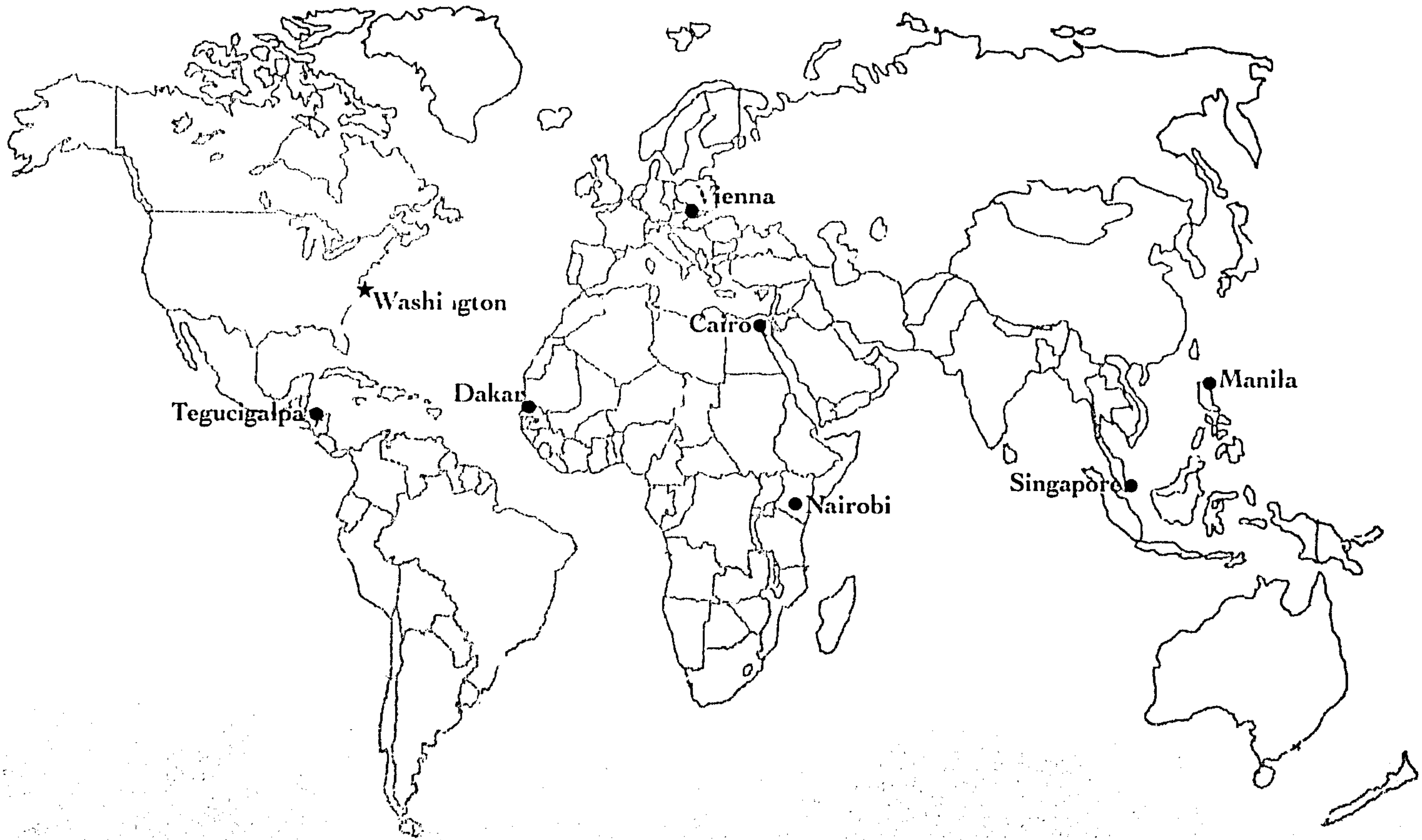
PD-ABJ-473

Regional Inspector General for Audit
Bonn

Audit of Economic Restructuring And Privatization Activities In Poland Under Project No. 180-0014

Report No. 8-180-94-011
June 30, 1994



INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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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 Poland Under Project No. 180-0014 (Audit Report No. 8-180-94-011)

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 the Czech Republic, 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 and are considered resolved based on your agreement that the actions are warranted and your promise to implement them. We will close the recommendations in this report in conjunction with our report on the Czech Republic (Audit Report No. 8-180-94-010). If you have any questions in this regard, please let us know.

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 Poland 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 Poland share management responsibility for the activities in Poland (See pages 1 to 3).

As of December 31, 1993, USAID had provided about $23.3 million for project activities in Poland. 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 Poland. 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 Poland. 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. For delivery orders issued prior to September 1993, we could not measure how well nor to what extent the contractor performed work in delivering technical assistance. However, three recent delivery orders (amounting to $11.3 million) demonstrated improvement in defining contractor requirements. While these did not fully identify performance indicators and/or benchmarks, the contractors were required to submit work plans containing necessary performance measures. 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 Poland could improve efforts in 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 and scopes of work had improved, ENI and the USAID/Representative still needed to establish 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, in coordination with USAID/Representatives, establish monitoring plans for project activities in each country (See page 13).

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 Poland. 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 15).

Office of the Inspector General

Office of Inspector General
June 30, 1994

Eastern Europe

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INTRODUCTION

Background

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

- Private sector development;
- Development of the financial sector;
- Public sector transformation to support democratic development and a market economy; and
- Strengthening institutions essential for sustainable democracy.
- Management training

According to the U.S. Embassy in Poland, economic statistics indicate that Poland has made strides in progressing toward a free market economy since the transition from communism began in 1989[1]. About 40 per cent of state-owned enterprises have entered into the privatization process and 27 per cent have been privatized as of September 30, 1993.

Although progress is being reported, the Polish Ministry of Privatization reports that of the 8,441 Polish state-owned enterprises registered in 1990, some 6,000 remain to be privatized. In addition, over 1,000 state-owned enterprises have been forced into bankruptcy through Poland's State Enterprise Act. According to a USAID study, the health of Poland's banks

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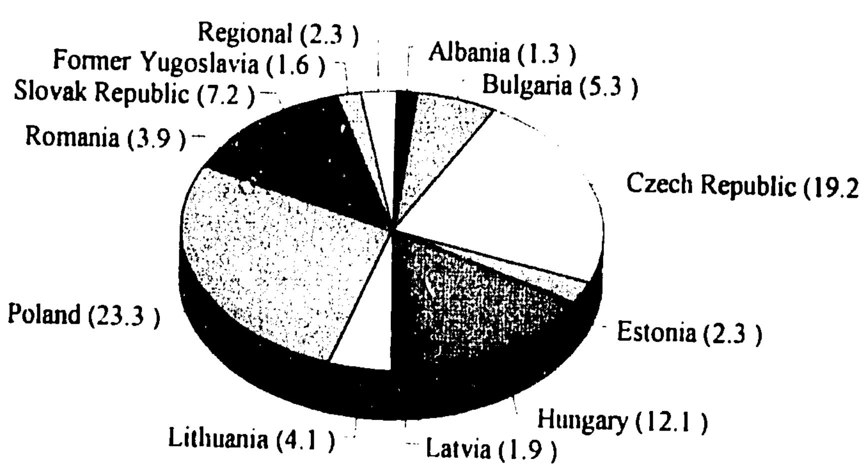
[1] Statistics provided by Economic Office, U.S. Embassy Warsaw. Supplementary information from "Poland's Emerging Financial System: Status and Prospects", USAID report prepared by Development Alternatives, Inc.; Contract PDC-0095-Z-00-9053-12; August 1993.

remains suspect, with many financial institutions holding large portfolios of non-performing loans. Only two of Poland's nine large domestic commercial banks have been privatized.

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 to assist in reforming the economic systems of Central and Eastern Europe to establish viable private sectors which can be the basis for sustained, broad based economic growth.

The project was first authorized in August 1990 at a funding level of $25 million with completion set for June, 1995. As of December 1993, project funding had increased to $150 million, with $84.1 million obligated and $43.2 million disbursed. Initially the project included three countries—Poland, Hungary, and Yugoslavia—but at the time of our audit, it had been expanded to cover 11 countries in Central and Eastern Europe. As such, the project is one of the most important of USAID's efforts to assist privatization in these countries. Figure one below shows the distribution of project funding 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 (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 creating one bureau for ENI. The USAID/Representative to Poland in Warsaw has project oversight and monitoring responsibilities in Poland.

Audit Objectives

As part of our fiscal year 1994 audit plan, the Office of the Regional Inspector General for Audit in Bonn audited activities in Poland 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 Poland follow their internal policy and procedures for monitoring and evaluating project activities in Poland?

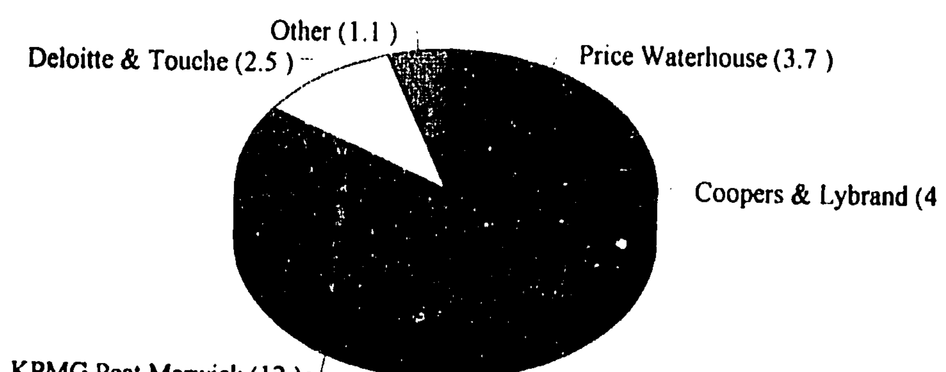
Appendix I contains a discussion of the scope and methodology for this audit.

REPORT OF AUDIT FINDINGS

What assistance has been provided by the USAID funded contractors?

As of December 31, 1993, USAID obligated $23.3 million for activities in Poland under the Economic Restructuring and Privatization Project (180-0014). USAID provided technical assistance through contracts and small grants to Government Ministries and to Polish state-owned enterprises. Initially, USAID provided technical assistance under an existing contract with Price Waterhouse for $3.7 million. Later, USAID began providing assistance using indefinite quantity contracts (IQC) awarded specifically for this project. The IQCs were with three U.S. public accounting firms—Deloitte & Touche; Coopers & Lybrand; and KPMG Peat Marwick. In Poland, these three firms provided technical services—advisors and consultants—at a cost of about $18.5 million. The following chart depicts the total obligations for each of the four contractors in relation to total obligated funds for this project in Poland.

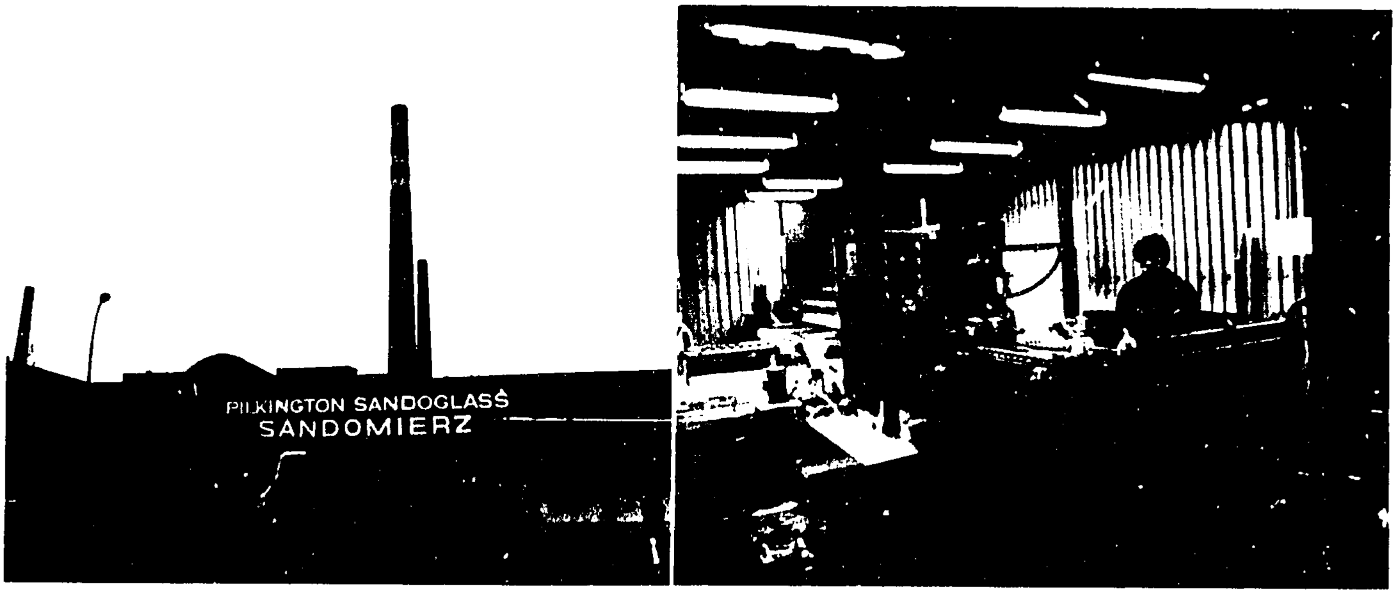
Project Funding in Poland
as of September 30, 1993
(millions of U.S. dollars)



Under these contracts with the U.S. public accounting firms, USAID awarded delivery orders which identified project activities for each contractor to address. Work required under the delivery orders varied from providing financial analysis and valuation of specific state-owned enterprises to across the board analysis of an industrial sector. Also, training was included in some delivery orders — usually formal seminars or on-the-job training programs. Technical assistance was directed at privatizing banks and businesses and facilitating the role of various Government of Poland ministries. To respond to this diversity of requirements, the USAID financed contractors formed teams consisting of accountants, lawyers, economists, investment bankers, marketing specialists and industry specific experts, as needed, to address the tasks under the delivery orders.

In Poland, these contractors were involved in 12 separate activities spanning 19 individual delivery orders. A listing of activities and delivery orders is given in Appendix II. Below are some examples of the assistance provided:

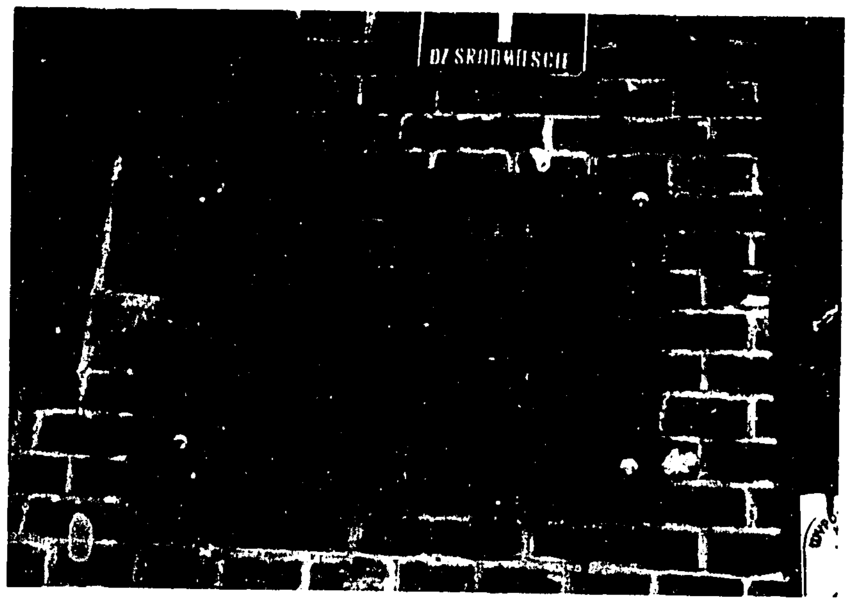
- Sector and individual firm analysis of 34 state-owned glass enterprises—three delivery orders amounting to about $3.7 million, and analysis of 70 furniture enterprises—two delivery orders amounting to about $2.5 million.



(Left to Right) The privatized Pilkington Sandoglass glass factory and a worker pr glass products at the plant. Privatization assistance was provided through USAID funding.

- Banking assistance for the National Bank of Poland, to develop a bank examiner's manual and conduct workshops—two delivery orders amounting to about $1.0 million.

- Firm-specific privatization and restructuring assistance for the Polish airline (LOT)—two delivery orders amounting to about $1.1 million, and state-owned steel enterprise (Huta Warszawa)—one delivery order amounting to about $100,000.



In September 1993, three new activities with a combined funding of $11.4 million, doubled the value of the project activities in Poland from the previous $10.8 million total to $22.3 million. Two of the new activities, which called for placing nearly a dozen investment bankers into two Polish banks (the Bank Przemyslowo Handlowy of Krakow and the Powszechny Bank Kredytowy of Warsaw), were both funded at $3.9 million. The third new activity—funded at $3.6 million—places investment bankers in various departments of Poland's Ministry of Privatization.

The delivery orders issued under the three IQC contracts awarded specifically for this project were structured somewhat differently than USAID's normal IQCs. 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 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, one accounting firm is billing USAID $950 for project managers on the fixed daily rate basis. 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.

Another difference concerns USAID's normal practice to limit the period of IQC delivery order to 120 days, recognizing that delivery orders are for specific events of limited duration. Some exceptions to the 120 day rule are allowed, but only with strong justification. However, under the IQCs used in Poland, services 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 22 contractors working on different project activities. Under each of the new delivery orders, we estimate that billings may reach over $200,000 a month.

Management Comments and Our Evaluation

USAID/ENI combined its comments on Poland activities with its comments on our draft report on project activities in the Czech Republic. Essentially USAID/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 technical assistance has furthered .. . Government of Poland's objective of fostering privatization and economic restructuring. A report issued by a USAID financed evaluation team concluded that U.S. assistance had met with mixed results. Also, the U.S. General Accounting Office generally found that ' use of indefinite quantity contracts was an effective method for providing technical as ..ance. However, the audit showed that vague work statements provided to the contractors and the lack of performance indicators or benchmarks, made it difficult for us to measure contractor performance.

A July 1993 USAID financed independent project evaluation[2] stated that USAID assistance had mixed results. The report concluded that the ultimate objective for the USAID assistance — e.g., privatization — had progressed, but not as quickly as expected. The evaluation report estimated that about two thirds of the project activities achieved success or had supported activities that achieved mixed results. The report also stated that about one third of the project activities were not effective.

A January 1994 report by the U.S. General Accounting Office (GAO)[3] stated that host government officials interviewed by GAO in Poland 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.

Recipients of the USAID financed technical assistance at the Polish Government Ministries and the firms we visited told us that, in general, they believed that the assistance provided by the short- and long-term consultants from the U.S. accounting firms had contributed to Poland's efforts toward economic restructuring and privatization. For example, the Polish official in charge of coordinating foreign assistance at the Ministry of Privatization stated that only foreign advisors, trained in Western business and management practices could provide the level of expertise needed by the Ministry. Although other recipients that we met with

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2 USAID Evaluation Report "Privatization Phase II Program Evaluation", Project No. 180-0014 July 30, 1993.

3 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.

expressed similar comments, some stated that project activities were not always complete successes.

Notwithstanding the above reports and comments on the merits of the USAID financed technical assistance, our audit identified factors which, in our view, detracted from the claimed success of this effort. We found that contractors were allowed to work with general statements of objectives and without the benefit of performance indicators and benchmarks. Under these circumstances, there was little to hold contractors accountable for, other than providing the numbers and types of advisors called for, and staying within the established overall budget. We found that the USAID/REP in Poland had recently taken action to require more definitive work statements and obtain meaningful reports on performance. The previously cited GAO report and USAID Inspector General reports[4] issued in 1993 noted the same problems in defining just what contractors were expected to do in carrying out their responsibilities in work orders issued under these IQCs.

Delivery order statements of work, while improved, still need quantitative performance indicators or benchmarks.

USAID policy and procedures require project officers to specify quantifiable progress indicators in contract scopes of work, including delivery orders. Delivery order work statements (or work plans) for activities in Poland awarded prior to September 1993 did not contain, in most cases, quantifiable progress indicators, specific task definitions, or associated budgets and schedules. Thus, for most delivery orders, we could not measure how well nor to what extent 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. Project officials stated that the newness of the program, the need to get started as soon as possible and the lack of knowledge about Poland caused them to provide only general work statements to contractors. However, three recent delivery orders (amounting to $11.3 million), while not fully identifying performance indicators and/or benchmarks, did require contractors to submit work plans containing the necessary performance measures. At the time of audit, the contractors were late in submitting these work plans.

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- 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.
- Audit of the Bureau for Europe's Technical Assistance Contracts, Report No. 8-180-93-05, Issued June 30, 1993.

<u>Recommendation No. 1:</u> 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[5] require quantifiable progress indicators in contract scopes of work, including delivery orders. This policy 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 USAID/ENI's internal policies. Specifically, Mission Order No. 503[6] 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 descriptions of services should outline to the greatest degree practicable the specific services the contractor is expected to perform.

The 1993 USAID evaluation of this project also highlighted the need for such performance indicators. The evaluation report stated that USAID should focus on monitoring a set of indicators that show whether the technical assistance is achieving the goals included in the scopes of work. The report commented further that indicators are intended to directly measure the impact of USAID assistance and are considered important enough to warrant constant attention by USAID managers. The evaluation stressed the need for quantifiable indicators by stating that: "... In order to provide timely and meaningful management guidance, any proposed indicators should be easily definable, obtainable and attributable."

Our audit determined that the contract work statements for most of the delivery orders signed before September 1993 (amounting to $10.8 million in project funding) did not always specify what USAID/ENI expected the contractors to do in terms of task accomplishment, associated budgets and scheduled performance. Furthermore, the scopes of work did not always include quantifiable performance indicators or benchmarks needed for measuring contractor performance. According to project officials, the newness of the program, the need to get started as soon as possible and the lack of knowledge about Poland caused them to provide only general work statements to contractors.

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5 USAID Handbook 3, Supplement A, (Appendix C).

6 Mission Order 503 (December 1993) Attachment A, page 10.

Of the 16 delivery orders awarded prior to September 1993, the following description of the scopes of work for two delivery orders demonstrate this point.

- A September 1992 delivery order to Deloitte & Touche—valued at $342,660—contained vague objectives and did not have performance indicators. The objective of this delivery order was to prepare companies for pilot privatization through a restructuring program and then select management groups for negotiating the restructuring of these companies. The scope of work called for these firms to develop business profiles and suggested it would be "helpful" if Deloitte assisted in the profile development.

- A June 1992 delivery order to KPMG Peat Marwick—valued at $495,000—contained vague objectives and did not have a schedule showing when tasks should be completed. The scope of work called for preparing a "realistic" and detailed implementation plan for distributing and trading of National Investment Fund shares in Poland. Although weekly progress reports were required, there was no definition of a realistic plan or the degree of analysis expected. Also, there was no requirement for an overall schedule for completing tasks.

We found, however, a significant improvement in identifying performance indicators in three delivery orders awarded in September 1993, valued at $11.4 million. Two of the new delivery orders (for activities to improve investment banking services at two Polish commercial banks) provided established objectives and sub-objectives in the areas of portfolio management and investment banking/corporate finance. While being more specific than earlier delivery order statements of work, these still did not contain quantifiable performance indicators. Instead, the contractor's work plan is to incorporate an assistance start-up plan, which is to include a description of how activities are to be organized, the distribution of work between tasks, and the coordination with other assistance programs. These delivery orders require contractor progress reports to include a bar chart illustrating proposed timing of activities and objective completion at each stage of the activities.

The improvement in these delivery orders can partly be attributed to the involvement of the USAID/REP and recipient banks in outlining the scope of work for the USAID/ENI project officer. The investment by the USAID/REP in providing staff to help prepare and finalize these orders should allow for better assessment of contractor performance. Unfortunately, at the time of our audit, contractors were several weeks late in submitting these work plans.

The efforts by the USAID/REP and ENI on the recent delivery orders should, if properly implemented, bring activities in Poland more in line with the actions called for in the

Administrator's procurement reform program for USAID. 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 which has been used in Poland. The USAID/REP's proactive involvement in the development of the scopes of work for the three latest delivery orders and its efforts to involve the Polish institutions in defining work to be performed by contractors moves USAID closer to performance based contracting in this project.

However, we still believe that continued improvement should be made in existing delivery orders to specifically require performance indicators in work plans. Also, USAID/ENI needs to continue following up with contractors to obtain the required work plans.

Management Comments and Our Evaluation

USAID/ENI coupled its comments on the Poland draft report with its comments on our similar draft report on the Czech Republic 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 specific delivery order. For Poland, ENI reported that it believed that the contractors in Poland had submitted the required work plans for the current delivery orders.

The ENI action goes beyond our recommendation for Poland and the Czech Republic activities, and essentially addresses concerns for the project as a whole. Because ENI recognized the issues brought out in this report and our Czech Republic 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 draft audit recommendation for Poland based on the ENI policy statements, and ENI's belief that work plans were submitted for delivery orders requiring these at the time of audit.

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

The USAID/ENI project manager and the USAID/REP in Poland generally followed internal policy and procedures for evaluating project activities. With regard to monitoring, we concluded that additional monitoring efforts are needed when contractor work statements are vaguely written. While monitoring took place and contractor work statements have improved, USAID/ENI and the USAID/REP still need to establish a formal monitoring plan. Similarly, the General Accounting Office reported in January 1994 that USAID 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 and financed by USAID, were performed by independent contractors. USAID/ENI project officers stated that they considered the evaluation recommendations in managing the project. For instance, sector studies—which the evaluation recommended be discontinued—are no longer being planned for future project activities. According to the USAID/ENI project officer, the evaluation report recommendations were utilized in the design of the most recent (September 1993) delivery orders for technical assistance to Poland.

Concerning monitoring in Poland, our audit disclosed that although the USAID/REP had given emphasis to monitoring technical assistance contractors, we do not consider it 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 reporting necessary to monitor the level of effort provided by long- and short-term advisors was unavailable to USAID/REP and responsible officials of the Government of Poland. However, due to the recency of the GAO report and the planned corrective actions by USAID addressing GAO's concerns, we are addressing a material internal control weakness of not having a monitoring plan for the activity. This area was not specifically addressed in the GAO report.

Monitoring Plan Needed
For Adequate Oversight

USAID/ENI internal policies require that monitoring be done on a systematic basis. This is even more important when, as in Poland, delivery order contracts do not contain performance indicators or benchmarks, or specifically describe the end product of the delivery order. However, we found that while project monitoring was performed, the USAID/ENI and USAID/REP had not prepared a formal written plan, directing monitoring to the most critical areas. This occurred, in part, because of insufficient staffing in 1993. The USAID/REP's program-wide monitoring plan was still being developed; therefore, USAID/ENI's internal control for ensuring that monitoring is adequately directed and complete was ineffective.

> <u>Recommendation No. 2:</u> **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.

The internal policy contained in the former Regional Mission for Europe's Mission Order 103 states 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 dated 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.

Our audit found that although the requirement for this plan was established in July 1993, the USAID/ENI and USAID/REP had not yet prepared a monitoring plan. According to project officials this occurred, in part, because of insufficient staff in Washington and overseas in 1993. The staffing situation has improved. The USAID/REP was, however, in the process of developing the program-wide monitoring plan. USAID/REP project officials stated that they did not have the staffing resources until recently to adequately develop a monitoring plan. As a result, the USAID/REP has to determine monitoring priorities based on problems reported by the Polish recipients and the U.S. contractors and not priorities based on the mutual needs of USAID/ENI and USAID/REP.

While monitoring was being done without the required plan, it was not being done with the type of structure envisioned by the internal policy. This resulted, in our opinion, in a weakness in USAID/ENI's internal controls over project monitoring. If the work plans in the three recent delivery orders provide the performance indicator information required, then USAID/ENI and USAID/REP can utilize those work plans as the basis of their monitoring plan.

Management Comments and Our Evaluation

In combining its comments on this report and our similar report on the Czech Republic, USAID/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, and it is correct that 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 Representative 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 stated 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 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 19 delivery orders awarded on or before to September 30, 1993 (See Appendix II) for work performed in Poland under the Economic Restructuring and Privatization Project 180-0014. These orders, totalling $22.3 million were awarded under USAID contracts with the U.S. accounting firms of Coopers & Lybrand, Deloitte & Touche, KPMG Peat Marwick, and Price Waterhouse. Our work was done in accordance with generally accepted government auditing standards. We conducted the audit from January 10, 1994 through March 18, 1994.

Our audit work was performed in the office of the USAID Representative to Poland in Warsaw (USAID/REP) and contractor/assistance-recipient work sites. Neither grants nor contracts awarded prior to fiscal year 1991 were reviewed.

Although we limited our audit to activities in Poland, 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 and disbursed $43.2 million for the overall project.

For the purposes of determining the scope of our audit and for reporting on project financial information, we relied on data from USAID/ENI's computer based project information systems. 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 the scope of our audit or 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 PBK

Bank of Warsaw, LOT Airlines, BPH Bank of Krakow, the National Bank of Poland, the Polish Ministry of Privatization, and the Pilkington Sandoglass and Huta Szkla Jaroslaw glass factories. In addition, we held interviews with USAID direct hire project officers and staff in Washington, D.C. and Poland, 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 obtained collaborating comments on the effectiveness of the contractors work from officials of the Government of Poland. While in Poland, we also interviewed individuals of the U.S. Embassy who provided 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 Report "Privatization Phase II Program Evaluation (Project No. 180-0014 issued July 30, 1993).

We verified some of the results of these reports through interviews with USAID, Polish, 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 Poland 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 Europe and New

Independent States Bureau's or USAID/ENI's overall compliance 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 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 internal control weakness or lack of compliance as they pertained to project activities in Poland.

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USAID Technical Assistance Provided by U.S. Accounting Firms for the Privatization and Economic Restructuring Project in Poland as of September 30, 1993			
U.S. Accounting Firm	Assistance Activity	Date of Obligation	Funds Obligated
Coopers & Lybrand	Huta Warszawa Privatization	12/06/91	$106,553
	PBK Bank of Warsaw Assistance	09/30/93	$3,933,145
Deloitte & Touche	Ancillary Assets Privatization	05/18/92	$656,800
	LOT Airlines	12/31/91	$762,100
	LOT Airlines	08/21/92	$303,915
	Privatization through Restructuring	09/10/92	$342,660
	Securities Commission	05/01/92	$453,140
KPMG Peat Marwick	BPH Bank of Krakow Assistance	09/30/93	$3,600,788
	Banking Supervision	01/31/92	$446,030
	Banking Supervision	05/19/93	$547,983
	Banking Supervision (Regional Award)	09/01/93	$542,366*
	Furniture Sector Privatization	06/10/92	$1,300,035
	Furniture Sector Privatization	01/01/93	$1,263,360
	Mass Privatization Program	01/14/92	$420,920
	Mass Privatization Program	06/01/92	$495,000
	Ministry of Privatization Assistance	09/30/93	$3,915,245
Price Waterhouse	Glass Sector Privatization	09/01/91	$2,204,486
	Glass Sector Privatization	07/01/92	$1,415,430
	Glass Sector Privatization	05/19/93	$116,383
Total Obligations (* Regional award excluded from total)			$22,283,973

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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 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)

MANAGEMENT COMMENTS

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.

<u>Other Comments on the Text</u>

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

To:	Richard Burns@EUR.RME@AIDW William Binns@EUR.RME@AIDW,Jim Grossman@EUR.RME@AIDW MARK ABRAMOVITCH@EUR.RME@AIDW Kelly Keyes@EUR.RME@AIDW,Mark Karns@EUR.RME@AIDW Nataki Reynolds@EUR.RME@AIDW,Frank Vita@EUR.RME@AIDW Gary Maher@EUR.RME@AIDW,Lawrence Camp@EUR.RME@AIDW William Penoyar@EUR.RME@AIDW Laurie Landy@EUR.RME@AIDW,Jean Lange@EUR.RME@AIDW Brandon Prater@EUR.RME@AIDW Kimberley McKeon@EUR.RME@AIDW William Anderson@EUR.RME@AIDW Donald L. Pressley@AIDREP@WARSAW Carl Duisberg@AIDREP@WARSAW Eve Anderson@AIDREP@WARSAW,John Rogers@IRM.SDM@AIDW Bratislava@Bratislava@Europe Mitzi Likar@AIDREP@BUDAPEST,Zagreb@Zagreb1@Europe Tallinn@Tallinn@Europe,Riga@Riga@Europe Vilnius@Vilnius@Europe,Diane Howard@OP.A@AIDW Mark Walther@OP.A@AIDW
Cc:	Amanda Kim@EUR.RME@AIDW,Ted Landau@EUR.RME@AIDW Maria Mamlouk@EUR.RME@AIDW 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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MANAGEMENT COMMENTS

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

To: Richard Burns@EUR.RME@AIDW
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Cc: 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 àcceptable 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