government of Oman. Our tests were sufficient to provide reasonable assurance that our answers to the above audit objectives are valid. In addition, our tests were designed to provide reasonable, but not absolute assurance of detecting abuse or illegal acts that could significantly affect the audit objectives.

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


Oman
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Nairobi

REPORT OF AUDIT FINDINGS

Did OAR/Oman follow A.I.D. procedures and Agency-wide guidance for monitoring host country construction and architectural and engineering contracts to give reasonable assurance that:

(a) the host country followed acceptable competitive or noncompetitive procedures when awarding the contract;

(b) the host country executed a contract that had been reviewed and approved by the mission; and

(c) the host country contract award process complied with other A.I.D. requirements?

OAR/Oman followed A.I.D. procedures and Agency-wide guidance for monitoring host country construction and architectural and engineering contracts to give reasonable assurance that the host country followed acceptable competitive or noncompetitive procedures when awarding such contracts and the host country executed contracts that OAJC had reviewed and approved. However, OAR/Oman did not fully comply with other policies and procedures related to its responsibilities to ensure that the host country contract award process complied with other A.I.D. requirements.

A.I.D. Handbook 11, Chapter 1, Section 2.4.1, requires that host country contracting agencies follow competitive procedures in procuring services with A.I.D. financing. Such procedures include obtaining as many proposals as practical and competitive selection based on technical quality. Our review of OAJC records indicated that the two host country contracts reviewed were awarded on the basis of formal competitive bidding procedures, including public advertisement of the proposed award and the pre-qualification process in U.S. and local publications. Both contracts were awarded on the basis of financial negotiations with the firms receiving the highest rankings for their technical proposals.

Handbook 11, Chapter 1, Sections 2.1 and 2.3.1, state that whenever the total amount of a host country contract is anticipated to exceed $250,000, A.I.D. must approve specific steps in the contracting process, including announcements to prospective offerors; lists of pre-qualified offerors; solicitations for proposals, prior to their issuance; contractor selections; draft contracts, prior to their execution; and final, signed contracts, prior to initiating A.I.D. financing. Both of the host country contracts for construction services included in our audit exceeded $250,000 and, therefore, formal A.I.D. approvals were required for specific contracting actions, including those listed above. Documents provided to us showed that, for one of the two contracts we reviewed, OAJC formally approved all required contracting actions, except that it did not formally approve the final, signed contract before initiating financing. Documents related to the second contract showed that OAJC formally approved only the draft contract and contractor selection.

Our review of OAJC documentation indicated that OAR/Oman did not follow other A.I.D. procedures and Agency-wide guidance related to ensuring that the host country award process complied with A.I.D. requirements. Specifically, OAR/Oman (1) conducted limited rather than comprehensive assessments of the contracting capabilities of two host country agencies before delegating contracting responsibilities to them, (2) did not formally approve all required host country contracting actions, and (3) did not have written procedures for identifying and resolving conflicts of interests that, because of local procurement customs, were likely to arise during the contract award process. Because of these internal control weaknesses, which OAJC staff attributed to staffing constraints and higher priority responsibilities, OAJC risked the successful and timely achievement of project objectives.

Although workloads and staffing levels may fluctuate, OAJC and A.I.D/Washington officials told us that OAJC is considered to currently have adequate staff to meet present and projected workload requirements. As a result, we have not made any recommendations to increase staffing levels.

The problems we noted related to inadequate assessments of host country contracting agencies, failure to formally approve some host country contracting actions, and lack of written procedures for identification of potential conflicts of interests are discussed below.

Need to Improve Assessments of
Host Country Contracting Capabilities

Contrary to A.I.D. policies and procedures, OAR/Oman did not conduct comprehensive assessments of the contracting capabilities of the Ministry of Electricity and Water or the Municipality of Dhofar before delegating contracting responsibilities to those agencies. In each case, OAR/Oman undertook a limited review of the contracting agency's past

experience and management capacity but did not review its procurement processes or procedures as required by A.I.D. procedures and Agency-wide guidance.

Our review of project records failed to disclose why former OAJC staff did not conduct a comprehensive assessment of the Ministry of Electricity and Water in 1986. Current OAJC staff advised us that their 1992 capability assessment of the Municipality of Dhofar did not fully comply with Agency-wide guidance because they were not aware of all aspects of this guidance. In addition, OAJC management stated that, because of staffing constraints, other responsibilities had been given a higher priority. Although we did not identify any adverse effect on the Water Resources Development Project because OAR/Oman delegated crucial contracting responsibilities to these agencies on the basis of limited reviews, proceeding without comprehensive reviews put the timely achievement of the project's goals at risk. Further, comprehensive reviews are an invaluable tool for identifying and resolving host country weaknesses before problems can occur. Reducing such risk is particularly important as OAR/Oman initiates the next phase of the Water Resources Development Project in which the Municipality of Dhofar will award and manage multiple contracts for complex, new construction activities. A.I.D.'s contribution to these activities is expected to total about $30 million.

Recommendation No. 1: We recommend that OAR/Oman:

1.1 establish procedures to ensure that the capabilities of host country contracting agencies to award and/or manage A.I.D.-funded contracts are assessed and documented in accordance with Agency-wide guidance and procedures;

1.2 establish a plan to reassess the contracting capabilities of the Municipality of Dhofar, prior to financing new contracts or amendments to current contracts awarded by the Municipality and ensure that the assessment is conducted and documented in accordance with A.I.D. policies and Agency-wide guidance; and

1.3 report to the Assistant Administrator the problems noted in this report concerning assessments of host country contracting capabilities as a material internal control weakness in its next report under the Federal Managers' Financial Integrity Act if the problems have not been corrected.

Decisions concerning the use of host country contracting are typically made during the project design process and documented in the project paper. Handbook 3, Supplement B, Host Country Contracting, in effect since 1986, states that a decision to assign contracting

responsibilities to a host country agency must be based upon a careful case-by-case assessment of that agency's procurement and payment systems, staffing, experience, and adaptability to the rules of A.I.D. Handbook 11. Handbook 3, Supplement B also requires that a written record of the assessment be maintained in project files.

Additional Agency-wide guidance was issued by cable in November 1990. This guidance stated that, before using host country contracting procedures for contracts exceeding $250,000, mission directors must certify, based on a comprehensive assessment, that the specific host country contracting agency has, or will obtain, the capability to manage the procurement process. The guidance outlines a series of assessment steps that should be undertaken and summarized in a report supporting the mission director's certification. The guidance states further that assessments will be updated or repeated within three years.

We identified two host country contracts for construction services which required capability assessments. These contracts are described below.

- A $1.02 million contract for construction design and supervision awarded by the Omani Ministry of Electricity and Water (MEW) in 1989 and a $993,300 amendment signed in mid-1991.

- A $2.8 million contract for the development of a water and waste water master plan awarded by the Municipality of Dhofar in December 1990; a $50,865 amendment signed in November 1991; a $303,116 amendment approved by A.I.D. in July 1992; and a $5.2 million amendment approved by A.I.D. in October 1992.

Ministry of Electricity and Water

The 1986 project paper for the Water Resources Development Project included a brief discussion of MEW's capabilities to award and manage A.I.D.-funded contracts. The project paper reported that MEW had appropriate experience and qualified staff but suggested that, because MEW's staff was overworked, OAJC assistance would be required throughout the contract award process and during implementation. The project paper did not include an analysis of MEW's procurement, payment, or accounting procedures or processes. The project's files do not contain any information about the scope or methodology of the assessment.

Two former OAJC staff members, when contacted by current staff, stated that the information included in the project paper was based on a limited review of MEW's

contracting capabilities which were considered satisfactory. This official did not consider this review to be a formal assessment. Our review of project records also did not disclose why former OAJC staff performed a limited, rather than comprehensive, assessment of MEW in 1986.

This limited assessment of MEW was not repeated or updated before OAJC approved a $993,300 amendment to MEW's contract in mid-1991. A former OAJC staff member acknowledged that a formal assessment was not done prior to approving the amendment but reported that he, other OAJC staff, and the A.I.D. Regional Legal Advisor, discussed MEW's contracting procedures in depth on several occasions with MEW officials and believed the procedures to be acceptable with minor exceptions.

Although the audit did not identify any adverse effects directly related to the fact that OAJC conducted a limited rather than comprehensive assessment of the contracting capabilities of the Ministry of Electricity and Water in 1986 and no assessment in 1991, OAJC's decision to delegate contracting responsibilities to MEW under these circumstances put the successful and timely achievement of project objectives at risk. We believe that OAJC should follow Agency-wide procedures and guidance which require that comprehensive assessments should be conducted before contracting responsibilities are delegated to host country agencies for future contracts.

Municipality of Dhofar

When the 1986 project paper was written, no activities were planned to take place in the Municipality of Dhofar. Therefore, no assessment of the Municipality was required or made at that time. However, an assessment was required, but was not conducted, when OAJC decided to expand the Water Resources Development Project to the Municipality of Dhofar and it approved a $2.8 million A.I.D.-funded contract, awarded by the Municipality in 1990.

Three former OAJC staff members acknowledge that a comprehensive assessment of the Municipality was not done. One stated that the Municipality's capabilities were informally examined on several occasions. He recalled that these reviews indicated that OAJC staff would need to closely monitor the Municipality's contracting process. A second staff member recalled discussions with the Regional Legal Advisor concerning the Municipality's contracting capabilities and believes that there was a consensus that the Municipality's capabilities would approximate those of MEW which was proceeding satisfactorily. The third former OAJC staff member recalled that there had been plans to conduct a comprehensive assessment of the Municipality in January 1991, but that Agency travel restrictions prevented it from taking place.

In September 1991, A.I.D.'s Regional Legal Advisor suggested that OAR/Oman not conduct an assessment prior to proceeding with a proposed $5.2 million amendment to the 1990 contract. He noted that the useful time for conducting such an assessment had passed, a favorable assessment at that late date would be an unnecessary expenditure of funds, a negative assessment would cause friction with the Municipality, and conversion to an A.I.D. direct contract would delay the procurement for a year. As a result of this suggestion, no assessment was done before negotiations for the amendment commenced.

However, before negotiations were concluded in late 1992, OAJC staff had conducted limited contracting and management capability assessments in contemplation of approving additional funding for complex, new construction activities in the Municipality. A.I.D.'s contribution to this construction effort is expected to total about $30 million.

On the basis of these limited staff assessments and an analysis of the Municipality's management capabilities prepared by the contractor which developed the Municipality's water/waste water master plan and after consultations with the Regional Legal Advisor and Regional Contracting Officer, the A.I.D. Representative certified that the Municipality has the capacity to manage the multiple contracts that would be required to accomplish the major, new construction program only if a project management unit was established and staffed. The formation of such a unit was made a condition precedent for future A.I.D. funding for these activities.

We found, however, that the limited assessments of the Municipality's capabilities conducted by OAJC staff in mid-1992 were not documented and that several assessment steps were not performed. OAJC staff indicated that this was caused, in part, by the fact that they were unaware of the 1990 guidance. The A.I.D. Representative acknowledged these problems but explained that the office had only two foreign service officers in country during the summer of 1992 and that he had, of necessity, given higher priority to other responsibilities such as preparing two project papers and two project agreements which had very tight deadlines for completion.

Although we did not identify any monetary losses or contract implementation problems related to the fact that OAJC had conducted only limited assessments of the contracting capabilities of the Municipality of Dhofar, OAJC's decision to delegate contracting responsibilities to the Municipality under the circumstances described above put the achievement of project objectives at risk. In order to eliminate any questions about the validity of its past assessments, OAR/Oman has agreed to contract for a government-wide capability assessment focussing on the Municipality of Dhofar to be conducted in strict accordance with the 1990 guidance, in the near future. This decision should reduce the risk that unexpected management problems will impede the award or implementation of the

multiple contracts needed to build a sewerage system including a water reclamation plant in the Municipality, for which A.I.D. is expected to contribute about $30 million.

Need to Ensure that All Required Host Country
Contracting Actions are Formally Approved

Although project files indicate that OAJC closely monitored the award of host country contracts by MEW and the Municipality of Dhofar, in 1989 and 1990 respectively, and formally approved some contracting actions, A.I.D. did not formally approve all contracting actions, as required by A.I.D. Handbook 11, Chapter 1. In some instances, OAJC staff informally approved host country contracting actions, but did not document their approval. Current staff are unable to explain why formal approvals were not provided in the past. However, project documents suggest that OAJC staff were so actively involved in all phases of the award process for the two contracts that formal approval of actions that they had initiated or even implemented for the host country might have seemed superfluous.

We identified no monetary losses or contract award irregularities resulting from the fact that A.I.D. did not formally approve several host country contracting steps and attribute this, in part, to OAJC's involvement in the two contract awards. However, by not formally approving all required contracting steps, OAJC missed opportunities to identify and correct errors in a timely fashion, clarify and safeguard A.I.D.'s rights and oversight role, and provide a necessary record of Agency actions for future reference.

> **Recommendation 2: We recommend that OAR/Oman establish procedures for monitoring the host country contract award process and ensuring that all required approvals are provided, fully documented, and maintained in appropriate contract and project files. The guidance should include an office-specific checklist for required and recommended actions.**

A.I.D. Handbook 11, Chapter 1, Sections 2.1 and 2.3.1, state that whenever the total amount of a host country contract is anticipated to exceed $250,000, A.I.D. must provide formal approval for specific steps in the contracting process, including:

- announcements to prospective offerors;
- lists of pre-qualified offerors;
- solicitations for proposals, prior to their issuance;
- contractor selections;

- draft contracts, prior to their execution; and

- final, signed contracts, prior to initiating A.I.D. financing.

Both of the host country contracts for construction services included in our review exceeded $250,000 and, therefore, formal A.I.D. approvals were required for specific contracting actions, including those listed above. According to A.I.D. policy, mission directors are authorized to grant these approvals.

For the contract awarded by MEW in 1989, the A.I.D. Representative formally approved all required contracting actions, except that he did not approve the final, signed contract before initiating financing. For the contract awarded by the Municipality of Dhofar in 1990, the A.I.D. Representative formally approved some actions. Other actions were informally approved and, once again, the final, signed contract was not approved before A.I.D. initiated financing. Although, we found no evidence that the A.I.D. Representative reviewed or approved either contract after it had been signed, OAJC did request and receive copies of both signed contracts, which were available in project files.

In those instances in which the A.I.D. Representative did not provide formal approval for intermediate contracting actions undertaken by the Municipality of Dhofar, OAJC's subsequent activities clearly implied concurrence with the Municipality's actions. Examples of such informal approval are described below.

- In 1989, OAJC staff members independently evaluated pre-qualification data submitted by 18 firms in response to pre-qualification announcements about the A.I.D.-funded contract to be awarded by the Municipality of Dhofar. OAJC prepared its own short-list of the most qualified firms that was used with the Municipality's own ranking to develop a mutually acceptable short-list. OAJC then mailed notification letters to each firm informing them of the results of the pre-qualification process. We have characterized this action as constituting informal, rather than formal, approval.

- OAJC did not formally approve the solicitation for proposals developed by the Municipality of Dhofar. However, OAJC officials scrutinized draft documents and suggested many changes to ensure that A.I.D. requirements were met. OAJC ultimately mailed the solicitation to all pre-qualified firms. We have characterized OAJC's action as informal approval.

Current OAJC officials are unable to explain why their predecessors did not provide formal approval for all host country contracting actions, as was required by Handbook 11, Chapter 1. Former officials contacted by current staff recalled that they had closely monitored the award of both contracts and were surprised that the files did not contain documentation to show that they had approved all contracting steps. Our review of project files supported their claim of considerable involvement.

Neither we nor current OAJC officials are aware of any problems or monetary losses that occurred because formal approvals were either not given or cannot be located. However, OAJC's failure to review and/or formally approve all crucial host country contracting steps limited its ability to ensure that (1) errors would be identified and corrected in a timely fashion; (2) final contracts, which were the basis for A.I.D.'s funding commitment to the contractors, were identical to the draft contracts that it previously approved; and (3) its liabilities were limited and its rights were protected.

Further, formal approval documents, such as Project Implementation Letters, form a valuable and necessary record of Agency actions for future staff. Adherence to the formal review and approval process mandated by A.I.D. procedures will be critical to OAJC's ability to ensure the successful award and implementation of A.I.D.-funded, host country contracts during the next phase of the Water Resources Development Project.

Need to Focus on Potential For Conflicts of Interests During Contract Award Process

In accordance with its policies and procedures, A.I.D. may not approve the host country's selection of firms which have, in the opinion of the approving official, achieved an unfair competitive advantage. We found that U.S. firms competing for A.I.D.-funded, host country contracts had business relationships with firms owned by senior Omani Government officials. In at least one case, the selected firm had a sponsorship agreement and a subcontract, both ultimately funded by A.I.D., with a firm associated with an Omani government official who is required to approve and sign all final government contracts. Former OAJC officials sought A.I.D. and Omani legal advice as regarding these sponsorship arrangements but did not document the advice they received or the rationale for their decision to approve the selection of a contractor with such an arrangement. In our opinion, OAJC needs policies and procedures for identifying and resolving questions of conflicts of interests or achievement of unfair competitive advantage that are likely to arise during the award of A.I.D.-funded, host country contracts in Oman.

<u>Recommendation 3</u>: We recommend that OAR/Oman establish policies and procedures to identify and resolve actual or potential conflicts of interests or the appearance of conflicts of interests that may arise during the host country contract award process. These procedures should ensure that determinations made by the A.I.D. Representative are documented and maintained in project files.

A.I.D. Handbook 11, Chapter 1, Section 2.1, requires A.I.D. to formally approve the contractor selected by the host country. Section 2.7 further stipulates that A.I.D. may not approve the selection of a firm that, in the judgement of the A.I.D. approving official, has been, or might be, placed in a position where it has achieved an unfair competitive advantage.

During the course of the audit, we were told by OAJC and contractor officials that foreign firms wishing to do business in Oman, including U.S. firms working on A.I.D.-funded host country contracts, must be sponsored by an Omani organization. The sponsoring organization may be a private firm, a government ministry, or OAJC. We were also told that many, if not most, large Omani businesses are owned by or associated with senior government officials, some of whom are involved in the award of host country contracts.

We also learned that the Municipality of Dhofar awarded an A.I.D.-funded, host country contract to a U.S. firm sponsored by an Omani firm associated with an Omani government official required to approve and sign all final government contracts. A.I.D.'s payments for this contract, which totalled about $2.6 million, included the cost of sponsorship fees and unrelated subcontract expenses paid to the Omani firm.

In mid-1989, during the pre-qualification process for this contract, OAJC became aware that several potential contractors were represented by Omani firms owned by or associated with government officials. In fact, it appeared that several potential contractors were sponsored by Omani firms owned by one government official. OAJC sought advice from Omani and A.I.D. legal advisors. However, evidence of the advice that was provided by these officials was not placed in the project's files.

The A.I.D. Regional Legal Advisor in Jordan was able to provide a copy of a 1989 memorandum which it sent to OAR/Oman in response to a request for legal advice. The memorandum informed OAR/Oman that U.S. law prohibits government employees from having personal financial interest in any government-funded contract and guessed that the same would be true in Oman. The memorandum also stated that, no matter how far removed from the award process a U.S. government employee might be, any firm that he owned or was an officer or board member of would be disqualified from competition. The opinion, however, did not provide any guidance as to what OAJC's position should be if it

was determined that such situations were acceptable under Omani law. We found no evidence of further communication between OAR/Oman and the Regional Legal Advisor on this issue.

A former OAJC staff member recalled that he and an Omani legal advisor studied Omani rules and regulations regarding conflicts of interests and concluded that a U.S. firm under contract to the Oman Government could be sponsored by an Omani firm owned by a government official because such relationships did not violate Omani law or regulation. He stated further that OAR/Oman staff then decided that (1) there were no clear reasons for rejecting or disqualifying the use of local firms owned by government officials and (2) such relationships were beneficial to U.S. firms who needed technically competent local partners which were in nearly every case owned by senior Omani government employees. Our review of the files showed that these discussions and decisions were not documented.

We also contacted Omani legal advisors and were told that it was permissible, under Omani law, for government employees to own and benefit from companies receiving government contracts, as long as the interests of the government were not harmed. We were told that most contracts are awarded to the lowest bidder and that it is difficult for government employees to influence the tender process. We were also told that government employees, including members of tender boards, are expected to abstain from actions in which they have a personal interest. However, it was not clear whether specific employees whose participation in the contract award process is required by law could abstain. We found no evidence that suggested that the interests of the Omani government were harmed by the selection of the U.S. contractor in question.

Current OAJC staff members said that they were not aware that the U.S. firm's sponsor/subcontractor was owned by an Omani government official. They also said that they were not aware that former OAJC staff members had sought legal advice about this issue. They noted that OAJC files did not contain documentation related to this issue.

We contacted the A.I.D. Inspector General's Legal Counsel for an opinion as to whether OAJC had acted properly in approving the selection of a U.S. contractor which had sponsorship and subcontract arrangements with an Omani firm owned by a government official involved in the procurement process for that contract. We also asked whether OAR/Oman could now approve an amendment to the same contract. We were advised that, because the arrangements had been determined to be acceptable under Omani law, the former A.I.D. Representative was authorized to approve the contractor selected by the host country and the current A.I.D. Representative could approve an amendment to that contract.

However, because there was and remains an appearance of a conflict of interests, the I.G. Legal Counsel recommended that the A.I.D. Representative (1) request the government official who owned the sponsoring firm to abstain from the amendment approval process and (2) seek non-A.I.D. funds to pay the fees and expenses owed by the U.S. contractor to its sponsor and subcontractor. However if, in the opinion of the A.I.D. Representative, these actions were not possible, the Legal Counsel stated that the A.I.D. Representative might still accept the situation and approve the amendment.

When the audit raised this issue, the A.I.D. Representative sought advice from the U.S. Ambassador and OAJC's Managing Director, on which basis he determined that the procedures followed by the host country agency in awarding this contract precluded the official in question from influencing the contract award and that the conflict was one of appearance only. In addition, the A.I.D. Representative determined that the alternatives suggested by the IG Legal Counsel to eliminate even the appearance of a conflict of interests were not viable under present circumstances. Documentation related to this decision, and the A.I.D. Representative's approval of the $5.2 million amendment, was placed in the project's files.

Because OAJC is currently sponsoring at least one U.S. contractor, we asked OAJC's Managing Director whether OAJC could sponsor all U.S. contractors working on A.I.D.-funded contracts, thereby eliminating questions of conflicts of interests that may arise when Omani firms are used as sponsors. He told us that OAJC did not have sufficient staff to take on the extra work required by sponsorship, which included obtaining visas, customs and police clearances, etc. Because project files indicated that government ministries had also sponsored U.S. firms in the past, we asked whether OAJC could request the Omani government to sponsor U.S. firms working on A.I.D.-funded contracts as part of that government's contribution to a project. We were told that government ministries were not generally receptive to such requests.,

OAJC's failure to document previous discussions and decisions led to a situation in which current staff were unaware, until a very late date, that an appearance of conflict of interest existed and that additional determinations and, possibly, actions on the part of the A.I.D. Representative were necessary. The fact that this situation is likely to recur in the future argues for the development of policies and procedures outlining the actions that must be taken to resolve conflicts of interests or appearances of conflicts that may be identified.

Did OAR/Oman follow A.I.D. procedures and Agency-wide guidance to give reasonable assurance that payments of A.I.D. funds for construction services were made only for services rendered and acceptably performed in accordance with the terms of the contracts and project agreements?

OAR/Oman followed A.I.D. procedures and Agency-wide guidance to give reasonable assurance that payments of A.I.D. funds for construction services were made only for services rendered and acceptably performed in accordance with the terms of the contracts and project agreements, except that OAJC did not fully document all monitoring activities. This problem area is discussed in more detail on page 18.

As required by A.I.D. Handbook 3, Supplement B, Chapter VII, OAJC took oversight steps designed to ensure that payments of A.I.D. funds were made only for approved purposes. These included (1) administrative approval of payment vouchers, (2) preparation of project status reports, (3) periodic meetings with contractors and host country officials, and (4) periodic visits to project sites.

We reviewed documentation in OAJC's files pertaining to the payments made by A.I.D. in connection with the two host country contracts and two fixed amount reimbursement agreements that funded construction services under the Water Resources Development Project. Documentation accompanying each voucher indicated that OAR/Oman complied with A.I.D.'s requirements for administrative approval of the vouchers. Payments reviewed were found to be in accordance with the relevant contracts and agreements. In all cases, administrative approval was evidenced by attachment of the standard administrative approval checklist to the voucher. This document indicates the project officer's satisfaction with the performance of these services for which payment is requested.

In addition, OAJC staff routinely prepared quarterly Project Implementation Reports to record project progress and problems. We agreed with OAJC staff that these reports serve the purpose of the periodic project status reports prescribed by Handbook 3. They provide information to management, covering project and contractor progress and problems. We found that quarterly reports were not prepared for the second and third quarters of fiscal year 1992. Because of workload constraints, OAJC had decided to replace quarterly reports with annual reports. We found that OAJC did prepare an annual report for fiscal year 1992. During our field work, OAJC decided that quarterly reports were preferable and advised us that status reports will be prepared quarterly in the future.

Project records show that OAJC staff met periodically with contractors and host country officials as required by A.I.D. policies. Such meetings were normally attended by the project officer and officials from the host government implementing agency and/or the contractor.

The meetings focused on key activities and events of the project. For the two contracts and two fixed amount reimbursement agreements we reviewed, we found six memorandums of meetings. However, OAJC staff advised us that they had not documented every meeting or telephone conversation held with host country or contractor officials.

Project records also show that OAJC staff made periodic visits to project sites as required by A.I.D. policy. During such visits, staff reviewed contractor performance and identified and acted upon problems. OAJC staff provided us with copies of eight reports written to document visits to project sites. OAJC officials stated that many other site visits, especially those made in the Muscat area, were not documented.

The problems we noted regarding documentation of monitoring activities are discussed below.

Need to Improve Documentation of Project Monitoring Activities

General Accounting Office (GAO) standards require significant events to be clearly documented while A.I.D. policy requires project officers to maintain contract monitoring files to document significant project monitoring actions. Nevertheless, in some instances some project monitoring actions were not documented or, when documented, the records were not readily available for examination. This occurred, in part, because of lack of formal guidance on documenting monitoring actions. In addition, according to the A.I.D. Represe ıtive, OAJC's staffing constraints generally limited the time available to document all monitoring activities and, furthermore, the project lacked a U.S. engineering officer between February 1991 and September 1992. As a result, OAR/Oman did not maintain a full account of project activities.

> **Recommendation No. 4: We recommend that OAR/Oman establish written procedures to set uniform standards for minimum documentation requirements for contract monitoring.**

GAO's Standards for Internal Controls in the Federal Government require significant events to be clearly documented and the documentation to be readily available for examination. Also, A.I.D. Handbook 3, Supplement B, Chapter VII requires project officers to maintain contract monitoring files in which contract monitoring activities are documented. The Handbook requires the files to contain documents such as contract monitoring plans, progress, shipping and other reports memos, cables, etc. Further, the Handbook requires that (1) such contract monitoring file(s) exist in addition to the official files and (2) that the

project officer ensure that copies of all monitoring documents are included in the official project files.

Although we found evidence of project monitoring as described above, the documentation was not readily available for examination as required by GAO standards and A.I.D. Handbook 3. For example, of the eight trip reports provided to us by OAJC staff, only three had been placed into the project's files. After searching for relevant documents in the personal computer files of individual staff members, OAJC gathered five additional trip reports, memorandums of meetings, and other correspondence for our review. In three additional instances, however, OAJC officials only had travel vouchers as evidence of their travel to project sites. Moreover, OAJC staff acknowledged that no reports had been prepared for an unknown number of additional site visits, meetings, or telephone calls, particularly those in the nearby Muscat area.

According to OAJC staff, the missing documentation was caused by lack of a formal mission policy on documenting site visits and meetings and general staffing constraints in the office. Different project officials followed individual preferences in documenting project activities. Moreover, according to the A.I.D. Representative, the office had an extremely heavy workload that focused staff attention on other priority tasks. The U.S. direct hire engineering officer responsible for the Water Resources Development Project departed in February 1991 and was only replaced in September 1992 by a U.S. engineering officer working under a personal services contract. In the intervening period, monitoring activities were performed by the Omani project officer who, according to the A.I.D. Representative, was not fully familiar with A.I.D. requirements for performing various and documenting project monitoring actions. This official has since left OAJC.

As a result of the lack of documentation of project activities, the project's files did not provide a historical record of project activities for future reference. Moreover, because monitoring activities were not documented, OAJC management may not have been fully informed as to the progress made or problems encountered under the two host country contracts and two fixed amount reimbursement agreements, which together had obligations exceeding $21 million. Frequent and well-documented monitoring by OAJC staff will be critical as the Municipality of Dhofar begins to award and implement the multiple construction projects, including the A.I.D.-funded waste water reclamation plant, which are envisioned to take place during the next phase of the Water Resources Development Project, and in view of the fact that OAJC has concluded that the Municipality currently lacks the capacity to manage these projects and must establish and staff a new management unit dedicated to these activities.

Based on the above, we concluded that OAR/Oman should establish written procedures setting minimum requirements for the documentation of project monitoring activities.

REPORT ON INTERNAL CONTROLS

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

Scope of Our Internal Control Assessment

We conducted our audit in accordance with generally accepted government auditing standards.

We assessed

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

We limited our assessment to those controls applicable to the audit's objectives and did not assess the auditee's overall internal control structure.

In addition, for the purposes of this report, we classified significant internal control policies and procedures applicable to the audit into categories. For each category, we obtained an understanding of the relevant policies and procedures and determined whether the policies and procedures had been implemented and 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.'s management, including OAR/Oman, is responsible for establishing and maintaining adequate internal controls. In addition, 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 and procedures for U.S. foreign assistance are to provide management with reasonable -- but not absolute -- assurance that resource use is consistent with A.I.D. 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.

In performing the audit, we found one problem that we considered reportable under the Federal Managers' Financial Integrity Act. Reportable conditions are those which, in our judgement, could adversely affect A.I.D.'s ability to ensure that resource use is consistent with laws, regulations, and policies: that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and disclosed in reports.

Conclusions for Audit Objective One

The first objective sought to establish whether OAR/Oman followed A.I.D. policies and procedures for monitoring the award of A.I.D.-funded, host country contracts for construction services to ensure that these contracts complied with A.I.D. requirements. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D Handbook 3B and Handbook 11, Chapter 1. For the purpose of this report, we classified the relevant policies and procedures into the following categories: (1) the host country contracting capability assessment process; (2) the pre-qualification process; (3) the solicitation process, including the preparation, distribution, and evaluation of solicitations for proposals; and (4) the negotiation and award process.

Our tests showed that the Agency's controls were consistently applied except that OAR/Oman did not adequately assess the capabilities of host country contracting agencies prior to delegating contracting responsibilities to them, nor did it always approve specific host country contracting actions in accordance with Handbook 11, Chapter 1.

As part of our consideration of internal controls, we reviewed OAR/Oman's fiscal year 1992 internal controls assessment report under the Federal Managers' Financial Integrity Act. The assessment report did not report the weaknesses we noted with respect to OAR/Oman's assessment of host country contracting capabilities. Therefore, we have recommended that

OAR/Oman report these weaknesses in its next reporting cycle under the Federal Managers' Financial Integrity Act if they have not been corrected by that date.

Conclusions for Audit Objective Two

This objective sought to establish whether OAR/Oman followed A.I.D. policies and procedures for monitoring the performance of A.I.D.-funded construction services contractors, to ensure that payments of A.I.D. funds for construction services were made only for services rendered and acceptably performed in accordance with the terms of project agreements and construction services contracts. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 1, Supplement B; Handbook 3, Supplement B; Handbook 11 (Chapter 1); Handbook 19 (Chapters 1 and 3); and the General Accounting Office's Standards for Internal Controls in the Federal Government.

For the purpose of this report, we classified the relevant policies and procedures into the following categories: (1) processes for monitoring contract implementation (including site visits, final inspections, and meetings with contractor and/or host country officials) and (2) processes for payment voucher processing, certification, and approval.

Our tests showed that the Agency's controls were consistently applied except that OAR/Oman did not always document its monitoring activities. In addition, the documentation that was prepared was not readily accessible as required by A.I.D. Handbook 3 and General Accounting Office standards.

REPORT ON COMPLIANCE

This section summarizes our conclusions on OAR/Oman's compliance with applicable laws, regulations, binding policies, contracts, and grant agreements.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards which require that we

- assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which include designing the audit to provide reasonable assurance of detecting abuse and illegal acts that could significantly affect the audit objectives) and

- report all significant instances of noncompliance and abuse and all indications or instance of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

We tested OAR/Oman's compliance with (1) the Federal Managers' Financial Integrity Act, as set forth in Department of State cable 267812, dated August 19, 1992, and (2) the General Accounting Office's Standards for Internal Controls in the Federal Government. However, our objective was not to provide an opinion on OAR/Oman's overall compliance with such provisions.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants, bilateral agreements, and binding policies and procedures governing an organization's conduct.

Noncompliance constitutes an illegal act when the source of the requirement not followed or prohibition violated is a statute or implementing regulation, including intentional and

unintentional noncompliance and criminal acts. Not following internal control policies and procedures cited in the A.I.D. Handbooks generally does not fit into the 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 the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with the Federal Managers' Financial Integrity Act is the overall responsibility of A.I.D. which, in turn, requires each mission to comply with the Act as set forth in binding policies described in cables sent by the Department of State to missions each year. Compliance with the General Accounting Office's Standards for Internal Controls in the Federal Government is also a management responsibility.

Conclusion on Compliance

No irregularities or instances of noncompliance came to our attention with respect to the general assessment cable guidance of 1992, which is used by the Agency to implement the Federal Managers' Financial Integrity Act. However, we found that OAR/Oman did not always comply with those provisions of the General Accounting Office's Standards for Internal Controls in the Federal Government which require that significant events be documented and that documentation be readily accessible.

MANAGEMENT COMMENTS AND OUR EVALUATION

This section summarizes management's comments on our draft report and our evaluation of those comments. The section is organized in the order in which management presented its comments. The complete text of management's comments, together with its audit representation letter, is included as Appendix III to this report.

Briefly, management generally agreed with the report's findings but took exception to some of the report's conclusions. Management believed that the audit demonstrated that there had been no material weaknesses in its operations. It found our recommendations to be salutary in nature and has taken steps to implement them.

Assessments of Host Country Contracting Capabilities

Management disagreed with our conclusion that its 1986 assessment of the contracting capabilities of the Ministry of Electricity and Water did not comply with the requirements of A.I.D. Handbook 3. Management argued that, because Handbook 3 did not specify a methodology for conducting such assessments, its limited assessment complied with the limited requirements in effect at that time.

It is our opinion that, although the Agency had not established a methodology for conducting host country contracting assessments prior to 1990, Handbook 3, Supplement B, Project Officers' Guidebook, Host Country Contracting, which is still in effect, clarified the Agency's expectations regarding the conduct of such assessments. Missions were advised to conduct "a systematic review of the organization, management, and staffing" of each proposed host country contracting agency; a "careful case-by-case assessment" of the agency's procurement system; and a "reasonably detailed examination of the host country's contracting system and policies". The guide also stated that a written record must be made of the assessment and retained in the project files.

The only evidence of an assessment by OAJC of MEW capabilities was a brief description of MEW in the 1986 Water Resources Project Paper. It noted that MEW had appropriate experience but warned that MEW's overworked staff would require additional OAJC assistance. There was no analysis of MEW's procurement, payment, or accounting procedures or processes. In our opinion, this discussion does not support a conclusion that

OAJC conducted a careful, detailed review of MEW's capabilities prior to delegating contracting responsibilities to it.

OAJC agreed that its 1992 assessment of the Municipality of Dhofar did not fully comply with Agency-wide guidance issued in November 1990 and, as we recommended, is contracting for an assessment of the Municipality's capabilities to properly award, manage, and audit a large, internationally competed construction contract. As recommended, OAJC also issued a mission order on host country contracting that provides guidance for conducting assessments of host country agency contracting capabilities. Because we found OAR/Oman's weaknesses with respect to conducting host country contracting capability assessments to be reportable under the Federal Managers' Financial Integrity Act, we also recommended that OAR/Oman report these weaknesses in its next report under the Act, unless corrected by that time. The actions taken by OAR/Oman correct the weaknesses noted during the audit, therefore, we are closing Recommendation No. 1 upon issuance of this report.

Approval of Host Country Contracting Actions

OAR/Oman agreed that it had not documented all approval actions as required by A.I.D. policies and procedures. It did not, however, agree with our opinion that there is a critical distinction to be made between formal and informal approval actions.

Handbook 11, Chapter 1, requires formal A.I.D. approval of specific contracting actions. In addition, the General Accounting Office's Standards for Internal Controls in the Federal Government require that significant events, transactions, and decisions be documented and that documentation be readily available for examination. In our opinion, "formal approval" requires an explicit and documented action on the part of the approving official. Accordingly, we do not believe that informal, undocumented approval actions meet either the Agency's or GAO's standards.

We recommended that OAR/Oman establish procedures for monitoring the host country contract award process and ensuring that all required approvals are provided, fully documented, and maintained in appropriate contract files. We recommended that the guidance include an office-specific checklist for required and recommended actions. Although, OAJC recently issued a mission order on host country contracting, the order does not clarify processes within the office for obtaining and documenting OAJC approval of specific host country contracting actions, nor does it contain a checklist or other mechanism for ensuring that required approvals are obtained, provided to the host government, and documented in project files. Recommendation No. 2 will be resolved when we reach agreement on an acceptable course of action and will be closed when we receive evidence that the action has been completed.

Conflict of Interests

Management's comments focused on the specific example we used in the report to illustrate our conclusion that Omani business customs provide opportunities for unexpected conflict of interests during the host country's contract award process. OAR/Oman restated its belief that, because the government official described in this example was not involved in the contractor selection process, the U.S. firm selected for the A.I.D.-financed host country contract had not achieved an unfair competitive advantage and, therefore, OAJC's approval of the selection of this contractor was appropriate. OAJC agreed to issue mission-specific guidance on this issue, but we have not agreed on the nature of the guidance to be issued. Recommendation No. 3 will be resolved when we reach agreement on an acceptable course of action and will be closed when we receive evidence that the action has been completed.

Monitoring of Contractor Performance

OAR/Oman did not comment directly on our finding that it had not fully documented its contract monitoring activities. However, it acknowledged that OAJC generally needed to do more to upgrade its documentation of decisions and events. Recommendation No. 4, related to the need to improve documentation of contract monitoring, will be resolved when we reach agreement on an acceptable course of action and will be closed when we receive evidence that the action has been completed.

Audit Representation Letter

At the time that OAR/Oman commented on our draft report, it had presented us with an audit representation letter that we found to be unacceptable in two respects. The A.I.D. Representative refers to the negotiations leading to that letter in his comments to the draft report. OAR/Oman provided us with a revised representation letter that fully met the needs of both offices and we were able to issue this report, citing OAR/Oman's general compliance with A.I.D. policies and procedures, without any disclaimers or qualifications. At OAR/Oman's request, we included its audit representation letter with its comments to our draft report (see Appendix III). In the audit representation letter, the A.I.D. Representative states that, as a counterweight to our request that he provide us with a representation letter, he requested us to provide him with an "engagement letter", such as that used in the private sector. We advised the A.I.D. Representative that, in our opinion, the IG's annual work plan and RIG/A/Nairobi's notification cables, both of which describe the scope and objectives of planned audits, serve the purpose of engagement letters.

SCOPE AND METHODOLOGY

Scope

We audited OAR/Oman's management of construction services in accordance with generally accepted government auditing standards. We conducted the audit from September 26 to November 23, 1992. The audit covered construction services funded through the Water Resources Development Project, which was the only OAR/Oman project involving construction services, and which was either ongoing or had been completed within the preceding three years. The project funded two host country contracts and two fixed amount reimbursement agreements for construction services. A list of the contracts and agreements covered by this audit is included as Appendix II. As of September 30, 1992, the project had cumulative obligations and disbursements for construction services of $21.02 million and $8.36 million, respectively.

We conducted our audit at the co-located offices of the Omani-American Joint Commission and OAR/Oman, in Muscat, Oman. We visited the completed waste water stabilization ponds in Salalah and in-process construction at the Ghubrah desalination plant in Muscat. We obtained testimonial evidence from the U.S. Ambassador to Oman and officials from OAJC, the Omani Legal Affairs Office, the Municipality of Dhofar, and the two U.S. firms which were providing services under the two host government contracts we reviewed. In addition, we reviewed and obtained documentation from OAJC project files and obtained legal advice from the IG/Legal Counsel. Our analyses of this information is discussed under the methodology for each audit objective.

As part of this audit, we examined OAR/Oman's internal controls related to management of construction services.

We did not test the reliability of computer generated data used in the report because (1) the validity of the data was not crucial to accomplishing the audit objectives and (2) computer generated data has been used only to a limited extent for background and informational

purposes. We have cited the source of the information wherever computer generated data was used.

Methodology

The methodology for each audit objective follows.

Audit Objective One

This objective sought to determine whether OAR/Oman followed A.I.D. policies and Agency-wide guidance concerning monitoring the host government's contract award process for A.I.D.-funded, host country construction services contracts. To accomplish this objective, we examined all projects involving host country contracts for construction services which were either ongoing or had been completed within the preceding three years. Only the Water Resources Development Project met these criteria. The project funded two host country contracts for construction services -- we reviewed them both.

We tested OAR/Oman's compliance with policies and procedures cited in A.I.D. Handbook 3B and Handbook 11, Chapter 1 and with Agency-wide guidance issued in November 1990 concerning host country contracting. Specifically, we compared these criteria to documentation provided by OAR/Oman relating to (1) assessing host country contracting capabilities, (2) monitoring host country contracting agencies' contract award processes; and (3) providing formal approval of specific host country contracting actions, including advertising, lists of pre-qualified offerors, solicitation documents, draft and final contracts. We also interviewed current OAR/Oman and OAJC officials to obtain explanation of the procedures used to monitor the award of host country contracts.

Audit Objective Two

The second objective sought to establish whether OAR/Oman followed A.I.D. policies and Agency-wide procedures requiring missions to monitor contractor performance to ensure that payments of A.I.D. funds are made only for services rendered and acceptably performed in accordance with the terms of project agreements and contracts. To accomplish this, we examined all projects involving host country contracts for construction services which were either ongoing or had been completed within the preceding three years. Only the Water Resources Development Project met these criteria. The project funded two host country contracts and two fixed amount reimbursement agreements for construction services -- we reviewed all four.

We tested OAR/Oman's compliance with the provisions of A.I.D. Handbook 3, Chapter 11; Handbook 3B and Handbook 19, relating to project monitoring and the processing of project payments. Specifically, we compared these criteria to documentation provided by OAR/Oman related to (1) making periodic visits to the project's construction and office sites and documenting those visits; (2) holding meetings related to contractor performance with host government and contractor officials and documenting those meetings; (3) reviewing and administratively approving invoices submitted by the host government for reimbursement or direct payment to contractors; and (4) correctly calculating reimbursements and direct payments in accordance with contract and agreement terms.

For items one and two described above, we reviewed site visit reports and meeting minutes retained in the project's files and in the personal files of individual staff members. We visited the completed waste water stabilization ponds in Salalah to view the completed construction and interview the Omani officials who supervised its construction. We also visited in-process construction at the Ghubrah desalination plant to interview staff of the supervisory architectural and engineering firm to obtain information about the status of this construction effort. We also observed the laying of pipeline originating from the desalination plant.

We reviewed the Water Resources Development Project agreement and its amendments and the two host country contracts and their amendments to identify their terms and conditions related to payments of A.I.D funds for construction services. We subsequently reviewed all payment vouchers and contractor invoices with their supporting documentation to determine whether payments of A.I.D. funds were calculated and made only for services rendered and performed in accordance with agreement and/or contract terms, as applicable. Specifically, we checked whether the periodic payments requested by contractors and the Government of Oman and paid by OAR/Oman agreed with the terms of the applicable contracts and fixed amount reimbursement agreements. We examined the host country's certifications and project officers' approvals which described the work completed by contractors at each phase of the construction to ensure that such work agreed with contract and agreement terms. We also inspected construction completed under a fixed amount reimbursement agreement and obtained assurance from both host government and OAJC officials that the completed construction met pre-agreed specifications. We also interviewed OAR/Oman officials to determine how they monitored contractor performance, documented monitoring activities, and processed payment vouchers.

APPENDIX II

CONTRACTS AND AGREEMENTS AUDITED

Host Country Contracts

Contracting Agency	Obligations (millions)	Expenditures (millions)
Ministry of Electricity and Water	$ 2.00	$1.25
Municipality of Dhofar	$ 2.84	$2.68

Fixed Amount Reimbursement Agreements

Contracting Agency	Obligations (millions)	Expenditures (millions)
Ministry of Electricity and Water	$14.00	$4.21
Municipality of Dhofar	$ 2.18	$0.22
TOTAL	$21.02	$8.36

Omani-American Joint Commission
for Economic & Technical Cooperation

اللجنة العمانية الأمريكية المشتركة
للتعاون الاقتصادي والفني

MEMORANDUM

TO: Everette B. Orr
RIG/A/Nairobi

FROM: Mark S. Matthews
A.I.D. Representative/Oman

SUBJ: Audit of OAR/Oman's Management of Construction Services

DATE: February 17, 1993

The OAR/Oman believes that the audit of our management of construction services has been a useful exercise, conducted in a professional manner by the audit team, which has indicated that the program has been well managed with no evidence of waste or excessive cost to the U.S. Government. The facilities have been designed and built by competent American and Omani engineering and construction firms. They are indicative of the effectiveness of the Omani-American Joint Commission which is a unique organization structure for USAID. We would, however, like to comment on various aspects of the audit report.

Host Country Contracting Assessments

We believe that the OAR/Oman has generally complied with the pre-November 1990 requirements as stipulated in Handbook 3. The concerns which the RIG has raised are based on Supplement B to Handbook 3 which is entitled "Project Officer's Guidebook." This guidance is merely that, guidance, which does not supersede the requirements provided in Handbook 3. Handbook 3, prior to November 1990, did not require a comprehensive assessment. The OAJC's limited assessment of host country contracting capability performed in 1986 during development of the project paper was consistent with Handbook 3 guidance at that time and considered appropriate by former OAJC management. No problems related to host country contracting have been identified which would have been mitigated if a more extensive evaluation had been made.

We agree that the host country contracting assessment made during the development of the Water Resources Development Project Amendment, approved in 1992, is not in full compliance with the November 1990 guidance. Therefore, we are contracting with an accounting firm to carry out a comprehensive assessment. The tendering process will not be initiated for the related host country construction contract until the assessment is completed and all mitigative recommendations are in-place. We would like to add that the engineering/management consulting firm, Dames & Moore, executed a Master Plan which included an extensive institutional analysis of the host country contracting agency. This was considered as a primary source of information

at the time of the certification in July 1992.

Approval of Host Country Contracting Actions

We agree that all actions were not fully documented; however, based on the close involvement of OAJC staff in managing the contracting process with counterparts, that the missing approvals were perfunctory. Again, RIG and ourselves cannot identify one example of monetary loss or contract award irregularity, whether related to the written approval process or not. Therefore, we cannot agree with the statement on page 20 that "...OAJC missed opportunities to identify and correct errors in a timely fashion...." We also do not see such a clear distinction between "formal" and "informal" approval. Regardless, we will continue to strive to carefully document all actions for the project files. Written procedures have been distributed.

Conflict of Interest

The RIG refers to Section 2.7 of Handbook 11, Chapter 1 as stipulating that A.I.D. may not approve the selection of a firm that, in the judgment of the A.I.D. approving official, has been, or might be placed in a position where it has achieved an unfair competitive advantage. It is clear that former and present OAJC personnel were aware of the fact that a senior Omani official responsible for contract financial approval, not selection, is the official sponsor of an American firm which has provided services on an OAJC-financed project. The OAJC approval of this contractor was based on an objective selection process without the involvement of the Omani sponsor. The situation had been the subject of OAJC scrutiny and it was determined that the firm did not have an unfair advantage. We do not believe that any guidance in addition to Section 2.7 is needed. However, due to the specific circumstances, we do not object to issuing additional written guidance.

Representation Letter

The draft covering memorandum to the draft report contains language that suggests that the OAJC's management declined to provide the RIG/A/Nairobi "with all the information essential for us to render a professional conclusion." This theme is repeated throughout the report and tends to obfuscate the legitimate findings and quality of the effort that both parties brought to the audit. An inordinate amount of time and effort has been expended in attempting to provide a satisfactory representation letter to exorcise the disclaimer language which tends to distract the reader from the merits of the OAJC's performance depicted in the report. The OAJC believes it has provided essential information to the RIG/A/Nairobi to make a conclusion, and would urge the reader to review our "Representation Letter" to form his or her own opinion on the fairness and objectivity of our representations. We have repeatedly communicated in that letter that we have provided to the RIG/A/Nairobi all items that might materially affect the outcome or opinion of the audit.

We would be remiss if we did not comment on the magnitude of effort expended in Oman, and we presume around the world, on the issue of representation letters. To the best of our knowledge, the General Accounting Office (GAO)

rarely requests representation letters on their performance audits. The GAO is generally recognized as the authority on Federal Government auditing standards and should be asked to review the issue within AID to see if it has been taken to unnecessary levels bordering on waste and mismanagement or a sound auditing technique whose time has come. We believe if it is, in fact, deemed necessary, a standard letter should be negotiated at the highest levels of the IG and the mainstream Agency and not be left to repeated subjective negotiations between mission directors and RIG/A's.

Summary

We believe that the audit has been useful and has demonstrated that there are no material weaknesses. We agree that more needs to be done to upgrade the documentation of decisions and events in line with the Agency's movement in this direction during recent years. Therefore, we believe the recommendations are salutary in nature and have taken steps to implement them.

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for Economic & Technical Cooperation
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اللجنة العمانية الأمريكية المشتركة
للتعاون الاقتصادي والفني
ص.ب : ٦٠٠١ روي
مسقط
سلطنة عمان
تليفون : ٧٠٣٠٠٠
فاكس : (٩٦٨) ٧٩٧٧٧٨

No 117/93 الرقم

Date February 23, 1993 التاريخ

Mr. Everette Orr
Regional Inspector General for Audit
P. O. Box 30261
Nairobi, Kenya

RE: WRDP Project No. 272-0104

Dear Mr. Orr:

In connection with your audit of the Omani-American Joint Commission's (OAJC) management of the construction and engineering services project listed above ("Project"), and covering the period under audit from September 27, 1986 through September 30, 1992, you have requested a "Representation Letter" in accordance with the generally accepted practice in the private sector. This letter is in compliance with that request.

It should also be noted that I have requested the issuance of an "Engagement Letter" which is an equally accepted practice by CPA firms in taking prudent steps to avoid malpractice exposure. Engagement letters are intended to explicitly define the nature and terms of the services to be provided, the purpose of the engagement and the distribution of the report and its findings. As one who is a strong believer in the utility of the audit function as a management tool and a supporter of the representation letter concept as a generally held CPA practice technique, I only ask that we do not selectively utilize private sector auditing concepts and ignore the other half of the equation. It should be noted that my response to AID management when asked to comment on representation letters was as stated above, which endorsed representation letters, providing that engagement letters also be required for all audits as well.

For the purpose of this audit, I asked appropriate members of my staff, particularly OAJC's Engineer/Project Officer, Project Operations Officer, and the Controller, to make available to you all records in OAJC's possession. Based on the representations made by those individuals to me, I believe that those records are accurate and complete, and that they give a fair representation as to the status of the Project for the period under audit. After consultation with my staff, I represent that in connection with the Project during the period under audit:

Mr. Everette Orr
February 23, 1993
page two

1. The OAJC is responsible, as and to the extent provided by U.S. laws and regulations, for the internal control system and compliance by the OAJC with applicable U.S. laws and regulations and for the fairness, completeness and accuracy of the accounting and management information.

2. To the best of my knowledge and belief, the OAJC has provided to you all financial and management information and records related to the management of the Project for the period under audit.

3. To the best of my knowledge and belief, the OAJC is not aware of irregularities arising under U.S. laws and regulations and which the OAJC considers substantive involving management or employees of the OAJC who had roles in the management of the Project during the period beginning on August 29, 1991, the date on which my tenure as A.I.D. Representative to the OAJC commenced until the ending date of the period under audit, and is not aware of the above-mentioned irregularities from the beginning date of the period under audit up to August 28, 1991 which have come to my attention, other than those discussed in the RIG/A/Nairobi draft audit report. Although not an expert, nor claiming any expertise regarding the rules governing the operations of other organizations besides the OAJC, to the best of my knowledge and belief, I am not aware of any documented communications from other organizations concerning irregularities arising under U.S. laws and regulations involving management or employees who had roles in the management of the project during the period under audit which the OAJC considers substantive. I have discussed concerns which are not discussed in the audit report with RIG/A/Nairobi auditors. One or more of these concerns may prove to be irregularities in the future, as defined above. However, based on my present knowledge about these issues, I am not aware that any of these concerns currently constitutes a material irregularity as defined above.

4. To the best of my knowledge and belief, the OAJC is not aware of material instances where financial or management information on all matters directly relating to the Project for the period under audit has not been properly and accurately recorded and reported, other than those which are discussed in the RIG/A/Nairobi draft audit report. I have discussed concerns which are not included in the draft report with RIG/A/Nairobi auditors. One or more of these concerns may prove to be material in the future. However, based on my present knowledge about these issues, I am not aware that any of these concerns currently constitutes a material instance where financial or management information was not properly disclosed or accurately recorded and reported.

It should be noted that the official financial records of the OAJC are kept at an off-site accounting center located in Amman, Jordan and my representations, and those of my staff, are qualified to the extent of review of the financial reports issued by the accounting center in Jordan and our knowledge of USAID/Jordan's processing of our data which, by its geographic and management separation, is limited.

Mr. Everette Orr
February 23, 1993
Page three

5. To the best of my knowledge and belief, for the management of the Project, the OAJC is not aware of information about material noncompliance by the OAJC with A.I.D. policies and procedures or material violations of U.S. laws and regulations directly relating to OAJC's management of the Project during the period under audit, other than those which are discussed in the RIG/A/Nairobi draft audit report. I have discussed concerns which are not included in the draft RIG/A/Nairobi audit report with RIG/A/Nairobi auditors. One or more of these concerns may prove to be material in the future. However, based on my present knowledge about these issues, I am not aware that any of these concerns currently constitutes material noncompliance or an irregularity as defined above.

As mentioned earlier, I have been AID Representative to the OAJC since August 29, 1991, and the entire U.S. OAJC staff, both direct hire and personal services contractors, have approximately the same length of time in the country or less. All OAJC staff have been directed to be as candid and cooperative as possible with members of your staff and they have provided all records in our possession for the purpose of this audit. Any information regarding possible material violations of U.S. laws or regulations or material noncompliance by the OAJC with A.I.D. policies and procedures in the management of the Project during the period under audit that we have knowledge of, both before and during our tenures in Oman, have been discussed with members of your staff.

6. To the best of my knowledge and belief, the OAJC is not aware of information about material noncompliance by the OAJC with the terms of contractual agreements to which the OAJC was a party and which directly related to the OAJC's management of the Project during the period under audit, other than those discussed in the RIG/A/Nairobi draft audit report. I have discussed concerns which are not included in the draft RIG/A/Nairobi audit report with RIG/A/Nairobi auditors. One or more of these concerns may prove to be material in the future. However, based on my present knowledge about these issues, I am not aware that any of these concerns currently constitutes material noncompliance or an irregularity as defined above.

7. To the best of my knowledge and belief, the above representations are based on the information available to me as of the date of this letter. No events have occurred subsequent to the period under audit which would affect the above representations.

For purposes of clearances for this Representation Letter, the on-site PSC Controller and the PSC Engineer/Project Officer both are newly assigned to the OAJC (summer of 1992). Their personal knowledge of the details concerning the financial and management information associated with the management of the Project during the period under audit is necessarily limited. The USDH Project Operations Officer arrived at approximately the same time that I did, (August 1991), and our first-hand knowledge is also necessarily limited. The concerned staff are clearing this Representation Letter with those qualifications acknowledged.

Mr. Everette Orr
February 23, 1993
page four

For purposes of this Representation Letter, the term "irregularities" means intentional noncompliance with applicable U.S. laws or regulations and/or material misstatements, omissions, or failures to disclose.

I request that this Representation Letter be considered a part of the official OAJC comments on the draft report and be included in its entirety to the final report.

Sincerely,

Mark S. Matthews
AID Representative

APPENDIX IV

Report Distribution

American Ambassador to Oman	1
A.I.D. Representative, Oman	5
AA/NE	1
NE/DR/MENA	1
NE/ME	1
XA/PR	1
LEG	1
GC	1
AA/OPS	1
FA/FM	1
AA/FA	1
AA/R&D	1
POL/CDIE/DI	1
FA/MCS	2
FA/FM/FPS	2
IG	1
AIG/A	1
IG/A/PPO	3
IG/LC	1
IG/RM	12
AIG/I&S	1
IG/I/NFO	1
IG/A/PSA	1
IG/A/FA	1
RIG/A/C	1
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