PD-ABJ-052
84388

Regional Inspector General for Audit
Bonn

Audit of Economic Restructuring And Privatization Activities In The Czech Republic Under Project No. 180-0014

Report No. 8-180-94-010
June 30, 1994

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
DEICHMANNS AUE 29
53170 BONN
GERMANY

June 30, 1994

MEMORANDUM

TO: DAA/ENI/PA, Barbara N. Turner

FROM: RIG/A/Bonn, John P. Competello

SUBJECT: Report on the Audit of Economic Restructuring and Privatization Activities in the Czech Republic Under Project No. 180-0014 (Audit Report No. 8-180-94-010)

This is our final report on the subject audit. In preparing the report we considered the comments you provided to our earlier draft report. We have included these comments in their entirety as Appendix III.

In your comments on our draft report, you recognized that our recommendations, in this report and our report on project activities in Poland, address systemic problems in the project. Since you initiated or promised corrective actions effecting the project as a whole, we have modified our audit recommendations to be in accord with your actions. The report contains two recommendations which we consider resolved based on your agreement that the actions are warranted and your promise to implement them. We can close both recommendations when we receive documentary evidence that the recommended corrective actions have been implemented. In this regard, please let us know if you have any questions related to the documentation necessary for closure. Until we have closed the recommendations, please provide us with monthly status reports describing your progress toward implementing both audit recommendations.

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

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EXECUTIVE SUMMARY

In August 1990 the United States Agency for International Development (USAID) authorized the Economic Restructuring and Privatization Project (Project No. 180-0014) to assist Central and Eastern European countries establish viable private sectors - an important first step toward sustained, broad-based economic growth for these countries.

The Regional Inspector General for Audit/Bonn audited the privatization activities authorized by the project for the Czech Republic to determine what assistance has been provided, what has been the results of this assistance, and whether the USAID has adequately monitored and evaluated the assistance. USAID's Washington Bureau for Europe and the New Independent States (ENI) and the USAID/Representative Office in the Czech Republic share management responsibility for the activities in the Czech Republic (See page 3).

As of December 31, 1993, USAID had provided about $19.2 million for project activities in the Czech Republic. Most of these funds have been used to procure technical assistance through contracts with four major U.S.-based accounting firms. These contractors formed teams consisting of accountants, lawyers, economists, investment bankers, marketing specialists and industry specific experts, as needed to accomplish specific task established and documented by USAID in individual contract delivery orders. These teams assisted government entities establish legal and other institutional structures necessary to promote the general growth of privatization and also assisted individual businesses address specific restructuring problems (See page 4).

The audit concluded that the USAID-financed technical assistance has contributed positively to promoting privatization in the Czech Republic. Similar findings were reported in a July 1993 USAID-financed project evaluation and also in a January 1994 United States General Accounting Office report covering privatization activities in the Czech Republic. However, despite this general success, the audit found that ENI had not adequately assessed contractor performance against work requirements or closely monitored the implementation of project activities. For example, contrary to USAID policy and procedures, the work required of contractors was vague and general. Performance indicators, work plans, and budget schedules were not prepared by the contractors with any degree of specificity. Thus for delivery orders amounting to $12 million we could not measure how well nor to what extent the contractor performed work in delivering technical assistance. In our opinion, allowing contractors to operate without specific objectives, performance indicators and benchmarks, detracted from the claims of success. To correct this problem, we recommended that ENI establish specific objectives, performance indicators, and benchmarks in each new and existing contract delivery order (See page 8).

Besides not establishing a basis for measuring contractor performance, ENI and the USAID/Representative in the Czech Republic were not closely monitoring the contractors' implementation of project activities. The GAO reported in January 1994 that oversight of contractors was inadequate for the project as a whole. Our audit found that while monitoring took place, it was "ad hoc" and ENI and the USAID/Representative had not established the required detailed monitoring plan. Our audit also concluded that additional monitoring efforts were needed especially given the vague work statements provided in delivery orders to the U.S. contractors. To correct this problem we recommended that ENI establish monitoring plans for project activities in each country (See page 14).

ENI generally agreed with the audit findings and recommendations, although they believed that some of the statements in the draft report were overstated, particularly with respect to the ineffectiveness of current monitoring practices. Nevertheless, in April 1994, ENI issued instructions to ensure that project contract delivery orders included performance indicators and benchmarks. These instructions cover all of the Bureau's privatization activities in all Central and Eastern Europe, not only for the Czech Republic. ENI stated that because project performance, and not just contractor performance, was their ultimate objective some indicators and benchmarks will cover time periods and actions which go well beyond a specific delivery order. Concerning problems in monitoring, ENI believed that it and the USAID/Representative had made tremendous strides in the past 12 months in increasing the level of monitoring. It agreed, however, that formal plans had not been prepared and the lack thereof resulted in inefficiency and monitoring gaps. To remedy this situation, and eliminate confusion over coordinating Washington and field roles in monitoring, ENI stated that the Bureau will soon task each USAID/Representative with establishing quarterly monitoring plans and reports for project activities (See pages 7, 13, and 17).

Office of Inspector General

Office of Inspector General
June 30, 1994

Eastern Europe

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INTRODUCTION

Background

The overall U.S. policy goal for the Czech Republic is to support economic and institutional reforms to help ensure that Czech citizens are once again incorporated into the economic and political mainstream of the West. U.S. economic assistance is provided to the Czech Republic under the Support for Eastern European Democracy Act of 1989 (the SEED Act). Begun in 1990, the assistance program focuses on the following priority sectors for U.S. assistance:

- Privatization and economic restructuring
- Banking and financial services
- Energy
- Environment
- Management training

According to the July 1993 U.S. Assistance Strategy for the Czech Republic, the Czech economic transition has been successful to date, although slowed somewhat in 1992 due to the breakup of the Czech and Slovak Federation. The strategy paper stated that if the economic and institutional reforms in the Czech Republic continue at a rapid pace, U.S. assistance program can begin to phase out in fiscal year 1995.

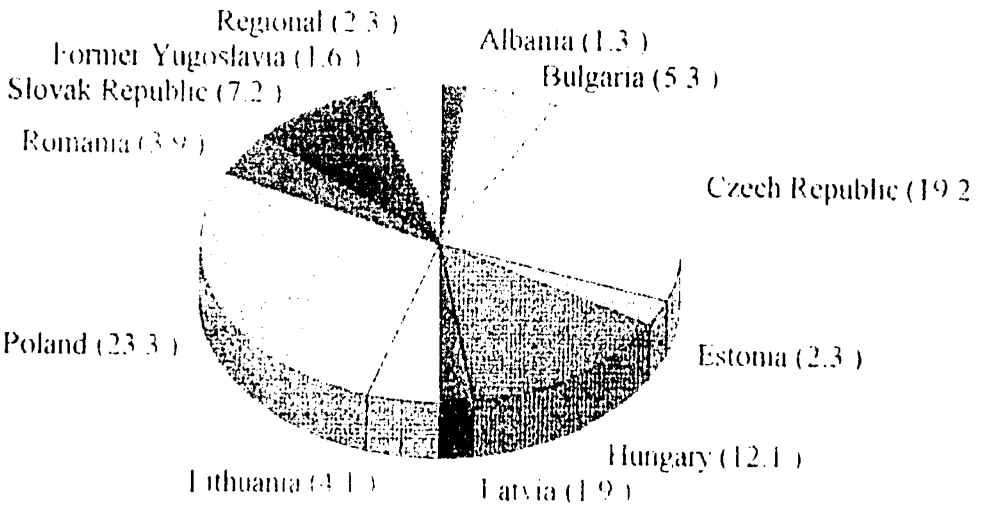
The Economic Restructuring and Privatization Project (Project No. 180-0014) was developed by the U.S. Agency for International Development (USAID) to address several of the priority assistance needs mentioned above. The project supports private enterprise activities in selected countries in Central and Eastern Europe. Consistent with the SEED Act and the Foreign Assistance Act, the purpose of the project is 1) to assist Eastern European governments in establishing a legal and institutional framework governing the process of privatization, and 2) to provide assistance to individual firms in addressing managerial deficiencies and adjusting to the market mechanism.

The project was first authorized in August 1990 at a funding level of $25 million with completion set for June, 1995. The project has since been increased to a funding level of $150 million with $84.1 million obligated and $43.2 million disbursed as of December 31, 1993. The project also increased the number of countries receiving assistance from three to 11 countries of Central and Eastern Europe at the time of audit. As such, the project is one of the most important of USAID efforts to assist privatization in these countries. The figure below shows the distribution of project funding, in millions of dollars, by country.

Project Obligations by Country

as of December 31, 1993

(millions of U.S. dollars)



USAID project management responsibilities reside in the Bureau for Europe and New Independent States (USAID/ENI) in Washington, D.C. In October 1993, USAID reorganized its Central and Eastern Europe (CEE) and New Independent States (NIS) operations, eliminating the Regional Mission for Europe (RME) and created one bureau for ENI. The USAID Representative for the Czech Republic in Prague (USAID/REP) has project oversight and monitoring responsibilities in the Czech Republic.

(Left to Right) Czech citizens being interviewed on their participation in the privatization process by Prague Television station. Czech couple display their newly acquired vouchers, signifying their ownership interest in the privatization of Czech enterprises. (Prague, November 6, 1993)

Audit Objectives

As part of our fiscal year 1994 audit plan, the Office of the Regional Inspector General for Audit in Bonn audited the Czech Republic activities under the Economic Restructuring and Privatization Project No. 180-0014 to answer the following questions:

1. What assistance has been provided by the USAID funded contractors?

2. What have been the results of USAID funded assistance?

3. Did the Bureau for Europe and New Independent States and the USAID Representative to the Czech Republic follow their internal policy and procedures for monitoring and evaluating project activities in the Czech Republic?

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

REPORT OF AUDIT FINDINGS

What assistance has been provided by the USAID funded contractors?

As of December 31, 1993, the United States Agency for International Development (USAID) had obligated approximately $19.2 million for the Economic Restructuring and Privatization Project in the Czech Republic. USAID provided technical assistance through contracts and small grants. Initially in the Czech Republic, USAID provided about $2.0 million of technical assistance under an existing USAID contract with the U.S. accounting firm of Price Waterhouse. Later, USAID began providing assistance using indefinite quantity contracts (IQC) specifically awarded for this project to three other U.S. accounting firms. The IQCs firms were Deloitte & Touche; Coopers & Lybrand; and KPMG Peat Marwick. In the Czech Republic, these firms provided technical services—advisors and consultants—at a cost of about $16.4 million. Figure one shows the levels of obligated funds for all four principal contractors in relation to total obligated funds for this project in the Czech Republic.

Project Funding in the Czech Republic

as of September 30, 1993

(millions of U.S. dollars)

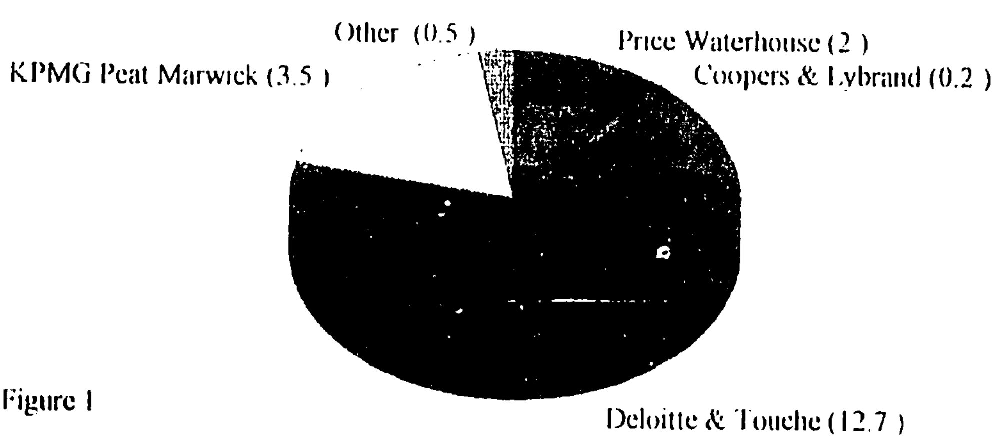


Figure 1

Under these contracts with U.S. public accounting firms, USAID awarded delivery orders, which identified project activities for each contractor to address. The contractors provided advisors and consultants to government entities to help establish legal and institutional frameworks for privatization and to individual firms to address management problems. Technical assistance was directed at privatizing banks and businesses and facilitating the role of municipal governments and various Ministries of the Czech Republic. The Czech ministries assisted were in Health, Industry, Economy, and Privatization.

The USAID financed contractors formed teams consisting of accountants, lawyers, economists, investment bankers, marketing specialists and industry specific experts, as needed to meet this requirement under the delivery orders. The teams performed financial analyses and valuations of specific state-owned enterprises, analysis of firms in specific industrial sectors, and negotiations/privatization transaction assistance in Czech Ministries. Training was also provided which included formal seminars and on-the-job training programs. A listing of the technical assistance provided by each contractor is shown in Appendix II. Below are some examples of the assistance provided:

- Under four consecutive delivery orders covering a period of two years, USAID provided assistance to the Czech Ministry of Privatization. USAID obligated about $12.3 million for this activity which represents approximately 65% of the total funding for this project in the Czech Republic. Accountants were provided by Deloitte and Touche and investment bankers were provided by Deloitte and Touche's subcontractor, Crimson Capital. The contractors assisted the Ministry by helping to establish the privatization transaction process, conduct negotiations with foreign investors, make recommendations to the Ministry, and assist the National Property Fund in distributing state assets.

- Under another delivery order with KPMG Peat Marwick of $1.8 million, USAID provided assistance to the Czech State Savings Bank. This assistance provided training and advice in the establishment and management of investment funds, design and implementation of appropriate credit risk management, implementation of procedures for processing foreign payments, and review and restructure of the banks' financial management and accounting procedures. The Czech Savings Bank is the largest holder of domestic savings and investment funds from Czech citizens.

Kmart department store in downtown Prague. Kmart shoppers make purchases in the formerly state-owned enterprise now privatized by the Czech Government through a process supported in part by USAID.

- Three of the accounting firms developed financial information for the Czech and Slovak American Enterprise Fund[1] on four Czech firms who were candidates for privatization and investment by the Fund. USAID obligated about $345,000 for this assistance. The four candidate enterprises included manufacturers of musical instruments, specialized dryers and pressure tanks. The Fund requested the financial information to assist in making investment decisions.

The delivery orders issued under the three IQC contracts (including those in the Czech Republic) differ from USAID's normal practice in several ways. While we did not note any significant problems, these differences in themselves are significant. First, the delivery orders provide for fixed daily rates of payment for each category of consultant (e.g., attorney, accountant, investment banker). The fixed rate is the reimbursement to the U.S. accounting firm—not the consultant— and is an average daily salary cost or consultant fee that applies to all consultants in that respective labor category plus other costs, such as benefits and per diem (lodging and meals). For example, under the fixed daily rate basis one accounting firm

[1] The Czech and Slovak American Enterprise Fund is one of several funds, established by the U.S. in selected countries of Central and Eastern Europe, providing investment funds to enterprises.

bills USAID $950 for project managers. USAID's normal practice is to use the consultant's actual salary plus a multiplier formula. This multiplier is negotiated with a USAID contracting officer and covers benefits and other indirect (overhead) costs. Also, USAID would reimburse the cost of per diem separately, based on established rates for the country where the consultant is working.

Secondly, USAID's normal practice is to limit the period of an IQC delivery order to 120 days, recognizing that delivery orders are for specific activities of limited duration. Some exceptions to the 120 day rule are allowed, but only with strong justification. However, under the IQCs used in the Czech Republic, the assistance activities frequently extended over long periods of time. Advisors and consultants are working on both short-term and long-term bases, with some individuals working for more than one year on continuing project activities. During our audit, we observed that the contractors had between 6 and 20 advisors in country. Based on vouchers paid in February of 1994 for work under two different delivery orders, we estimated that for one day USAID was billed between $2,000 (for four consultants) and $20,000 (for up to 24 consultants). One invoice covering just one delivery for a 28 day period came to over $500,000 for up to 24 consultants' services during the period.

Management Comments and Our Evaluation

ENI combined its comments on the Czech Republic activities with its comments on our draft report on project activities in Poland. Essentially ENI had no comments on this finding, except to point out that the "norm" of 120 days for USAID Indefinite Quantity Contracts (IQCs) was never intended in this program. They pointed out that these IQCs were set-up, advertised, and contracted for longer periods. We did not intend to indicate that there was a problem, but believe it is important to differentiate these IQCs from USAID's normal IQCs.

What have been the results of USAID funded assistance?

USAID funded assistance generally achieved positive results in promoting privatization. Notwithstanding these positive results, we found it difficult to measure contractor performance because of vague statements of work and a lack of performance indicators and benchmarks.

A July 1993 USAID financed project evaluation found that most of the USAID assistance had been successful. The report concluded that:

> Privatization support by [USAID] in the policy/program area has had a very high success ratio...The effective training program in fund management in the Czech Savings Bank is one of the key elements that can make the Czech Republic's mass privatization program a long-term success...

The evaluation report also stated that the Deloitte & Touche/Crimson Capital assistance, valued at about $12.3 million, to the Czech Republic's Ministry of Privatization was cost-effective. The evaluation concluded that the KPMG Peat Marwick assistance to the Czech Savings Bank, valued at about $1.8 million, had a very high potential impact on the Czech Republic's economy.

The evaluation report found, however, that about $4.2 million for firm specific and sectorial assistance was not cost-effective. Although sector studies were made and assistance provided in accounting, financial, and market analyses, most of this assistance did not achieve its primary objective, i.e., privatization. ENI has since discontinued these types of assistance.

A January 1994 report by the U.S. General Accounting Office (GAO)[2] stated that host government officials interviewed by GAO in the Czech Republic were generally satisfied with the quality and performance of the contractors. GAO reported that there were some complaints, such as delivery orders taking too long to process and host governments not receiving adequate information to monitor contractor performance. The GAO also concluded that USAID's use of indefinite quantity contracts had proven to be an effective mechanism for responding to the needs of Eastern Europe for technical assistance on privatization.

Our discussions with USAID/ENI and Czech Republic officials showed that they were satisfied with the results of the assistance. A USAID/ENI manager stated that this particular project in the Czech Republic was one of the most successful USAID projects ever. Also, our interviews with Czech officials from the Ministry of Privatization, the National Property

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[2] U.S. General Accounting Office report "Eastern Europe AID's Indefinite [Quantity] Contracts Assist Privatization Efforts but Lack Adequate Oversight", GAO/NSIAD-94-61, January 1994.

Fund and Czech State Savings Bank confirmed that U.S. assistance generally met or exceeded their expectations. For example, a Czech Deputy Minister of Privatization explained that direct investments in the Czech Republic had grown significantly since 1991 as a result of the USAID funded assistance. He felt that the U.S. provided advisors had been very successful in convincing foreign investors to make these investment decisions. As of June 1993, Deloitte & Touche/Crimson Capital reported that foreign private investors had invested about 49.7 billion crowns (equivalent to about $1.8 billion) into the Czech economy.

Notwithstanding the apparent success of project activities cited above, we believe that allowing contractors to operate without specific objectives, performance indicators and benchmarks, detracted from the claims of success. Our audit disclosed that the work required of contractors was vague and general, and that the only basis of contractor accountability was whether the contractor: 1) provided the numbers and types of advisors requested, and 2) stayed within the funding level authorized by USAID. Performance indicators, work plans, and budget schedules were not prepared by the contractors with any degree of specificity. Although the GAO report noted above and the previously issued USAID Inspector General reports have cited these problems, we believe that the situation in the Czech Republic is notable because of the large number of contractor personnel involved, the length of time the contractors have been working in country, and the amounts of money being paid each day for their services.

Delivery order statements of work need
quantitative performance indicators

USAID policy and procedure require project officers to specify quantifiable progress indicators in contract scopes of work, including delivery orders. Delivery order work statements (or work plans) for four of the five latest delivery orders reviewed did not contain quantifiable progress indicators, specific task definitions, or associated budgets and schedules. Thus for these delivery orders amounting to $12 million (or 65 percent of the amount tested of the 16 delivery orders), we could not measure how well nor the extent that the contractor performed work in delivering technical assistance. Furthermore, it was not possible to measure whether the expected assistance was provided on time, provided with the minimum resources needed, or in fact completed. This occurred because USAID/ENI believed that it was all but impossible to establish these indicators and benchmarks for these delivery orders.

> **Recommendation No. 1: We recommend that the Bureau for Europe and New Independent States, for this project, establish specific objectives, performance indicators, and benchmarks in each new delivery order statement of work (or in the work plan under the delivery order), and revise work plans for current delivery orders to meet these requirements.**

USAID policy and procedures[3] require quantifiable progress indicators in contract scopes of work, including delivery orders. This handbook citation states that ***performance indicators and benchmarks (targets and time frames) will enable project managers to objectively monitor and evaluate the contractors' progress against the expenditures of both time and money.*** This concept is incorporated in the former Regional Mission for Europe's internal instructions. Specifically, Mission Order No. 503[4] requires a clear, adequately detailed, description of technical assistance to be procured in contracted work statements. Also, Section 10.004(b)(4) of the Federal Acquisition Regulations states that purchase descriptions of services should outline to the greatest degree practicable the specific services the contractor is expected to perform.

We identified four Deloitte & Touche delivery orders, totalling $12.3 million (or about 65 percent of the amount tested) which did not have specific objectives, time frames for performance, and performance indicators. The delivery orders, which requested technical assistance to the Czech Republic's Ministry of Privatization (MOP), only provide the number of staff days to be provided in several skill categories without describing the output of the work to be done or any specific time schedules and related budgets. For example, the scope of work for one of the four Deloitte and Touche delivery orders, signed in December 1991 and obligating $4.6 million, does not specifically define the tasks or sub-tasks to be performed, the time frame for a task to be completed or the level of effort (cost) of a task. The delivery order's stated objective was simply for the contractor:

> To assist the Czech Ministry of Privatization in the planning and management of the privatization process involving effective implementation of a prompt and expedient decision-making process, covering approximately 2,500 enterprises.

The latest delivery order for this activity, signed in June 1993 and totaling $5.2 million, also included general objectives in the scope of work that contained no quantitative or qualitative performance indicators or benchmarks. The objectives of this second delivery order are:

- Complete outstanding first wave privatization projects;
- Review, negotiate and continue second wave privatization projects;
- Supervise tenders for the government ministries;
- Assist in the further development of policies and regulations;
- Assist the ministry with its public relations program; and
- Continue to provide training to ministry personnel on a hands-on, daily basis.

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[3] USAID Handbook 3, Supplement A.

[4] Mission Order No. 503 (December 1993), Attachment A, page 10.

The general objectives contained in the above two delivery orders do not afford USAID/ENI an adequate basis for either monitoring contractor progress or ensuring effective stewardship of Federal funds. USAID/ENI and the Czech Republic's expectation of what contractors are expected to achieve over the period of work remains vague, and thus left to the interpretation of the contractor. Questions like: "How long should the first wave of privatization take to complete and how much should be spent?", and "What type of assistance in developing policies is intended and just what kind of policies are necessary?" are left unanswered. Further, some of the above general objectives reflect traditional institution-building, an area which USAID has long been involved in. We believe it is in these areas—at a minimum—where much better objectives, benchmarks and performance indicators can be established.

(Left to Right) KPMG Peat Marwick banking consultants working on technical assistance plans for the Czech Savings Bank. Deloitte and Touche project managers discussing work completed at the Czech Ministry of Privatization.

In commenting on a discussion draft of this report, USAID/ENI officials believed that the audit had overstated the effect of the lack of specific objectives and benchmarks. They explained that—

- the lack of benchmarks or detailed work plan did not necessarily preclude the evaluation of a contractor's performance or the success of the project.

- the assistance was needed immediately and time did not allow for developing benchmarks which may have been obsolete before the ink was dry.

- even with almost three years of experience in this process, it was all but impossible to determine in advance the level of effort needed to sell a particular state-owned enterprise, a large group of enterprises, or to determine if the enterprise could indeed be privatized.

In our view, USAID/ENI's position goes against the USAID Administrator's call for procurement reform through "performance-based" contracting and the Agency's reply to two Inspector General audit reports[5] on the same issue of providing technical assistance. In January 1994, the Administrator issued a statement promoting "performance-based" contracting which would institutionalize a quantifiable contract approach to project implementation, as opposed to the level of effort such as was used in the Czech Republic. If indeed what USAID/ENI contends is true, i.e., that even after three years experience they cannot do a better job of defining what it wants it's contractors to do, we doubt that the Administrators's emphasis to move to "performance-based" contracting, will succeed.

In responding to two 1993 Inspector General audit reports identifying the same issues, the Agency agreed with the reports' findings and promised action. In particular, the Bureau for Europe responded by issuing internal procedures in December 1993 to require performance indicators in technical assistance contracts. Unfortunately, we saw no recognition of action taken in the Czech Republic. We believe USAID/ENI, in coordination with the AID/REP Czech Republic, needs to take positive action on the current work orders now.

Management Comments and Our Evaluation

USAID/ENI coupled its comments on the Czech Republic draft report with its comments on our similar draft report on Poland and stated that both audits were thorough and fair efforts. The comments went on to state—"We agree that we can and must do better in measuring performance and we are fully committed to USAID's reform agenda. ..." Further, ENI commented that it regretted that it may have appeared defensive in earlier comments on the discussion draft and trusts it can be viewed as a willing partner in the changes it agrees are needed.

USAID/ENI reported that in April 1994 instructions were issued requiring that all new delivery orders issued for the Project, including the Czech Republic and Poland, are to include specific statements of objectives, performance indicators and benchmarks of performance expected over defined time periods. ENI stated that because project performance, and not just contractor performance, was their ultimate objective some indicators and benchmarks will cover time periods and actions which go well beyond a

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5 Audit of the Office of Procurement's Management of the Award and Administration of Technical Services Contracts, Report No. 9-000-93-004, March 31, 1993. Audit of the Bureau for Europe's Technical Assistance Contracts, Report No. 8-180-93-05, June 30, 1993.

specific delivery order. For the Czech Republic, ENI requested the audit recommendation be modified to not require revision to current (in effect) delivery orders. ENI pointed out that the delivery order at the Ministry of Privatization is due to run out in September and the new delivery order, which will include benchmarks, is now being designed. For the remaining delivery orders in effect, ENI requested that rather than formally amending the orders, the work plans be revised to obtain the same effect and save time.

The ENI action goes beyond our recommendation for the Czech Republic and Poland activities, and essentially addresses concerns for the project as a whole. Because ENI recognized the issues brought out in this report and our Poland draft report, we believe that the actions taken and planned to be taken should go a long way to ensure that contractors' performance is measurable. We modified the audit recommendation for the Czech Republic based on the ENI policy statements and we agree that new delivery orders should conform with the new policy and it seems more timely to revise the work plans for the remaining activities.

Did the Bureau for Europe and New Independent States and the USAID Representative in the Czech Republic follow their internal policy and procedures for monitoring and evaluating project activities in the Czech Republic?

The USAID/ENI project manager and the USAID/REP in the Czech Republic generally followed internal policy and procedures for evaluating project activities. With regard to monitoring, we concluded that additional monitoring efforts are needed due to the vague work statements provided in delivery orders to the three U.S. contractors. While monitoring took place, it was "ad hoc" and USAID/ENI and the USAID/REP had not established the required detailed monitoring plan. Similarly, the General Accounting Office reported in January 1994 that oversight of contractors was inadequate for the project as a whole.

Concerning USAID/ENI's evaluation responsibilities, two performance evaluations, both issued in July 1993, were financed by USAID and performed by independent contractors. USAID/ENI project officers stated that they had considered the evaluation recommendations in managing the project. For instance, sector studies—which the evaluation recommended to be discontinued—are no longer being planned for future project activities. We also found that the country specific recommendations were addressed in the July 1993 USAID Assistance Strategy for the Czech Republic.

Concerning monitoring in the Czech Republic, our audit disclosed that the extent of monitoring was not sufficient given the lack of specific objectives, performance indicators and benchmarks for contractor performance. The January 1994 GAO report cited earlier identified several areas where monitoring was deficient in the project as a whole. We saw evidence of some of GAO's concerns, e.g., the fact that USAID/REP not always receiving copies of delivery orders and reports. Due to the recency of the GAO report and the planned corrective actions by USAID in addressing GAO's concerns, we are only making recommendations concerning a material internal control weakness — not having a monitoring plan for the activity — that was not specifically addressed in the GAO report.

Monitoring Plan Needed For Adequate Oversight

USAID/ENI internal policies, in effect since December 1992, required that monitoring be done on a systematic basis. This is even more important when, as in the Czech Republic, delivery order contracts do not contain performance indicators or benchmarks, or specifically describe the end product of the delivery order. However, we found that project monitoring was performed on an "ad hoc" basis, without a required monitoring plan, at a time when the vague nature of the contract statement's of work warranted greater effort to systematically monitor and manage project activities. The lack of sufficient monitoring staff apparently contributed to not preparing a monitoring plan. Thus without the systematic review envisioned, contractor reporting deficiencies and outdated work statements went undetected for long periods. More importantly, USAID/ENI did not have the necessary level of monitoring to ensure that consultants were accomplishing the work at least cost.

> **Recommendation No. 2: We recommend that the Bureau for Europe and New Independent States, in coordination with each USAID Representative, prepare a monitoring plan for each country's activities under the Privatization and Economic Restructuring Project.**

Adequate monitoring should entail the systematic collection and analysis of information on activity inputs, expenditures, and outputs as well as a determination of whether the activity is meeting its purpose. USAID/ENI project officers and USAID/REP staff are responsible for ensuring that inputs, in this case consultants, are used as effectively as possible. Because USAID/ENI did not establish performance indicators or benchmarks in delivery orders, it is even more imperative that USAID/ENI use a systematic monitoring plan.

Beginning in December 1992, the internal policy (contained in the former Regional Mission for Europe's Mission Order 103) stated that monitoring of projects is to be done by the USAID/REP on a systematic basis against benchmarks established in approved work plans. The Mission Order further defines monitoring as "inspections of specific project activities, events, or sites to check whether goods and services financed by USAID are in fact being delivered and are having the intended effects, and how their effects compare with other USAID financed activities."

Another internal policy, (Mission Order 104 of December 1993), further specifies that project officers are responsible for establishing, in coordination with USAID/REPs in each country, an implementation monitoring plan for their sectoral programs and component project activities. Monitoring plans should be based on approved work plans for the project activities. The monitoring would include the scheduling, tracking and reporting of such activities as the in-country placement of personnel, delivery of commodities, products, goods and services, and the accomplishment of agreed-to milestones. These monitoring plans would better ensure that project activities are performed in accordance with USAID/ENI expectations as defined by contract work statements and related benchmarks.

Although the monitoring plan was not prepared as required, monitoring was done but not in the systematic manner envisioned by the internal policies. Our audit found that USAID/ENI project management staff had performed at least nine monitoring trips since January 1993. While other monitoring was performed by USAID/REP staff on an ad-hoc basis, we noted that there was no written plan to formalize monitoring requirements or control contractor progress.

The lack of sufficient monitoring staff contributed to not preparing the monitoring plan. A March 1, 1993 project implementation review by the USAID/ENI project officer explained the difficulties that USAID/ENI staff were having in monitoring the project.

> The Privatization Group, with current and projected staff and located in Washington, D.C., is not yet able fully to monitor the activities underway, and cannot be certain when this capability will be achieved given USDH [direct hire employees] and PSC [personnel services contractors] staffing problems. We understand that the AID/REP [USAID Representative] offices, also understaffed, may have equal difficulties in monitoring...

During a project monitoring visit to the Czech Republic in November 1993, the USAID/ENI officials told us that the staffing situation in Washington was improving, but they had not focused on developing a monitoring plan. According to the USAID/REP project officer, privatization activities in the Czech Republic are numerous. He and his staff are frequently called on by groups interested in the Czech privatization activities. Also, there are several other major USAID privatization projects and this means numerous meetings with various contractors and grantees. Thus, USAID/REP staff has had to take the posture of monitoring activities by primarily responding to problem areas and by accompanying visitors to various project sites. In his opinion, the USAID/REP still does not have the resources to formally monitor project activities. For example, no one performs detailed monitoring of project deliverables for completeness and quality, of the whereabouts of contractor personnel in country, or independent verification of contractor time-charges to the project. He stated that for the Deloitte & Touche/Crimson Capital delivery orders, totalling $12.3 million, to properly monitoring this effort only, as currently structured, he believes that it would require at least one full time employee.

The lack of systematic monitoring also caused some implementation problems to go undetected for long periods of time. For example, USAID/ENI project management had not recognized that 1) KPMG Peat Marwick was not reporting on some activities as described in delivery orders and that 2) the delivery order's work statement had become outdated. These conditions went unnoticed for about ten months.

We believe that USAID/ENI's internal controls over monitoring will be strengthened by preparing a detailed monitoring plan for this project. We believe that reasonable oversight of contractor performance, given the vaguely written scopes of work in these delivery orders, requires the establishment of a monitoring plan, developed in coordination with the USAID/REP.

Management Comments and Our Evaluation

In combining its comments on this report and our similar report on Poland, ENI agreed with the finding and recommendation for establishing formal monitoring plans for the project. ENI mentioned the Bureau had made tremendous strides in the past 12 months in increasing the level of monitoring, but formal plans had not been prepared and the lack of a system results in inefficiency and monitoring gaps. To remedy this situation, and the present confusion over coordinating Washington and field roles in monitoring, ENI stated that the Bureau will soon be tasking each USAID/REP with establishing quarterly monitoring plans and reports for the Privatization Project. ENI believes that this is more workable than establishing monitoring plans for each delivery order.

ENI commented that some of the statements in the drafts may be overstated with respect to the ineffectiveness of the present monitoring. The drafts' statement: "The only basis of contractor accountability was whether the contractor: 1) provided the numbers and types of advisors requested, and 2) stayed within the funding level authorized by USAID. ..." is misleading, as it ignores the substantial amount of project monitoring by the USAID/REP and ENI. In ENI's opinion, the contact with, and feedback from, counterpart institutions was closely maintained, and performance was regularly monitored. ENI went on to state that contractors may not have been accountable to quantifiable benchmarks, as the audit points out, but the contractors were very accountable to project officers and USAID/REPs.

We believe that formalizing monitoring plans for the project, as a whole, should assist in delineating roles between the USAID/REPs and the ENI project officers. These plans should identify the major performance indicators and benchmarks for contractors and, when coupled with quarterly reports, enhance monitoring efforts to reduce the chance for significant gaps. Our comments on contractor accountability are based on our review of the documents and terms of the contracts. We tried to show that monitoring was being done, but we found that it was not systematic and gaps occurred.

SCOPE AND METHODOLOGY

We audited 16 delivery orders awarded on or before September 30, 1993 (See Appendix II) for work performed in the Czech Republic under the Economic Restructuring and Privatization Project 180-0014. These orders, totalling $18.3 million were awarded under indefinite quantity contracts USAID has with the accounting firms of Coopers & Lybrand, Deloitte & Touche, KPMG Peat Marwick, and Price Waterhouse. After analyzing the 16 delivery orders and determining the major activities in the Czech Republic, we concentrated our audit on four delivery orders with Deloitte and Touche and one delivery order with KPMG Peat Marwick, which represented 77 percent of the value of items tested. Our work was done in accordance with generally accepted government auditing standards. We conducted the audit from September 21, 1993 through February 2, 1994.

Our audit work was performed in the offices of the Bureau for Europe and New Independent States (USAID/ENI) in Washington, D.C., the USAID Representative to the Czech Republic in Prague (USAID/REP), the Czech Ministry of Privatization, and the Czech State Savings Bank. The Grants provided under this project to the World Bank and International Finance Corporation, as well as a travel expenditure for a personal service contractor were not reviewed during the audit. Table 1 provides a listing of the awards that we did and did not review as part of our audit of the project.

Although we limited our audit to the Czech Republic, the Economic Restructuring and Privatization Project is being conducted throughout Central and Eastern Europe. As of December 31, 1993, the Bureau's "FACS Obligations and Expenditures" report indicated that USAID had obligated $84.1 million dollars for the overall project and disbursed $43.2 million of this amount.

For the purposes of determining the scope of our audit and reporting on project financial information, we relied on data from the USAID/ENI's computer based project information systems in the Office of Project Development in the former Regional Mission for Europe. Where possible, we confirmed the financial information provided in this report with contract and project documents. Nothing came to our attention to doubt the acceptability of this information for the purposes of determining scope and reporting on project financial information.

Our audit work consisted of an examination of the relevant contracts, review of the project files in the Office of USAID/REP, verification of deliverables required by the respective contracts, and visits to selected contractor work sites. The work sites visited included the Czech Ministry of Privatization, the National Property Fund of the Czech Republic, and the Czech State Savings Bank. In addition, we held interviews with USAID direct hire project officers and staff in Washington, D.C. and the Czech Republic, as well as personal services contractors serving in the role of project officers and project support positions in the USAID/ENI. We also interviewed contractors from three of the four accounting firms whose work we reviewed. We did not interview one of the contractors because the contract was completed and knowledgeable contractor representatives were no longer available in the Czech Republic for an interview. We obtained collaborating comments on the effectiveness of the contractors work from officials of the Government of the Czech Republic. While in Prague we also contacted representatives of the U.S. Embassy, and Czech and foreign businesses who provided some additional information and perspectives about the project overall and the work of the contractors.

To provide an answer to our third audit objective on compliance by USAID/ENI offices with mission orders of the Regional Mission for Europe, we examined the specific mission orders, as well as USAID handbooks and relevant laws and regulations including the Foreign Assistance Act and SEED Act. We relied to the extent indicated in the text of this report on other audit and evaluation work as reported in:

> USAID Office of the Inspector General (OIG) Audit of the Bureau for Europe's Technical Assistance Contracts (Report No. 8-180-93-05 issued June 30, 1993),
>
> OIG Audit of the Office of Procurement's Management of the Award and Administration of Technical Services Contracts (Report No. 9-000-93-004 issued March 31, 1993),
>
> U.S. General Accounting Office Report on Eastern Europe: AID's [USAID's] Indefinite Quantity Contracts Assist Privatization Efforts But Lack Adequate Oversight; (GAO/NSIAD-94-61, issued January 1994), and
>
> USAID Evaluation Final Report "Privatization Phase II Program Evaluation (Contract No. 180-0014 issued July 30, 1993).

We verified some of the results of these reports through interviews with USAID, Czech Republic and contractor representatives. Nothing came to our attention to doubt the validity of the conclusions in these reports.

Since our review focused only on activities in the Czech Republic that were part of the Economic Restructuring and Privatization Project, we did not conduct sufficient testing that would provide us with the necessary level of confidence to report on the overall compliance by the Europe and New Independent States Bureau's or USAID/REP's with applicable laws and regulations or adherence to internal controls. Accordingly we are not issuing a separate "Report on Internal Controls" or "Report on Compliance." However, we did note one material internal control weakness whereby the USAID/ENI project officer and the USAID/REP had not followed internal procedures on preparing a monitoring plan. We did not note any other material internal control weaknesses or lack of compliance as they pertained to the project activities in the Czech Republic.

Contractor	Assistance Recipient	Activity	Funds Obligated
AWARDS REVIEWED DURING THE AUDIT			
Price Waterhouse	Municipal Governments	Solid Waste Disposal	$280,388
Price Waterhouse	Ministry of Industry	Assist in Privatizations of State Owned Enterprises	$1,689,820
Coopers & Lybrand	CSAEF* and Enterprise	Financial Analysis of State Owned Enterprise	$93,020
Coopers & Lybrand	CSAEF and Enterprise	Financial Analysis of State Owned Enterprise	$82,430
Deloitte & Touche	CSAEF and Enterprise	Financial Analysis of State Owned Enterprise	$81,350
KPMG Peat Marwick	CSAEF and Enterprise	Financial Analysis of State Owned Enterprise	$79,261
KPMG Peat Marwick	Czech Ministry of Industry	Privatization Sector Analysis - Non-ferrous Metallurgy	$710,350
Deloitte & Touche	Czech Ministry of Industry**	Privatization Sector Analysis - Telecommunications/Utilities	$342,000
KPMG Peat Marwick	Czech Ministries of Health and Finance	Development of Health Care Non-Profit Sector	$599,488
KPMG Peat Marwick	Ministry of Economy**	Development of Standardized Management Contracts	$37,000
KPMG Peat Marwick	Ministry of Economy	Advisor to Ministry of Economic Policy and Development	$233,220
KPMG Peat Marwick	Czech Saving Bank	Bank Management Consulting	$1,815,880
Deloitte & Touche	Czech Ministry of Privatization	Assistance with Privatizations Involving Foreign Investors	$479,250
Deloitte & Touche	Czech Ministry of Privatization	Assistance with Privatizations Involving Foreign Investors	$4,585,000
Deloitte & Touche	Czech Ministry of Privatization	Assistance with Privatizations Involving Foreign Investors	$2,000,000
Deloitte & Touche	Czech Ministry of Privatization	Assistance with Privatizations Involving Foreign Investors	$5,217,373
AWARDS NOT REVIEWED DURING THE AUDIT			
Contractor	**Assistance Recipient**	**Activity**	**Funds Obligated**
International Finance Corp.	Skoda Pilsen	Grant to Assist in Privatization of State Owned Enterprise	$500,000
World Bank			$20,000
Personal Services Contractor	Project Operating Expense	Travel	$4,631

* CSAEF: Czech and Slovak American Enterprise Fund

** Czech Republic portion of delivery order for work in the Czech and Slovak Republics

MANAGEMENT COMMENTS

USAID
U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MAY 13 1994

MEMORANDUM

TO: RIG/A/Bonn, John P. Competello

FROM: DAA/ENI, Barbara Turner

SUBJECT: Draft Response on the Audit of Economic Restructuring and Privatization Activities in the Czech Republic and Poland Under Project No. 180-0014

We appreciate the opportunity to respond to the Poland and Czech Republic draft audit reports for privatization and economic restructuring activities. Since the narrative and recommendations for the two programs are very similar, we are providing only one set of formal comments. Where the discussion is particular to one of the programs, it is so indicated.

We believe that both audits are thorough and fair efforts and appreciate the citation of some of the positive accomplishments of both programs. As you suggest in your covering memo, we do intend to use your observations and recommendations for these two countries as lessons learned and we will issue appropriate instructions for project officers concerned with privatization and economic restructuring in other CEE countries.

We agree that we can and must do better in measuring performance, and we are fully committed to USAID's reform agenda, including measuring outputs more effectively. We believe we have steadily moved to better define deliverables under our privatization delivery orders, and are fully prepared to take additional steps, as noted below, to shift our emphasis from deliverables to specific benchmarks. We regret if we were overly defensive in our earlier comments, and trust we can be seen as a willing partner in changes we agree are needed.

Following are specific comments on the recommendations in both draft reports and some comments on a few points raised in the narratives.

Recommendation No. 1: We recommend that the Bureau for Europe and New Independent States:

1.a. In coordination with the USAID Representative, establish specific objectives, performance indicators, and benchmarks in each delivery order statement of work (or the work plan under the delivery order); (Poland)

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Recommendation No. 1: We recommend that the Bureau for Europe and New Independent States establish specific objectives, performance indicators, and benchmarks in each delivery order statement of work (or the work plan under the delivery order) and in coordination with the USAID Representative, revise current delivery orders to meet these requirements. (Czech Republic)

As of April 22, 1994, all new delivery orders issued under the Privatization Project for Eastern Europe (180-0014) will include specific statements of objectives, performance indicators, and benchmarks of performance expected over defined time periods. A copy of the e mail notification of this policy is attached. Because project performance, and not just contractor performance, is our ultimate objective, some indicators and benchmarks will obviously cover time periods and actions which go well beyond a specific delivery order. We will do our best to provide balance between narrow and broad measures of performance.

For the Czech Republic we request the recommendation to revise current delivery orders be dropped. The recent CSOB delivery order is the only long-running program now under contract. The present work with Ministry of Privatization will run out in September, and new delivery orders, which will include benchmarks, are now being designed. For the two ongoing ones, rather than formally amending current delivery orders, which would be a time consuming contractual process, we recommend that the same effect be attained through revising work plans with the contractors.

1.b. Continue to follow-up with contractors to obtain the required work plans for the current delivery orders. (Poland)

We believe that the plans required in these delivery orders have been submitted.

<u>Recommendation No. 2:</u> We recommend that the Bureau for Europe and New Independent States, in coordination with the USAID Representative to Poland, complete a monitoring plan for the activities under the Privatization and Economic Restructuring Project.

Recommendation No. 2: We recommend that the Bureau for Europe and New Independent States, in coordination with the USAID Representative for the Czech Republic, prepare a monitoring plan for the activities under the Privatization and Economic Restructuring Project.

The basis of this recommendation is found on p. 13 of the Poland audit: "However, we found that while project monitoring was performed, the USAID/ENI and USAID/REPs had not prepared a formal written plan, directing monitoring to the most critical areas."

MANAGEMENT COMMENTS

We agree with this finding, and the recommendations. Although the Bureau has made tremendous strides the past 12 months in increasing the level of monitoring, it is correct that formal plans have not been prepared, and that lack of a system results in inefficiency and monitoring gaps.

To remedy this situation, and the present confusion over coordinating Washington and field roles in monitoring, we will soon be tasking each AID Representative with establishing quarterly monitoring plans and reports for the Privatization Project. We believe this is more workable than creating a plan for each delivery order. We will be working with the AID Representatives to define the contents and process of this quarterly process.

We believe that some of the statements in the draft audits' text may be overstated with respect to the effectiveness of present monitoring. In particular, the sentence on p.ii, of both reports stating "The only basis of contractor accountability was whether the contractor: 1) provided the numbers and types of advisors requested, and 2) stayed within the funding level authorized by USAID" is misleading as drafted, as it ignores the substantial amount of project monitoring undertaken by the AIDRep Office and ENI. Contact with, and feedback from, counterpart institutions was closely maintained, and performance was regularly monitored. This went beyond just the numbers and funding levels and gets into the impact and results of the project. Contractors may not have been accountable to quantifiable benchmarks, as the audit points out, but they were very accountable to project officers and AIDReps.

Other Comments on the Text

p.i, in both reports mentions 11 countries. We are working or will very soon have activities in 12 countries and Eastern and Central Europe.

p. 6, in both reports. The paragraph as drafted hints that there may be something wrong with having IQCs over 120 days. While 120 days is the norm in AID, these are not usual IQCs and were never intended to have short limits as is the case with "normal" IQCs.

They would not work if they did, and from the beginning were set up, advertised and contracted to be much longer term.

Please refer to our opening remarks with respect to the statement on p. 11, of the Czech Report, "that after three years, USAID/ENI still believes that better task definition(s) cannot be done." Without the constraints of urgency in our earlier programs, improvements can be made and are endorsed in our comments.

p.12, Poland Report. Several sentences in paragraph two hint at a question as to whether evaluation recommendation were in fact used in designing new activities. We believe that the record

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speaks for itself here; it is clear that activities in Poland since the evaluation are fully consistent with evaluation recommendations.

We again thank you for your inputs and for taking into consideration our comments above in your final report.

MAMAGEMENT COMMENTS

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Barbara Howard@EUR.RME@AIDW
Bcc: Barbara Turner@OPS.CIS@AIDW
From: Gordon West@EUR.RME@AIDW
Subject: Privatization Benchmarks
Date: Friday, April 22, 1994 8:36:46 EDT
Attach:
Certify: N
Forwarded by:

Effective today, April 22, 1994, all new delivery orders under the 180-0014 Privatization Project must include both a clear statement of the objective of the delivery order, and benchmarks of performance. The objective statement is expected to be short and to the point. The benchmarks section should include clear performance indicators and benchmarks for reasonable intervals of performance. In some cases you may need benchmarks at one or more points before the delivery order is completed; in others there may be only benchmarks at the end; and in others yet there may be benchmarks at the end and then one or two years after the work is completed if for instance actual sales of firms by the host government may lag completion of contractor work.

In order to have this information for the delivery order, it must be included in the PIOTs as a distinct section of the scope of work. For PIOTs already in contracts, project officers will need to prepare these statements separately and get them to OP promptly. These may be discussed with the contractors since they will have to agree with the reasonableness of the targets. We do not however want to just ask the contractors to name their own benchmarks. They may have advice, but this should be our management tool to measure performance. There will be a learning curve on this, and some delivery orders will obviously be easier to nail down than others. Do your best.

We will meet soon in AID/W to discuss initial progress/problems once project officers have given it a first shot. Field comments are most welcome, since the next step coming will be the field taking over full responsibility for all monitoring of delivery orders. (A separate message on proposed new monitoring program structure will be coming out shortly for field

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input/comment.) These actions are both consistent with the directions the Bureau and Agency are headed, and recommendations coming from recent audits of the Czech and Polish privatization programs. While there were earlier discussions concerning the difficulty of precisely defining this type of work in a changing environment, we must do better and this is a first step. Richard Burns, Mark Karns and Gordon West are ready to help on specific issues that come up. Your best efforts on this are greatly appreciated. Thanks! Gordon

MANAGEMENT COMMENTS

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Barbara Turner@OPS.CIS@AIDW, James B. Durnil@IG@AIDW
Bcc:
From: Gordon West@EUR.RME@AIDW
Subject: Benchmarks for Privatization
Date: Monday, April 25, 1994 16:59:11 EDT
Attach:
Certify: N
Forwarded by:

Further to the April 22 notice on establishing benchmarks for all privatization delivery orders, it already is apparent that many situations lend themselves to establishing the benchmarks and detailed performance indicators in the initial workplan required under the delivery order rather than the delivery order itself. This will be an acceptable alternative provided the delivery order itself states the objective and incorporates by reference the workplan statement of benchmarks and indicators, and defines explicitly the time frame by which the workplan is expected. In no case should this time frame exceed 60 days from the date of the delivery order unless waived by the division chief because of unexpected delay in the start up of work. I look to the division chief for privatization to ensure the consistency in quality of benchmarks and indicators, and to also ensure the benchmarks are either a USAID or a joint USAID/contractor product, and not merely a rubberstamp of the contractor's work. There are other cases suchas the regional diagnostics delivery order that Laurie Landy manages, where the benchmarks will be provided under individual scopes of work for discrete pieces performed, or under workplans submitted against respective scopes of work. This is also acceptable given the same time frames of submission noted above.

Bottom line: Workplans are an acceptable alternative mode to define benchmarks and indicators, but this should be spelled out in the delivery scope of work as well as time schedule for receipt. And this is principly our responsibility to get it right, not the contractors. I wouuld like to emphasize that this is a serious undertaking, even though a royal pain. If you feel there aren't enough hours in the day to get this and everything else done, don't gloss over it -- tell us. Perhaps we will need more contract or other assistance to help us institute this process.

MANAGEMENT COMMENTS

Thanks! Gordon