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Report to the Chairman, Subcommittee on Oversight of Government Management, Committee on Governmental Affairs, U.S. Senate

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FOREIGN ASSISTANCE

AID Can Improve Its Management and Oversight of Host Country Contracts

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GAO

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The Honorable Carl M. Levin
Chairman, Subcommittee on Oversight
of Government Management
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

In response to your request, we have reviewed the Agency for International Development's (AID) policies and procedures for host country contracting at AID missions in Bangladesh, Egypt, Jordan, and Pakistan.

We are sending copies of this report to the Administrator of AID; the Director, Office of Management and Budget; cognizant congressional committees; and other interested parties. Copies will also be made available to others on request.

Please call me on (202) 275-5790 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix II.

Sincerely yours,

Harold J. Johnson
Director, Foreign Economic
Assistance Issues

Executive Summary

Purpose

The Agency for International Development (AID) provides project assistance overseas primarily through the use of direct and host country contracts. Under host country contracting, agencies of host country governments act as contracting parties for AID-financed procurement of technical assistance services, construction services, and commodities. As of October 1989, AID reported that active host country contracts totaled $1.5 billion or 56 percent of AID's total overseas project assistance.

The Chairman, Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, requested that GAO review AID's policies and procedures for host country contracting. At AID/Washington and missions in Bangladesh, Egypt, Jordan, and Pakistan, GAO examined

- whether project officers overseeing individual contracts support the use of host country contracting,
- whether AID assesses each host country agency's contracting capabilities prior to using a host country contract,
- how AID determines whether the expected benefits of host country contracting are being achieved, and
- whether AID's monitoring and oversight of host country contracts is effective.

Background

AID policy allows mission directors to decide on a case-by-case basis whether to use direct or host country contracts. This decision must be based on (1) a formal assessment of the host country agencies' capability to initiate contracts, review vouchers, and perform audits; (2) an informal assessment of expected benefits; and (3) certain other factors, such as host agency preferences or foreign policy concerns. AID officials believe that host country contracts are generally more vulnerable to fraud, waste, abuse, and mismanagement than AID direct contracts; however, certain expected benefits and other factors can influence a mission director's decision to use this type of contracting.

AID expects that three principal benefits will be achieved when a host country is assigned contract responsibility: (1) the host country's contracting and administrative skills will be improved on a permanent basis, (2) the host country will be more committed to the project, and (3) AID's administrative burden will be reduced. The first expected benefit is often labeled "institution building."

Results in Brief

Project officers responsible for contract oversight at the missions GAO visited support the use of host country contracting as a way of providing project assistance. They reported that the host country contracts they manage compare favorably with AID direct contracts with regard to competition, price, and quality. However, the contract award process for host country contracts was judged to be significantly slower than for direct contracts.

Contrary to AID guidance, missions generally did not conduct assessments of host country contracting, voucher review, and audit capabilities before deciding whether to use a host country contract. In those cases when assessments were made, they generally were after the fact and were of such low quality that they were of little practical use.

AID did not assess or document whether the expected benefits of host country contracting were being achieved. As a result, it had no basis for measuring whether the rationale for using host country contracting was sound. The consensus among senior mission officials GAO interviewed was that the expected benefits have not been consistently achieved. In contrast, project officers reported that the expected benefits have generally been achieved.

Recognizing the inherent risks associated with host country contracting, missions extensively monitored the contract award process and assumed responsibility for fund disbursement and audit. The missions, however, did not ensure that host country contracts were audited and properly closed out. Consequently, they had little assurance that contract costs were reasonable, that all contract requirements were met, or that unused funds were promptly recovered.

Principal Findings

Project Officers Support the Use of Host Country Contracting

Project officers reported that the host country contracts they manage compare favorably with AID direct contracts regarding level of competition, price, and quality. However, the contract award process for host country contracts was judged to be significantly slower than for direct contracts due to the cumbersome approval procedures used by many host country agencies and the need to coordinate host country actions with required mission approvals.

Project officers and other mission officials reported that host country contracts are generally more suitable for the procurement of construction services than AID direct contracts. They cited the following key reasons for this view.

- Host country agencies are in a better position than AID to obtain required work permits and authorizations from local government agencies.
- The host country agency is more likely to receive favorable judgments in local courts for cases involving contractor or subcontractor nonperformance.

Capability Assessments Were Not Done or Were Inadequate

Since the mid-1970s, AID policy has required that missions assess the host agency's ability to award, administer, and audit contracts before authorizing the use of a host country contract. GAO found that only 1 of 103 host country contracts examined at 4 overseas missions had a capability assessment conducted at the project design phase—when decisions on contract type are made. The most frequently mentioned reasons for not conducting a capability assessment were (1) it was not necessary because the mission had positive prior experience with the agency and (2) the host country agency had not been identified at the time the project design phase was completed.

Project officers told us that about one-fourth of all contracts had a capability assessment conducted at some point after the project design phase. GAO reviewed 18 capability assessments provided by mission personnel in Egypt and Pakistan (none could be located in Bangladesh and Jordan) and found that these assessments were generally superficial and included few specifics on the host agency's capability to award contracts, review invoices, and audit contractor records.

In June 1990, AID convened a committee of senior managers to review the agency's policies and procedures for host country contracting. One of the group's first priorities was to revise AID policy regarding capability assessments. In November 1990, all overseas missions were notified of several new requirements designed to correct AID's problems with capability assessments. These new requirements had not been in place long enough for GAO to determine their effectiveness in correcting the deficiencies noted.

Expected Benefits Have Not Been Assessed

AID has not attempted to measure or assess whether the principal expected benefits of using host country contracting are occurring. Senior mission officials generally discounted the claimed benefits of institution building and reduced administrative burden, although they acknowledged that an increased sense of project ownership was a valid reason for using a host country contract. In contrast, project officers stated that all three benefits were consistently being achieved.

Several AID managers stated that certain factors not related to the host agency's capabilities or expected benefits can play a key role in deciding whether to use a host country contract. These factors include mission director or host agency preferences and foreign policy considerations.

Missions Failed to Conduct Periodic and Final Cost Audits

The four missions GAO visited provided extensive oversight of the contract award process, disbursed funds directly to contractors, and assumed responsibility for conducting contract audits. However, each mission failed to arrange for appropriate audit coverage. GAO reviewed 18 out of 47 cost-reimbursable host country contracts at the 4 missions visited and found that only 4 contracts had been audited. Furthermore, AID officials in all four missions told GAO that contract close outs and final cost audits were generally not being performed for host country contracts. In part, this low level of audit activity was due to (1) a lack of clear audit requirements for host country contracts, (2) the absence of AID guidance on how AID's audit process is structured, (3) poor planning for audit at the project design stage, and (4) mission reliance on project officers to request contract audits.

Recommendations

GAO makes several recommendations to the AID Administrator to improve AID's host country capability assessments, determine whether the expected benefits of host country contracting are being achieved, and clarify specific requirements for auditing host country contracts. (See chs. 3 and 4.)

Agency Comments

In commenting on a draft of this report, AID stated that it generally agreed with the report's recommendations. (See app. I.) AID plans to address the specific recommendations and the actions planned or taken when it responds to the final report. AID also provided several specific comments, which have been incorporated in the report where appropriate.

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Abbreviations

AID	Agency for International Development
GAO	General Accounting Office
PPAP	Procurement Planning Advisory Panel

Introduction

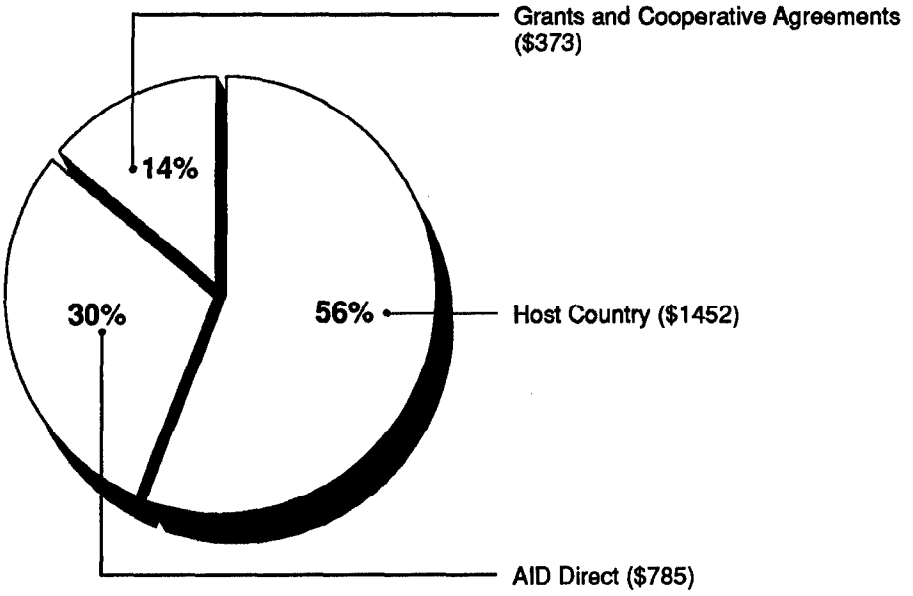
The Agency for International Development (AID) administers the U.S. government's overseas economic assistance programs and projects. Project assistance is provided mainly through host country contracts and AID direct contracts. Under host country contracting, host government agencies are responsible for both contract award and implementation—subject to AID oversight and monitoring of key host agency actions. Direct contracts are those awarded by AID and were the subject of a report we issued in October 1990.[1]

Number and Value of Active Host Country Contracts

Accurate data on the number and value of active host country contracts is not readily available. The best available information is from fiscal year 1989, when AID requested its overseas missions to report the number and value of active host country contracts as of October 1, 1989. Based on this information, host country contracts totaled about $1.5 billion or 56 percent of the value of all financial instruments used by AID's overseas missions to implement overseas projects, with the balance of funds awarded through direct contracts, grants, and cooperative agreements. (See fig. 1.1.)

[1]Foreign Assistance: AID Can Improve Its Management of Overseas Contracting (GAO/NSIAD-90-31, Oct. 5, 1990).

Figure 1.1: Overseas Contracts, Grants, and Cooperative Agreements
Dollars in millions



Note:
Overseas awards active as of October 1, 1989, based on AID data as of January 1990. AID was unable to provide us with data showing how funds were spent for a given period of time. As a result, the relative proportion of funds spent on host country contracts versus other financial instruments may be overstated. This is due to AID's frequent use of host country contracts for construction projects which tend to be of higher dollar value and longer duration than grants, cooperative agreements, or AID direct contracts.

AID provides other forms of overseas assistance that is not shown in the figure, such as cash transfers and the Commodity Import Program.

A substantial portion of the funds for host country contracts have been committed by the AID mission in Egypt. In 1989, Egypt accounted for $978 million or 67 percent of the host country contract amount in figure 1.1. In contrast, Jordan—the second largest user of host country contracts—accounted for $66 million or 5 percent of total committed funds.

Organizational Responsibilities

Mission directors determine which method of implementation is most appropriate for any given project. This decision is normally based on the recommendation of a project design committee, which develops the plans for implementing AID-financed projects. These plans, referred to as project papers, include recommendations on how the project should be organized and whether individual project components should be implemented through direct contracts, host country contracts, or some other arrangement.

Project implementation begins with the host country contract award phase and continues through the final close out of completed contracts. Throughout this period, the host agency is in charge of the contract. However, a project officer from the cognizant mission program office is assigned to monitor and oversee host agency actions. Although the project officer is charged with taking the lead role in oversight and monitoring, a number of other AID mission employees are normally involved.

- Mission controllers and their staff review contractor vouchers before authorizing payment except in certain limited instances. AID guidance calls for mission controllers to annually review the host agency's voucher review procedures and to ensure that each host agency's contracting abilities are assessed during project planning.
- Regional or local legal advisers review bid solicitations and draft contracts. They can also provide specific information on AID's policies and procedures for host country contracting.
- Regional or local contracting officers may be consulted on technical issues relating to contract award and administration. However, AID's handbooks do not assign them responsibility for monitoring or overseeing host agency contracting actions.
- Regional Inspectors General are available to assist with requests for overseas contract audits and to monitor the quality of host agency conducted audits. The Inspector General's Office in Washington, D.C., is available to coordinate audit requests pertaining to U.S. contractors.

In addition to AID officials, outside contractors (such as architect and engineering firms and procurement service agents) are frequently used to assist the host agency with contract award and implementation duties.

AID/Washington Oversight

While the management and oversight of host country contracts is the mission's responsibility, AID/Washington exerts considerable influence by setting contracting policy and by producing related handbook guidance. Since the mid-1970s, AID policy has required that missions assess the host agency's ability to award, administer, and audit contracts before authorizing the use of a host country contract.

In December 1983, AID consolidated in its Payment Verification Policies a number of key internal controls aimed at reducing vulnerability to fraud, waste, abuse, and mismanagement. These policies set out many of the oversight and monitoring tasks associated with host country contracts, including the requirement that missions assess the host agency's

ability to award contracts, examine invoices, and audit contractor records.

AID's Procurement Executive oversees the Planning, Policy, and Evaluation Staff, which develops AID contracting policy. He is also responsible for ensuring that AID direct contracts meet the requirements of U.S. contracting laws and regulations, such as the Federal Acquisition Regulation and the Competition in Contracting Act. While host country contracts are not subject to these laws and regulations, AID has attempted to comply with the spirit and intent of these requirements by modeling its policies and procedures for host country contracting along similar lines.

AID also has a Procurement Policy Advisory Panel (PPAP), which is chaired by the Procurement Executive and is comprised of senior-level managers from each of AID's bureaus. PPAP is convened when particularly important or sensitive procurement issues are being considered. In June 1990, PPAP formed a subcommittee to review AID's policies and procedures for host country contracting.

Objectives, Scope, and Methodology

The Chairman, Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, requested that we review AID's policies and procedures for host country contracting. Our objectives were to determine (1) whether project officers overseeing individual contracts support the use of host country contracting, (2) whether AID assesses each host country agency's contracting capabilities prior to using a host country contract, (3) how AID determines whether the expected benefits of host country contracting are being achieved, and (4) whether AID's oversight and monitoring of host country contracts is effective.[2]

We interviewed AID officials in Washington, D.C., and reviewed AID's policies and procedures for host country contracting. We also performed work at AID missions in Bangladesh, Egypt, Jordan, and Pakistan. These four missions accounted for approximately 75 percent of AID funding for host country contracts as of October 1, 1989.

[2]During our review, we found some managerial concerns relating to the use of AID's internal controls process to monitor mission implementation of certain key oversight requirements for host country contracts. These concerns were the subject of a separate report to the AID Administrator entitled Internal Controls: AID Missions Overstate Effectiveness of Controls for Host Country Contracts (GAO/NSIAD-91-116, Feb. 11, 1991).

At each mission visited, we interviewed senior mission officials and analyzed reports, statistical data, mission orders, audit reports, internal control assessments, capability assessments, and project papers. We also used structured interviews to obtain project officers' general views on host country contracting.

Of the 134 active host country contracts in the 4 missions visited, we obtained contract-specific judgments on a statistically valid sample of 103 contracts through structured interviews with the 37 project officers overseeing these contracts.[3] Information was obtained for all active host country contracts in Bangladesh (25), Jordan (20), and Pakistan (20), and for 38 of the 69 active host country contracts in Egypt. The 38 contracts in Egypt included all active contracts for construction services (13), all technical assistance and commodity-only contracts valued at over $15 million (5), and randomly selected contracts from the remaining 50 host country contracts (19).[4]

Our review was performed between October 1989 and December 1990 in accordance with generally accepted government auditing standards. In April 1991, AID provided written comments on a draft of this report. (See app. I.) AID stated that it generally agreed with our recommendations. It plans to address the specific recommendations and the actions planned or taken when it responds to the final report. Several specific comments were also provided and have been incorporated where appropriate.

[3]Our review focused on Handbook 11, which deals with host country contracts for construction services, technical assistance, and commodity-only procurements. Therefore, we did not evaluate fixed-amount reimbursable agreements with host governments and public sector Commodity Import Program procurements, which are managed under other handbook guidance.

[4]Results from these 19 contracts were projected to the full sample universe of 50 contracts. A 95-percent confidence interval applies to this projected data, which means that our reported results may be under or overstated by about 7 percent or up to 10 contracts.

Project Officers Support the Use of Host Country Contracting

Project officers in charge of individual contracts generally supported the use of host country contracting, particularly for construction services, which most host country agencies have had considerable success in managing. Project officers also reported that the host country contracts they manage compare favorably with AID direct contracts regarding level of competition, price, and quality. However, the contract award process for host country contracts was judged to be significantly slower than for direct contracts.

Project Officers Support AID's Policy on Selection of Contract Type

In 1976, AID established a policy that, whenever feasible, contracting for bilateral projects be done by the host country rather than directly by AID. This policy conformed with AID's basic philosophy that (1) ultimate responsibility for all development projects rests with the host government, (2) the process of implementation provides an important opportunity for institution building, and (3) AID is not a procurement agency and must conserve its staff resources for its primary function as a planning, financing, and monitoring agency.

In 1983, however, this policy was rescinded when it became evident that some missions were authorizing the use of host country contracts in instances where host agencies were not prepared to assume responsibility for managing their own contracts. Since 1983, AID's "no-preference" policy has allowed mission directors to select the contracting type on a case-by-case basis.

The project officers we interviewed generally approved of AID's flexible policy on selection of contracting type. When project officers were asked which contract selection policy best promotes AID's objectives, 64 percent chose the present policy of no stated preference, 22 percent chose the previous policy favoring host country contracting, and 14 percent favored a policy encouraging the use of AID direct contracts.

Project officers also thought that AID had usually been correct in choosing the host country contracting type for the contracts they currently manage. As shown in table 2.1, project officers reported that 80 percent of the active host country contracts in the missions we visited were assigned the correct type of contracting. Significantly, project officers indicated that 20 percent of active host country contracts should have been awarded using another contract type. However, they cited only seven instances where their preference for another type of contracting was linked to a specific problem with contract award or implementation.

Table 2.1: Project Officers' Preferred Contracting Type for Current Host Country Contracts

Dollars in millions

	Number of contracts		Value of contracts	
Preferred Type	**Percent**	**Number**	**Percent**	**Value[a]**
Host country	80	106	80	$920
Direct	13	17	14	158
Other	8	11	7	74
Total[b]	**100**	**134**	**100**	**$1,152**

[a]The contract value is AID's contribution at the time the contract was signed. All values were either verified by project officers or came from AID mission records.

[b]Percents do not add due to rounding.

Suitability Influenced by Type of Procurement

Host country contracts can be used to procure technical assistance services, construction services, or commodities. Project officers reported that all three types of procurement were generally well handled through host country contracts. However, their answers also indicated that the type of procurement should be considered before using this contracting type since host country contracts were judged to be less suitable for technical assistance and commodity-only procurement compared to construction services.

To gauge the relative dollar value of each procurement type, we asked project officers to provide current funding information for the host country contracts they manage. Table 2.2 shows this funding information for host country contracts by mission and principal product or service procured. The 36 construction contracts accounted for 60 percent of the dollar value of active contracts at the 4 missions visited, the 65 contracts for technical assistance services accounted for 32 percent, and the 33 commodity-only contracts accounted for 7 percent.

Table 2.2: Number and Value of Host Country Contracts by Mission and Principal Product or Service

Dollars in millions

	Principal product or service procured							
	Construction services		Technical assistance[a]		Commodity only		Total	
Mission	**Amount**	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**	**No.**
Bangladesh	$0	0	$38.3	7	$17.0	18	$55.3	25
Egypt[b]	661.2	13	300.1	44	67.8	12	1,029.2	69
Jordan	29.9	9	21.6	10	0.6	1	52.1	20
Pakistan	5.5	14	8.8	4	0.9	2	15.1	20
Total	**$696.6**	**36**	**$368.8**	**65**	**$86.3**	**33**	**$1,151.7**	**134**

[a]Training contracts and mixed content contracts with a substantial technical assistance component have been classified as technical assistance contracts.

[b]Contract values for 31 contracts in Egypt came from AID mission records and were not verified by project officers.

Note: Active host country contracts as of February 28, 1990, based on project officer responses to our survey questions. The amount of the contract is the value of AID's contribution at the time the contract was signed.

We asked the 37 project officers in our survey to consider the overall suitability of host country contracting for construction services, commodity-only, and technical assistance procurement. Table 2.3 shows their responses. The table does not include "cannot judge" responses from project officers who did not have experience with a particular type of procurement or who did not offer an opinion. The table shows that 93 percent of responding project officers thought that host country contracts are "always" or "very often" suitable for procuring construction services. About one-half of responding project officers held a similar view for commodity-only procurement. Just over one-third of responding project officers believed that host country contracting was "always" or "very often" suitable for procuring technical assistance services. These results are consistent with AID handbook guidance, which encourages the use of host country contracts to procure construction services.

Table 2.3: Project Officers' Views on Suitability of Host Country Contracting for Three Types of Procurement

Figures in percentages

	Type of procurement		
Host country contract suitable	**Construction services**	**Commodity only**	**Technical assistance**
Always	35	20	10
Very often	58	36	26
Moderately often	4	28	35
Occasionally	4	12	19
Never	0	4	10
Total	**100[a]**	**100**	**100**

[a]Does not add due to rounding.

AID officials cited two key reasons to explain why they preferred to use host country rather than AID direct contracts for construction services.

- Host agencies can more easily obtain required work permits and authorizations from local government agencies than AID.
- Host agencies are better able than AID to seek legal redress for cases involving contractor and subcontractor nonperformance in local courts.

AID officials also cited a number of factors to explain why host country contracts are more suitable for construction services than for technical assistance services.

- Many host agencies have had extensive experience contracting for construction services using AID funding, other donor funding, or host government funds. Most host agencies typically have not had extensive experience awarding and managing contracts for technical assistance services.
- AID handbook guidance recognizes and encourages the use of U.S. architect and engineering firms as intermediaries to assist the host agency with the award and implementation of construction services contracts. This guidance ensures that professional contracting advice and assistance is available when needed. However, AID's handbooks do not discuss the use of a formal intermediary to assist host agencies with the award and implementation of technical assistance contracts.
- Construction service contracts are awarded to the responsive and responsible bidder with the lowest proposed cost. Technical assistance contracts are awarded on the basis of technical merit, subject to agreement on price. This heightens the complexity of the contract award process.

- Construction contracts are awarded on a fixed-price basis. Technical assistance contracts are normally awarded on a cost-reimbursable basis, which requires periodic and final costs audits that many host agencies are incapable of performing.

Despite the potential difficulties of using host country contracts for technical assistance services, the missions we visited funded nearly $369 million in technical assistance services and were generally pleased with the host agency's performance in administering these contracts. One explanation for this high level of usage is that host agencies tend to favor a direct working relationship with technical assistance contractors to lessen the chance that sensitive or confidential information will be disclosed to the mission.

Host Country Versus Direct Contracting

We asked project officers to rate each contract in our survey according to whether a host country or direct contract would have been best with respect to the amount of competition, price, timeliness of the contract award process, and the quality of the goods or services procured. Based on a count of contracts, neither host country nor AID direct contracting was judged to consistently result in higher quality procurement, lower prices, or more competition. However, our analysis showed that project officers perceived that direct contracting would have resulted in "somewhat more competition" and "somewhat lower prices" for large dollar procurement.

Project officers indicated that individual contract award times would have been "somewhat" or "much faster" for 67 percent of all contracts if an AID direct contract had been used. Mission officials pointed out that delays are to be expected when a host country contract is used since both AID and the host agency must review, approve, and coordinate procurement decisions. In addition, lesser developed countries tend to have cumbersome approval and administrative procedures.

Selection of Contract Type Not Based on Capability Assessments or Documented Reviews of Benefits

AID guidance states that a mission director's decision to use a host country contract should be based on a case-by-case review of the host agency's capability or potential to manage an AID-financed procurement, the benefits expected from using this type of contracting, and certain other factors. In the four missions visited, we found that (1) systematic assessments of host agency's contracting capabilities were rarely conducted at the project design stage, (2) the expected benefits of using host country contracting had not been assessed or documented, and (3) other factors can play an important role in the decision to use a host country contract.

Limited Number of Assessments Conducted

In the mid-1970s, AID established its policy that missions must assess the host agency's contracting capabilities before electing to use the host country contracting type. In December 1983, this requirement was highlighted as part of AID's Payment Verification Policies. In November 1990, nearly 7 years later, AID issued revised guidance on conducting capability assessments in reaction to the general perception that AID missions had failed to adhere to the long-standing requirement that capability assessments be conducted.

AID's Payment Verification Policy requires that capability assessments provide a realistic evaluation of the prospective host agency's capability to (1) advertise, negotiate, and award contracts; (2) monitor contract implementation; (3) review invoices; and (4) audit contractor records and reports. AID's payment policies stress that the host agency's capabilities must be realistically assessed as part of the project design process. Related handbook guidance states that if the assessment concludes that the host country agency will need external assistance in meeting its procurement responsibilities, the precise nature and extent of such assistance must be determined and built into the project as an additional element, or consideration should be given to other alternatives.

At the four missions visited, we found that capability assessments were generally not performed at the project design stage. We determined that only 1 of the 103 contracts we discussed with project officers was covered by a capability assessment as required by AID's payment policies. Project officers told us that about one-fourth of all contracts had a capability assessment conducted sometime after the project design stage.

The two most frequently mentioned reasons for not conducting a capability assessment during the project design phase were that (1) AID had

prior experience with the host agency and (2) the host agency had not been identified at the time the project paper was written.

In a 1979 audit report on AID's use of host country contracting, AID's Inspector General reported that missions had generally failed to perform required capability assessments.[1] In September 1984, the Inspector General issued a follow-on report of AID's management of host country contracts based on a review of operations at six overseas missions.[2] The report stated that

> AID has had little success in implementing its policy guidance requiring assessments of host country contracting capabilities and practices . . . . Accordingly there is no verifiable basis for assigning procurement responsibilities to host governments. As a result of not realistically assessing host country contracting capabilities and addressing recognized problems early in the relationship, costly project delays have been experienced and a high degree of risk introduced into AID's payment processes.

As recently as June 1990, the Inspector General reiterated the concern that through its failure to conduct capability assessments, AID has increased its vulnerability to fraud, waste, abuse, and mismanagement. In June 1990 testimony before the Senate Subcommittee on Foreign Operations, the Inspector General stated that "in practice we find the host country contracting method is too often chosen when the host country's capabilities to perform are seriously deficient and any reasonable assessment would have so concluded and suggested an A.I.D. direct contract approach."

Assessments Were Generally Superficial in Nature

Given the limited number of assessments conducted and the difficulties we encountered in locating completed assessments, we asked mission officials to provide copies of the assessments that could be readily obtained from mission files. Mission officials in Bangladesh and Jordan were not able to locate any completed assessments. Officials in Egypt and Pakistan supplied us with a total of 18 assessments.[3]

[1] Review of the Application of the Host Country Contracting Mode (Audit Report No. 79-71, May 18, 1979).

[2] Host Country Contracting: Assessing Host Country Capabilities and Practices, and Reporting Host Country Contracts (Audit Report No. 84-38, Sept. 28, 1984).

[3] We could not readily determine if all of these assessments related to contracts in our sample since they did not necessarily mention specific contracts.

These 18 assessments generally did not cover the range of issues suggested by the AID guidance. For instance, several assessments only discussed a host agency's accounting systems, while omitting any discussion of the host agency's capability to award and audit contracts. These assessments were usually conducted by financial analysts located in the mission controller's office. In three cases, an outside contractor conducted the assessment.

AID handbook guidance requires that the mission or an outside contractor conduct a reasonably detailed examination of the host country's contracting system and policies, with emphasis on the adequacy of major contracting processes. AID has no prescribed methodology for undertaking these assessments, although the handbook guidance provides a checklist of basic questions that should be addressed when the mission is anticipating using a host agency for the first time. For instance, the checklist recommends that the following questions be considered:

- Is contracting for services or commodities a regular and continuing function of the host agency?
- Does the host agency have a technically qualified procurement staff?
- Does the host agency have adequate authority to negotiate and award contracts without requiring the approval of other host country entities?

We used these questions as a basis for evaluating the adequacy of the capability assessments we selected for review since other handbook guidance was not very specific. For example, related handbook guidance for host agencies with prior AID experience is limited to suggesting that the mission determine if past problems were encountered and whether such problems can be remedied. From the 18 assessments we reviewed, we found that 7 did not address any of the questions listed above and only 4 assessments addressed all 3 questions.

Steps Are Being Taken to Ensure That Assessments Are Performed

AID has reported the lack of capability assessments as a "material weakness" under the Federal Managers' Financial Integrity Act process since 1983. The corrective actions pursued by AID over the past 7 years, however, have been largely ineffective and this problem remains listed as a material weakness in the Administrator's latest certification to the Congress and the President. In June 1990, AID's PPAP formed a subcommittee to review the agency's policies and procedures for host country contracting. One of the group's first priorities was to revise AID policy regarding capability assessments.

Guidance Issued by AID's Management Group

As of November 1990, the PPAP subcommittee on host country contracting had taken several steps to tighten the host country contracting process. Missions were notified of new monitoring requirements in a June 1990 cable that was followed by implementing guidance in November 1990.

The November guidance outlined a number of new initiatives regarding capability assessments, the contract award process, and contract audits. For the first time, the mission director must certify in writing, on a case-by-case basis, that the host agency has the capability to undertake the procurement before a host country contract can be used. The new guidance requires that mission directors consult with the mission controller and appropriate technical specialists in the mission, including a contracting officer and legal adviser, before issuing a certification. Other important changes are discussed below.

- A capability assessment must be performed by the mission before assigning contracting responsibilities to a host agency for contracts anticipated to exceed $250,000 in value.
- Capability assessments must be prepared at least once every 3 years.
- A capability assessment must be conducted for each host country agency, even if the mission has had positive prior experience with the agency.
- Specific instructions on the scope of assessments are provided, although the subcommittee stopped short of requiring that all missions follow the same format.
- The assessment team, whether it is formed using mission or outside staff, must have knowledge and expertise in procurement matters and should have the necessary qualifications to review an organization's accounting systems and payment procedures.

Although the PPAP guidance addresses many of our concerns, the new requirements have not been in place long enough for us to determine the extent of mission compliance or the overall effectiveness in correcting the deficiencies we noted.

Expected Benefits Have Not Been Evaluated

AID guidance on host country contracting states that the primary reasons for using host country contracts are (1) institution building, (2) an increased sense of ownership on the part of the host agency, and (3) reduced administrative burden for the AID mission. These benefits should be weighed against the acknowledged risks associated with assigning contracting responsibilities to a host agency. However, neither

AID/Washington nor the missions we visited had attempted to measure whether these benefits are being achieved. The senior mission officials[4] and project officers we interviewed held sharply different views on whether these benefits were being achieved.

Institution Building

Of the three expected benefits, institution building was often cited by AID officials as the most compelling reason for using this type of contracting. Institution building refers to strengthening the host agency's contracting, invoice examination, and audit capabilities on a permanent basis. Institution building also includes transferring technical knowledge on project implementation and developing the host agency's ability to establish effective and ongoing business relations with U.S. firms.

In discussing the benefits and drawbacks of host country contracting, many senior mission officials expressed doubts about whether institution building has occurred.

- In Bangladesh, 8 of 11 mission officials stated that host country contracting had not resulted in any significant instances of institution building. The lack of institution building was generally attributed to the unwillingness of host agency officials to break with their traditional contracting practices and seeing little value in adopting AID-specific contracting procedures.
- In Pakistan, 9 of 11 mission officials said that host country contracting had not significantly strengthened host agency contracting capabilities. According to these officials, host agencies had not adopted AID's contracting practices for procurements that were not financed by AID. They prefer the British-based system they are more accustomed to using.
- In Egypt, two of six senior officials interviewed discounted the claimed benefit of institution building. Of the remaining four officials, one said that institution building is occurring, while the remaining three officials said that some institution building is bound to occur when a host country contract is used, but the level of improvement has never been measured and may only be marginal.

In contrast, project officers described improvements in host agency contracting skills that indicated institution building had occurred. To measure this, we asked project officers to subjectively assess whether the host agency's abilities to (1) award contracts, (2) monitor contract costs, (3) monitor contract performance, and (4) work with U.S. contractors

[4]These included mission directors, regional legal advisers, controllers, and senior contracting officers.

had gone up, down, or stayed about the same since the contract had begun. Project officers' responses to our structured interview indicated that host agency contracting capabilities "somewhat" or "greatly" increased for over half of all contracts.

Project Ownership

The senior mission managers we interviewed generally believed that host country contracting had stimulated an increased sense of project ownership on the part of the host agency. Project ownership was recognized as a potentially valid reason for using this type of contracting. Project officers also reported that a greater host country commitment was realized using a host country contract in 103 out of 116 cases, with 53 percent of these contracts leading to a "much greater" sense of commitment on the part of the host agency.

Administrative Burden

The senior mission officials we spoke with said that host country contracting had not led to a reduced administrative burden for the mission. Mission officials pointed out that this was particularly true for inexperienced host agencies where AID employees have to assist host agency officials with almost all contracting actions.

In contrast, project officers strongly believed that AID direct contracts place a greater administrative burden on project officers and the mission as a whole than do host country contracts. This was true for both contract award and implementation. The project officers' perception on burden may have been influenced by their views on the extensive use of outside contractors to assist the host agency during the contract award phase.[5] From the interviews with project officers, we estimated that an outside contractor was involved in the selection process for 67 out of the 107 host country contracts in our survey that went through a competitive final selection process. Project officers' answers indicated that when an outside contractor was used, AID's administrative burden was reduced a "great extent" in 81 percent of such cases.

[5]In contrast to host country contracts, contractor assistance is not normally used for awarding AID direct contracts since missions generally have contracting officers or other direct hire staff assigned to this function.

Other Factors Can Play an Important Role

In addition to reviewing the host agency's procurement capabilities and the expected benefits of host country contracting, AID guidance suggests that mission directors consider a number of other factors when deciding which type of contracting to use. These factors include host agency preferences, the experience and availability of AID staff to provide assistance to host agencies or undertake direct contracting, and the relative cost of each type of contracting.

According to several AID officials, certain other factors not mentioned in the handbooks can also influence whether or not a host country contract is used. These factors include foreign policy considerations that might require deferring to host country preference; the likelihood of fraud, waste, and abuse; and the mission director's personal preference.

Since the basis for the mission director's decision to use a host country contract was not documented in project papers or files, we could not specifically determine how much these factors played a role in the decision to use host country contracting. However, several senior AID officials told us that these factors can play a key role in the decision-making process. For example, officials in three missions cited "host agency preference" as an important factor influencing a mission director's decision to use a host country contract. These officials pointed out that since U.S. economic assistance generally supports political as well as development objectives, the host agency's contracting preference is accommodated whenever feasible.

Another factor mentioned was mission concerns over possible corruption and the host agency's general reputation for fairness. According to one senior mission official, this factor is never formally mentioned in project papers—even though it may have figured heavily in the final decision on which contract type was most suitable.

Finally, the mission director's preference was mentioned as another factor that can significantly influence how often host country contracting is used in a given mission. For example, one mission official told us that a prior mission director overruled a project design committee's recommendation to use AID direct contracting to implement a project and insisted that host country contracting be used instead. In this particular instance, the project design committee recommended that six contracts be managed as AID direct contracts. The mission director, however, instructed that most of these contracts be awarded as host country contracts.

Conclusions

The missions we visited generally did not conduct required assessments of host agency procurement capabilities. When assessments were conducted they were of such low quality that they were of little practical use. Without reliable information on host agency capabilities, mission directors had no specific basis to identify qualified host agencies or marginally competent agencies that could improve to an acceptable level if provided appropriate technical assistance.

AID's efforts to correct the long-standing material weakness relating to capability assessments have proven ineffective since this problem remains an AID material weakness reported under the Financial Integrity Act process. However, new initiatives promulgated by the PPAP subcommittee on host country contracting offer promise that this problem will be corrected.

Whether the expected benefits of host country contracting are being realized is unclear since neither AID/Washington nor the missions we visited have attempted to measure whether expected benefits are being achieved. Senior mission officials stated that two of these expected benefits have not been consistently achieved. Project officers, however, indicated that all three expected benefits are being achieved to a significant degree. In the absence of specific information on benefits, mission directors will continue to make decisions based on their own subjective evaluations.

Recommendations

We recommend that the AID Administrator

- ensure that missions fully comply with recently issued AID guidance on conducting capability assessments and
- determine whether institution building and the other expected benefits of host country contracting have been achieved on specific contracts and use the results of such evaluations to help guide future contracting decisions.

Missions Provided Extensive Oversight, but Contract Audits Were Not Performed

Recognizing the increased risk of using host country contracting, the missions we visited attempted to limit their vulnerability to fraud, waste, abuse, and mismanagement by monitoring the contract award process and by assuming responsibility for fund disbursement and audit. Each mission extensively monitored the contract award process and chose a low-risk form of disbursing contract funds, but they did not ensure that appropriate audit coverage was provided.

Extensive Monitoring of the Contract Award Phase

For contracts in excess of $100,000, AID handbook guidance requires that AID approve the signed contract between the host agency and the contractor. Each of the missions we visited required final approval of the signed contract and certain interim steps. The Egypt mission, for example, required mission review and approval of prequalification advertisement, the prequalification questionnaire, prequalification rankings, scopes of work and bid specifications, invitations for bids, requests for proposals, and contractor rankings at the contractor selection stage.

However, three out of four mission orders did not require contracting officer approval or clearance of any step in the host country contracting process. Each mission order required approval or clearance from a wide variety of mission officials, including the project officer, legal adviser, controller, office directors, and project development support staff. Conspicuously absent was the expectation that a contracting officer—the person in the mission most versed in contracting requirements—provide clearance or approval of any part of the host country contracting process.

Contracting officers operate under the authority of AID's Procurement Executive and are only responsible for U.S. government contracting actions. Under current handbook guidance, contracting officers have no formal role in the host country contracting process, unless the mission director wishes to formally involve the contracting officer. Our October 1990 report on AID direct contracting points out that responsibility for direct and host country contracts is typically split between contracting and program offices in overseas missions, resulting in nonprocurement personnel making procurement-related decisions.[1] The report recommends that AID place host country and direct contracting responsibilities within one office.

[1]Foreign Assistance: AID Can Improve Its Management of Overseas Contracting (GAO/NSIAD-90-31, Oct. 5, 1990).

The PPAP's November 1990 guidance on host country contracting incorporates the spirit of this recommendation by requiring missions to actively involve contracting and commodity officers in the host country contract approval process. According to one senior AID official, this guidance will later be incorporated in AID's handbooks.

Frequent Use of Optional Forms of Monitoring

In addition to AID approving signed host country contracts in excess of $100,000, AID's approval is required for invitations for bids for construction services and commodity-only procurements estimated to exceed $100,000 in value. According to one senior AID official, handbook guidance suggests that a number of other monitoring techniques can also be used, but the missions are allowed to decide what level of oversight is appropriate for each contract.

A contract could have received several "intensive" forms of monitoring, that is, a shadow evaluation,[2] mission participation on the host agency selection panel, outside contractor assistance, or a combination of these techniques. Another form of monitoring is the project officer's desk review of completed contracting actions and supporting documentation to see that all paperwork requirements were met. The latter form of monitoring is generally considered to be "non-intensive."

All four missions we visited provided some form of additional monitoring beyond the handbook requirement that missions approve the final contract. We asked project officers about the contract award monitoring process for both the prequalification[3] and contractor selection phases of the host country contracts they manage. Project officers noted that 94 percent of the contracts with a prequalification stage and 89 percent with a contractor selection stage received some form of "intensive" monitoring.

Given the greater demands placed on both AID and the host agency when awarding a host country contract for technical assistance services, we separately analyzed the level of mission oversight provided for this type of procurement. (See table 4.1.) The table shows only those contracts

[2]Missions could have arranged for an evaluation using the same evaluation and scoring criteria as the host agency. AID policy did not require that the results of this shadow evaluation match exactly with the host agency's rankings. Rather, the expectation was simply that the rankings generally coincide.

[3]A prequalification stage is used for some contracts to determine which firms have the technical, financial, and managerial resources to provide the needed goods or services.

that had a prequalification or contractor selection stage (35 and 40 contracts, respectively). Each technical assistance contract is classified by the highest level of monitoring it received, with intensity of monitoring decreasing from shadow evaluation, to panel participation, to the least intensive form, desk review only. The table also shows that at both the prequalification and contractor selection stages less than 10 percent of contracts received only the least intensive form of monitoring.

Table 4.1: Mission Monitoring of the Award Phase for Technical Assistance Contracts

Figures in percentages

	Contract award phase	
Forms of monitoring[a]	**Prequalification**	**Contractor selection**
Shadow evaluation	46	65
Panel participation	46	28
Desk review only	9	8
Total[b]	**100**	**100**

[a]Contractor assistance is not included since none of the technical services contracts reviewed had received this assistance as the highest form of monitoring.

[b]Does not add due to rounding.

Management Group Issued Revised Guidance

In November 1990, the PPAP subcommittee on host country contracting issued final guidance that included a number of new requirements relating to mission monitoring of the contract award process. Missions were instructed to approve certain key points in the contract award process. Before this guidance was issued, missions were encouraged to establish interim approval points, but only the final contract had to be approved by the mission. The new guidance states that contracting and commodity officers will be responsible for ensuring that procurement actions by host country agencies meet professional standards for solicitation, negotiation, selection, award, and administration. Contracting and commodity officers must now be formally involved in the review and clearance process during contract award; the development of procedures for reviewing host agency evaluations of proposals; and contract administration, including review and approval of subcontracts, change orders, and contract amendments.

The new guidance requires that a mission representative be present to observe the host agency's proposal evaluation panel to ensure that the evaluation is done fairly and according to the method and criteria stated in the solicitation document. Prior AID guidance only suggested that a mission representative be present at such meetings.

The new guidance also states that missions should no longer use documented shadow evaluations. Missions, however, are expected to continue to study submitted proposals to make an informed judgment concerning selection of the contractor by the host country agency. The subcommittee chairman explained that AID's past practice of formally duplicating the host agency's assessment process and documenting the results provided unsuccessful bidders and offerers with information that could be used to launch a bid protest.

The chairman stated that eliminating the use of documented shadow evaluations was appropriate since AID's newly strengthened procedures for reviewing the contract award process should provide adequate oversight of host agency actions. We did not collect sufficient information to judge whether eliminating formal shadow evaluations was judicious or not.

Missions Disbursed Funds and Reviewed Voucher Examination Procedures

Controllers in all four missions assumed the payment function for host country contracts, generally using a direct letter of commitment from AID to the contractor.[4] In Egypt, the mission controller explained that besides the desire to reduce mission vulnerability, the direct payment method is used because many host agencies do not have sufficient U.S. currency to pay contractors directly. In addition, contractors generally prefer a direct letter of commitment from AID since they receive their payments more quickly.

We also noted that missions generally conducted the annual reviews of host agency voucher examination procedures required by AID's payment policies. We reviewed the completed internal control assessments conducted at each of the four missions for 1988 and 1989.[5] The missions in Bangladesh, Jordan, and Pakistan rated themselves "satisfactory" regarding the control technique requiring that AID review invoice examination procedures followed by host country contracting agencies.

[4]AID's payment policies allow three forms of payment to be used: (1) a direct letter of commitment from AID to the contractor, (2) direct reimbursement of the host agency after the host agency has paid the contractor, or (3) a letter of commitment to a U.S. bank. When one of the first two payment methods is used, both the host agency and the mission administratively review and approve submitted cost vouchers. In contrast, the letter of commitment to a U.S. bank permits direct payment to the contractor without prior review or approval by the host agency or the mission. This form of payment is generally used when a large number of individual commodity procurements need to be made.

[5]These assessments were conducted as part of AID's annual review of internal controls as required by the Federal Managers' Financial Integrity Act of 1982.

In 1988, the Egypt mission rated this control technique "satisfactory." Our review of this assessment indicated that this control technique should have been rated "unsatisfactory." In 1989, the Egypt mission rated this control technique as "unsatisfactory" due to an acknowledged backlog of reviews. The remarks section of the mission's 1989 internal controls assessment stated that the controller's office was taking immediate action to start using local accounting firms to assist in conducting the reviews.

AID's Contract Audit Process

AID guidance allows the host agency to assume responsibility for contract audits if the mission determines that the host government has the capability—using its own auditors or qualified independent accountants—to effectively perform this function. Each mission we visited had assumed the audit function. However, we noted that only a limited number of contract audits have been conducted or requested for the contracts in our review.

AID's Payment Verification Policy requires that project papers include an evaluation of the need for audit coverage and that project funds be budgeted for independent audits unless adequate audit coverage by the host country is reasonably assured. The three types of audits commonly performed for all AID-funded contracts are annual audits of the contractor's indirect and direct costs, contract-specific audits of direct costs, and close out audits.

- An annual indirect and direct cost audit establishes the contractor's overhead rate for cost reimbursable contracts. AID policy requires that contractors submit an indirect cost rate proposal every year. These proposals represent the contractor's computation of actual indirect costs for the prior year (calculated as a percent of incurred direct costs) and the proposed indirect billing rate for the current year. AID Inspector General guidance requires that these proposed rates be audited. When the contractor's universe of contracts includes an AID-financed host country contract, AID Inspector General policy requires that such contracts be included in the audit.
- A contract-specific direct costs audit determines in a more comprehensive fashion whether such costs as salaries, equipment charges, and travel are fully supported by contractor records and are allowable under the contract's terms. AID guidance encourages the use of such audits when mission officials have concerns or suspicions about a contractor's billing practices on a specific contract.

- A close out audit reviews whether AID and the contractor have complied with all applicable terms and conditions of the agreement. All AID-direct, cost-reimbursable contracts valued at $500,000 or above must receive a final cost audit as part of the close out process to ensure that interim and final overhead rates were correctly applied and that all claimed costs were fully supported. No similar requirement exists for host country contracts, but the expectation exists that cost audits should be performed for large dollar cost-reimbursable contracts.

When a U.S. contractor is involved, routine audit coverage is generally provided by the federal audit agency charged with "cognizant" responsibility for that contractor. The cognizant agency is responsible for conducting annual reviews of the contractor's direct and indirect costs—based on a sample of expenditures cutting across all government contracts for the period audited. The cognizant agency may perform contract-specific direct cost audits and close outs on request. It can also perform these audits for overseas contracts since most U.S. contractors maintain necessary cost records in the United States.

The cognizant agency shares the results of annual audits with other federal agencies that have paid a prorated share of audit costs based on the total audited dollar amounts allocated to a given agency. The AID Inspector General is cognizant for approximately 200 U.S. firms that do business mainly with AID. Most of AID's commercial contractors do significant amounts of business with the Department of Defense and thus are audited by the Defense Contract Audit Agency, which has local and regional offices in the United States and a number of overseas locations.

There is no legislative or regulatory requirement for non-U.S. contractors to be included under the cognizant audit process. However, assuming the host agency is not given responsibility for an audit, each mission and the AID Regional Inspector General become cognizant for direct and indirect cost audits of the contractor, contract-specific direct cost audits, and close outs. Based on requests from project officers, the Regional Inspector General can arrange for local accounting firms to perform all three types of audits. While the Inspector General's staff could perform these audits, it is the Inspector General's policy to use local accounting firms; thereby conserving in-house audit resources for project, program, and other functional audits.

Contract Audits Were Generally Not Performed

We selected a sample of 18 of the 47 cost-reimbursable host country contracts we identified in the 4 missions visited.[6] Of these contracts, 11 were awarded to different U.S. contractors. The remaining seven contracts were awarded to six non-U.S. contractors. Information obtained from the Inspector General on the level of U.S. and overseas audit work performed since the time these contracts were signed showed that 6 of the 11 contracts with U.S. contractors had received an audit or a request for audit was pending.[7] Of these six contracts, one had received a contract specific audit and two had received direct and indirect cost audits; however, the audit reports did not identify the related host country contract as part of the audit universe. Six requests for audit—covering three contracts—were listed as pending.

The seven contracts with non-U.S. contractors received little audit coverage. Only one contract-specific direct cost audit had been performed. No direct and indirect cost audits had been performed for these non-U.S. firms and no requests for contract-specific audits had been received for these contracts.

We did not obtain information on contract close outs because the contracts we selected were all active as of February 1990. However, AID officials told us that close out audits—and as a result, final cost audits—were generally not being performed for host country contracts. This fact, combined with the analysis showing that periodic cost audits have generally not been performed, suggests that cost reimbursable host country contracts are largely going unaudited. While a number of factors might explain the lack of appropriate audit coverage for host country contracts, the primary factors we identified as causing this problem are

- inadequate AID guidance on audit requirements for host country contracts,
- limited understanding and use of AID's audit process by mission personnel,
- reliance on mission personnel to initiate the contract audit process,
- poor planning for contract audits in project papers, and
- the lack of an accurate inventory of host country contracts.

[6]Each contract exceeded $500,000 in total value. Average contract age was 49 months.

[7]Inspector General records showed that some firms had received direct and indirect cost audits prior to the contract signed date.

AID provides detailed guidance to auditors on how to audit a host country contract, but AID's program staff is provided only minimal guidance on how to plan for audits. AID simply instructs project officers and mission controllers to maintain records, particularly for cost-reimbursement contracts, indicating when contract audits should be performed and when they are completed. Regarding contract close outs, handbook guidance states that host country contracts should be closed out upon satisfactory completion of work by the contractor and that the project officer is to ensure that close outs are promptly completed in accordance with the terms of the contract.

The lack of guidance is significant since many mission officials we spoke with did not understand AID's system for contract audits. For example, project officers generally did not understand the cognizant audit process for U.S. contractors, the alternatives available for auditing non-U.S. contractors, the various types of contract audits that can be conducted, and other audit related topics. This represents a serious problem because requests for contract audits are normally initiated by project officers.

We found that project papers generally did not contain plans for contract audits. We reviewed a sample of 15 project papers completed after 1983—3 in Bangladesh and 4 each in Egypt, Jordan, and Pakistan—to determine whether the elements in AID's payment policies were generally covered. These elements include (1) evaluating the need for audit, (2) assigning responsibility for audit to AID or the host agency, (3) establishing the timing of planned audits, and (4) setting funds aside for audit. Our analysis showed that only five project papers evaluated the need for audit, none assigned responsibility for audit, two discussed the timing of required audits, and six set aside funds for contract audits.

Also contributing to the failure to provide adequate audit coverage is AID's lack of an inventory of host country contracts. Without an accurate inventory, AID cannot identify whether all host country contracts are being audited. AID officials acknowledge that the data base on host country contracts is not adequate and stated that numerous errors and omissions exist in the data base. They added, however, that the new Contract Information Management System being developed by AID's Office of Procurement offers a potential solution to this problem.

Conclusions

The four missions we visited sought to limit AID's vulnerability by monitoring the contract award phase for host country contracts and by assuming responsibility for both fund disbursement and contract audits.

Each mission closely monitored the contract award phase and disbursed funds in compliance with AID's payment policies, which stress the need for using low-risk forms of payment whenever possible. However, for a number of reasons, each mission generally failed to conduct or arrange for required contract audits.

We found that annual audits of indirect cost rates were generally not conducted. This implies that provisional overhead rates established at the outset of each contract are not being adjusted. We also found that contract-specific audits were generally not being conducted on a periodic basis or as part of contract close outs.

For the past 7 years, AID has recognized the lack of audits as a material weakness under the Financial Integrity Act process. The corrective actions, however, have not addressed the basic causes contributing to the overall lack of contract audits for host country contracts.

Recommendations

We recommend that the AID Administrator

- develop specific audit requirements for host country contracts, such as the need to periodically audit cost-reimbursable contracts or to include cost audits as part of close outs when appropriate;
- require detailed plans for audit in project papers;
- issue specific guidance on the cognizant audit process for U.S. contractors and encourage missions to use this process for all three types of contract audits; and
- establish a unified system for requesting, tracking, and coordinating host country contract audits.

Comments From the Agency for International Development

Note: The wording in the text has been revised to incorporate the suggested changes.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

APR 12 1991

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International Affairs
U.S. Government Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

APR 12 1991

Dear Mr. Conahan:

We have reviewed the draft report "Foreign Assistance, A.I.D. Can Improve Its Management and Oversight of Host-Country Contracts" and we are in general agreement with the recommendations contained therein. Our response to the final report will address the specific recommendations and the actions planned or taken.

Specific comments on the text of the draft report follow:

Now on p. 17.

Page 25--The first sentence of the second paragraph should read "Construction contracts are awarded on a fixed-price basis." in lieu of the current reference to a "fixed-fee" basis.

Now on p. 33.

Page 53--The second paragraph states that A.I.D. provides only minimal guidance on audits. We are concerned that the statement may have been made without regard to Appendix 4B of A.I.D. Handbook 11, Chapter 4, Program for Audit of Country Contracts Financed by A.I.D.

We are also enclosing additional comments offered by A.I.D.'s Inspector General for Audit.

We appreciate the time and effort expended by your staff in coordinating the information gathered for this draft report with A.I.D.'s Procurement Policy Advisory Panel.

Sincerely,

Kathleen O'Hara

for James D. Murphy
Chief, Procurement Policy,
Planning and Evaluation Staff

Enclosure:

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

Albert H. Huntington, III, Assistant Director
Michael M. ten Kate, Evaluator-in-Charge
James M. Fields, Social Science Analyst
Ann L. Baker, Staff Evaluator

European Office

John W. Nelson, Site Senior
Yolanda C. Garcia, Staff Evaluator
James A. Perez, Staff Evaluator

Far East Office

Michael D. Rohrback, Site Senior
Suzanne P. Nagy, Staff Evaluator

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