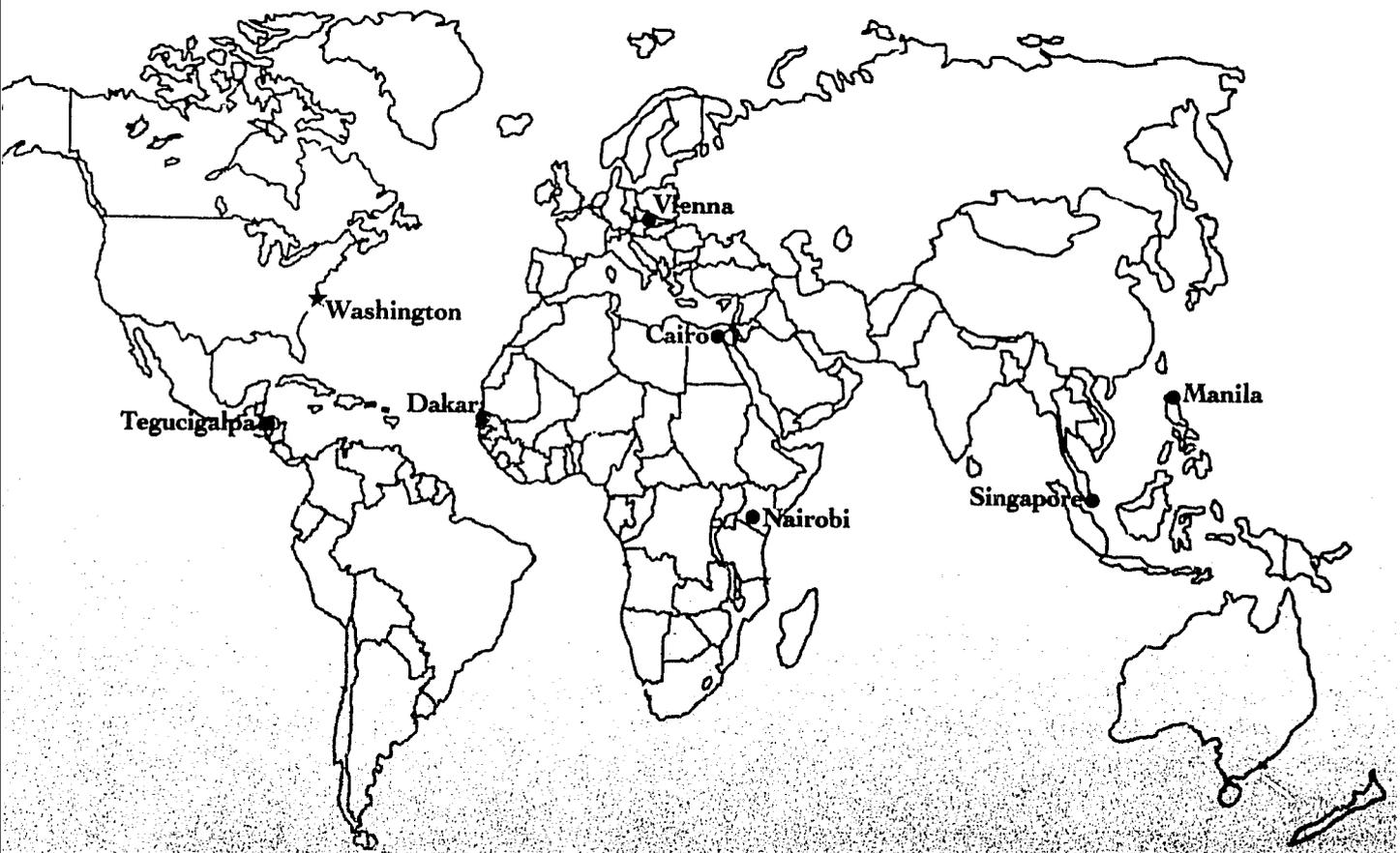


**Regional Inspector General for Audit
Singapore**

**AUDIT OF USAID/SRI LANKA AND THE
A.I.D. REGIONAL CONTRACTING OFFICE'S
CONTROLS OVER A.I.D.-DIRECT
CONTRACTS FOR TECHNICAL ASSISTANCE**

**Report No. 5-383-92-04
March 19, 1992**



Agency for International Development

Washington, D.C. 20523

*Assistant Inspector General
for Audit*

March 19, 1992

MEMORANDUM FOR AA/FA, Richard A. Ames

FROM: AIG/A, John P. Competello 

SUBJECT: AUDIT OF USAID/Sri Lanka and the A.I.D. Regional Contracting Office's Controls Over A.I.D.-Direct Contracts for Technical Assistance Audit Report No. 5-383-92-04

The Office of Inspector General has made an audit of USAID/Sri Lanka and the A.I.D. Regional Contracting Office's Controls Over A.I.D.-Direct Contracts for Technical Assistance. Attached are five copies of the final report.

The audit report contains recommendations addressed to USAID/Sri Lanka, the A.I.D. Regional Contracting Office and to your office. Recommendation Nos. 3, 10, and 12 are addressed to your office. Written comments were provided by your office to the draft report and to the recommendations addressed to your office. The written comments were considered when finalizing the audit report. The comments are summarized after each finding and presented in total as Appendix III. Based on your comments, all three recommendations are resolved and can be closed when the planned actions are completed.

Audits of USAID Missions' controls over technical assistance contracts have now been completed in Nepal and Sri Lanka. Additionally, substantial field work has been completed in Indonesia and the Philippines. While audit results from these reviews do vary, we have noticed a systemic problem concerning poor documentation in various contracting, monitoring, and payment procedures. Poor documentation weakens internal controls and does not ensure the A.I.D. funds are properly protected. I call this trend to your attention at this time to enable your office to consider appropriate worldwide action prior to obtaining additional final audit reports.

I do appreciate the cooperation and courtesies your Office of Procurement extended to my staff when finalizing the audit report. Please provide me a response within 30 days indicating the actions planned or taken to fully implement the three recommendations addressed to your office.

Attachments: a/s



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

DATE: March 19, 1992

REPLY TO

ATTN OF: *James B. Durnil*
James B. Durnil, RIG/A/Singapore

SUBJECT: Audit of USAID/Sri Lanka and the A.I.D. Regional Contracting Office's Controls Over A.I.D. - Direct Contracts for Technical Assistance
Audit Report No. 5-383-92-04

TO: Richard Brown, Mission Director
USAID/Sri Lanka

Enclosed are five copies of our final audit report on USAID/Sri Lanka and the A.I.D. Regional Contracting Office's Controls Over A.I.D.-Direct Contracts for Technical Assistance. We reviewed your comments to the draft report when finalizing the audit report and have included the comments in total as Appendix IV to this report. Based on your comments, Recommendation No. 7 is closed. All other recommendations addressed to USAID/Sri Lanka (Recommendation Nos. 1, 2, 8, 11, 14, and 15) are resolved and can be closed when planned actions are completed.

Please provide us information within 30 days indicating any actions planned or taken to implement the open recommendations. I appreciate the cooperation and courtesies extended to my staff during the audit.

Attachments: a/s



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

DATE: March 19, 1992

REPLY TO

ATTN OF: *James B. Durnil*
James B. Durnil, RIG/A/Singapore

SUBJECT: Audit of USAID/Sri Lanka and the A.I.D. Regional Contracting Office's Controls Over A.I.D.-Direct Contracts for Technical Assistance
Audit Report No. 5-383-92-04

TO: Leonard Kata, Regional Contracting Officer
USAID/India

Enclosed are three copies of our final audit report on USAID/Sri Lanka and the A.I.D. Regional Contracting Office's Controls Over A.I.D.-Direct Contracts for Technical Assistance. We reviewed your written comments on the draft report when finalizing this report and have included these comments in total as Appendix V to this report. Based on the comments you provided to the draft audit report, Recommendation Nos. 4, 5, 6, 9.1, 13 and 16 are resolved and can be closed when planned actions are completed. Recommendation No. 9.2 is unresolved pending an agreement on necessary corrective actions.

Please provide us information within 30 days indicating any actions planned or taken to implement the open recommendations. I appreciate the cooperation and courtesies extended to my staff during the audit.

Attachments: a/s

EXECUTIVE SUMMARY

A.I.D. - direct contracts for technical assistance are used to support most A.I.D. - funded projects in Sri Lanka. As of December 31, 1991, USAID/Sri Lanka administered 10 active A.I.D. - direct contracts for technical assistance with estimated costs of \$46.2 million. A.I.D. obligations and expenditures amounted to \$40.2 million and \$29.8 million, respectively. For these contracts, USAID/Sri Lanka is responsible for determining the need for technical assistance, monitoring contractor performance, and ensuring that A.I.D. funds are properly accounted for. Also, the A.I.D. Regional Contracting Office is responsible for the procurement process.

We audited USAID/Sri Lanka and the A.I.D. Regional Contracting Office's controls over A.I.D. - direct contracts for technical assistance in accordance with generally accepted government auditing standards (see Appendix I). The audit found that improvements could be made in the design and application of A.I.D.'s controls over direct contracts, particularly in the procurement, monitoring, and payment processes. For example, USAID/Sri Lanka did not prepare work statements and cost estimates in sufficient detail for (1) the Contracting Officer to evaluate effectively cost and technical proposals and (2) the Mission to evaluate effectively contractor performance. Moreover, the A.I.D. Regional Contracting Officer did not obtain provisional and final indirect cost rates in accordance with Government regulations, in part, because A.I.D.'s guidance in this area was not clear. Nor did the Contracting Officer monitor subcontracting. Furthermore, A.I.D. management did not establish requirements and guidance for obtaining periodic audits of contractors.

During our audit, however, A.I.D./Washington initiated a number of measures to help strengthen the contracting process, clarify roles and responsibilities, and reduce some of the confusion within A.I.D. of what is required. Part of this confusion has centered on the role of A.I.D. management versus the role of the Office of Inspector General in ensuring accountability over funds provided for technical assistance. A.I.D./Washington has been responsive to the concerns of the Office of Inspector General and continues to work closely with our Washington offices in strengthening controls over technical assistance. The following highlights significant findings in the design and application of controls over direct contracts for technical assistance in Sri Lanka:

- **Except for preparing detailed work statements and independent cost estimates, USAID/Sri Lanka planned for technical assistance in accordance with A.I.D. policies and procedures (see page 3).**

- **The A.I.D. Regional Contracting Office followed U.S. Government and A.I.D. policies and procedures in selecting the appropriate type of contract and providing for full and open competition. However, the A.I.D. Regional Contracting Office did not always follow these policies and procedures to ensure that technical assistance was procured from qualified contractors and at a fair price. Also, A.I.D./Washington needed to establish clearer procedures for obtaining provisional indirect cost rates (see page 8).**
- **USAID/Sri Lanka and the A.I.D. Regional Contracting Office did not follow U.S. Government and A.I.D. policies and procedures in monitoring contractor performance (see page 17).**
- **USAID/Sri Lanka and the A.I.D. Regional Contracting Office generally did not follow U.S. Government and A.I.D. policies and procedures in reviewing contractor vouchers for reimbursement, ensuring that contractor final indirect cost rates were promptly negotiated, or processing contractor progress payments in a timely manner. Also, A.I.D./Washington needed to establish requirements for periodic audits and to obtain final indirect cost rates (see page 26).**

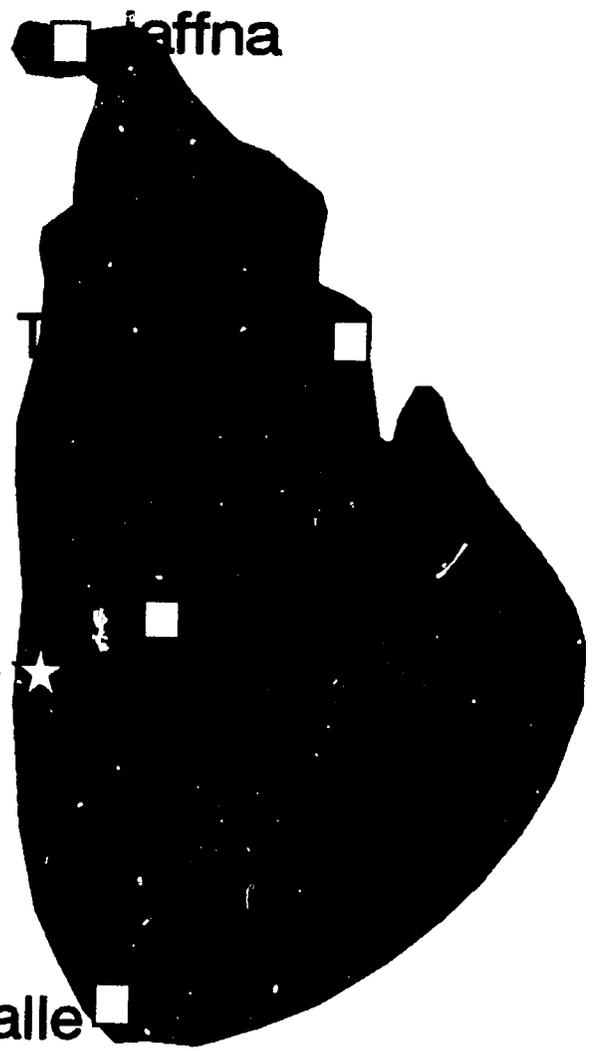
This report contains 16 recommendations addressed to three A.I.D. offices – the Office of the Associate Administrator for Finance and Administration, USAID/Sri Lanka, and the A.I.D. Regional Contracting Office. The report also presents our assessment of internal controls (see page 37) as well as USAID/Sri Lanka's and the A.I.D. Regional Contracting Office's compliance with applicable laws and regulations (see page 42).

In responding to the draft report, A.I.D. management generally agreed with the recommendations, but took exception to some of the report's conclusions. For example, the Associate Administrator for Finance and Administration believes that budget constraints, which the report did not give adequate recognition to, impaired A.I.D.'s ability to ensure better accountability over technical assistance. USAID/Sri Lanka believes that the Mission generally followed U.S. Government regulations and A.I.D. policies, and that the auditors were too subjective in assessing performance against those standards. The comments received from the Associate Administrator for Finance and Administration, USAID/Sri Lanka, and the A.I.D. Regional Contracting Office are summarized after each finding and included in their entirety as Appendices III, IV, and V to this report.

Office of the Inspector General

Office of the Inspector General
March 19, 1992

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Sri
Lanka

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INTRODUCTION

BACKGROUND

A.I.D. - direct contracts for technical assistance are used to support most A.I.D. - funded projects in Sri Lanka. For these contracts, USAID/Sri Lanka is responsible for determining the need for technical assistance, monitoring contractor performance, and ensuring that A.I.D. funds are properly accounted for. Also, the A.I.D. Regional Contracting Office (located in New Delhi, India) is responsible for the procurement process, including negotiations of contract amounts. A.I.D.'s Directorate for Finance and Administration is responsible for establishing indirect cost rates of those U.S. - based technical assistance contractors for which A.I.D. has cognizance. Additionally, the Directorate is responsible for formulating, reviewing, issuing and evaluating A.I.D. policies and regulations relating to A.I.D. - direct contracts.

As of December 31, 1991, USAID/Sri Lanka administered 10 active A.I.D. - direct contracts for technical assistance with estimated costs of \$46.2 million. A.I.D. obligations and expenditures as of that date amounted to \$40.2 million and \$29.8 million, respectively.

AUDIT OBJECTIVES

The Office of the Regional Inspector General for Audit/Singapore audited USAID/Sri Lanka and the A.I.D. Regional Contracting Office's controls over A.I.D. - direct contracts for technical assistance to answer the following audit objectives:

- Did USAID/Sri Lanka follow A.I.D. policies and procedures in **planning for technical assistance**?
- Did the A.I.D. Regional Contracting Office follow U.S. Government and A.I.D. policies and procedures in **procuring technical assistance** at a fair price, selecting the appropriate type of contract, providing for full and open competition, and selecting qualified contractors?
- Did USAID/Sri Lanka and the A.I.D. Regional Contracting Office follow U.S. Government and A.I.D. policies and procedures in **monitoring contractor performance**?

- **Did USAID/Sri Lanka and the A.I.D. Regional Contracting Office follow U.S. Government and A.I.D. policies and procedures in reviewing contractor vouchers for reimbursement, processing contractor progress payments in a timely manner, and ensuring that contractor final indirect cost rates were promptly negotiated?**

In answering these audit objectives, we tested whether USAID/Sri Lanka and the A.I.D. Regional Contracting Office followed applicable internal controls and complied with certain provisions of laws and regulations. Our tests were sufficient to provide reasonable assurance that our answers to the above audit objectives are valid. Also, we included steps to detect abuse or illegal acts that could affect the audit objectives. Furthermore, when we found problem areas, we performed additional work to:

- **Identify the cause and effect of the problem; and**
- **Make recommendations to correct the condition and cause of the problem.**

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

REPORT OF AUDIT FINDINGS

Did USAID/Sri Lanka follow A.I.D. policies and procedures in planning for technical assistance?

USAID/Sri Lanka planned for technical assistance in accordance with A.I.D. policies and procedures except for preparing well-defined work statements and detailed independent cost estimates.

The project designs identified technical assistance needs and provided procurement plans in accordance with A.I.D. policies and procedures. For the four contracts reviewed, with total estimated costs of \$21.5 million, technical assistance needs were related to project objectives. Also, project designs specified such information as the kinds of goods and services to be procured, probable sources, contracting modes and procedures to be used, and implementation plans in accordance with the policies and procedures described in A.I.D. Handbook 3, Chapter 3.

USAID/Sri Lanka, however, should improve its procedures for preparing work statements and independent Government cost estimates for proposed contracts.

Work Statements Need Improvement

Contrary to A.I.D. policies and procedures, USAID/Sri Lanka's Project Officers did not establish specific performance standards when preparing work statements. These officers wrote the work statements in general terms—lacking specific tasks and time requirements—because USAID/Sri Lanka did not require staff to follow the applicable policies and procedures. More detailed work statements can help (1) the Contracting Officer evaluate the reasonableness of contractor cost proposals and (2) USAID/Sri Lanka measure the effectiveness of contractor performance.

Recommendation No. 1: We recommend that USAID/Sri Lanka issue instructions requiring work statements to include measurable targets and time frames to objectively monitor and evaluate contractor progress.

A.I.D. Handbook 3, Supplement A (Appendix C), states that the work statement is the single most important portion of the planning document (Project Implementation Order/Technical Services) and resultant contract. The work statement must include specific targets and time frames which will enable A.I.D. and others (e.g. host government officials and project evaluators) to objectively monitor and evaluate the contractor progress in achieving project objectives. Even in contracts calling for level-of-effort, the work statement should provide the detail of what A.I.D. wants the contractor to do and when A.I.D. wants it done. For example, work might be divided into discrete phases of accomplishments, each of which must be completed and approved before the contractor may proceed to the next phase. The work statement is the essence of the agreement between A.I.D. and the contractor on what is to be done and should bind the contractor to specific obligations.

The work statements of the four USAID/Sri Lanka contracts reviewed do not clearly define the work to be performed. Specific examples are as follow:

- **The overall objective of a \$2.2 million technical assistance contract for the Private Sector Policy Support Project was to facilitate the growth of capital and securities markets in Sri Lanka by providing assistance to the Securities Council and the Colombo Securities Exchange. Although the work statement included six general tasks, none of these tasks included specific targets and time frames to measure contractor progress. For example, two project objectives were to increase significantly the number of companies listed and the number of shares traded on the Exchange. The work statement, however, only bound the contractor to "encourage more companies to seek listings on the Exchange." The contractor had no specific targets, such as numbers of new companies listed or shares traded, and USAID/Sri Lanka had no time frames with which to monitor contractor progress.**
- **The principle objective of a \$9.5 million technical assistance contract for the Mahaweli Agricultural and Rural Development Project was to develop a system for the generation and dissemination of new agricultural technologies and irrigation management strategies by providing assistance to the Mahaweli Authority in Sri Lanka. Although the work statement identified six tasks aimed at achieving this objective, it did not set out methodologies and interim objectives. For example, one task was to improve the capability of the Government of Sri Lanka to manage the main irrigation system. While this task was consistent with the contract objective, the work statement did not define specific areas of improvement required or time frames for accomplishing the improvements.**

The work statements were not clearly defined because USAID/Sri Lanka did not require its staff to follow the above A.I.D. policies and procedures. Mission officials said that work statements were written in general terms to allow contractors flexibility and not bind them to specific requirements. The officials believed that this practice prevents contractors from making excuses about inadequate performance; that is, a particular task may need to be performed even if it is not specified in the contract. The officials also said that, prior to contract award, it was difficult both to determine in sufficient detail what contractors could accomplish and to identify more specific indicators for monitoring contractor performance. The officials believed that the performance indicators should be established by contractors in work plans.

We disagree with USAID/Sri Lanka's position. A.I.D. Handbook 3 specifically requires detailed work statements. Also, if the Mission does not determine during planning what contractors are to do, there is very little basis for determining what type of technical assistance is needed and how much it should cost. In our view, work plans developed after the contract award process should complement, not substitute for, detailed work statements developed during the planning process and included in contracts.

Well-defined work statements can help (1) the Contracting Officer evaluate the reasonableness of contractor cost proposals (see page 13) and (2) USAID/Sri Lanka measure the effectiveness of contractor performance (see page 17). Accordingly, USAID/Sri Lanka should ensure that work statements are well-defined and include specific targets and time frames to measure contractor performance as prescribed by A.I.D. policies and procedures.

Management Comments and Our Evaluation

USAID/Sri Lanka did not fully agree with the auditors' opinion on this finding. Mission officials believe that the finding raised issues that are judgmental in nature, particularly in areas where A.I.D. guidance is less helpful. In areas that are not easily quantifiable and that deal with innovative development concepts, Mission officials believe that they have flexibility in deciding which procedures would achieve the intended results. Nevertheless, USAID/Sri Lanka agreed with the recommendation and proposed to modify Mission procedures to require detailed methodologies, interim targets, and timetables in work statements.

Based on USAID/Sri Lanka's planned actions, Recommendation No. 1 is resolved and will be closed when USAID/Sri Lanka provides documentary evidence that its procedures have been modified to ensure that work statements for technical assistance contracts include measurable targets and time frames to objectively monitor and evaluate contractor progress.

Government Cost Estimates Need Improvement

The Federal Acquisition Regulation and A.I.D. procedures require that independent U.S. Government cost estimates be prepared for use in evaluating cost proposals. Although USAID/Sri Lanka prepared cost estimates for the four contracts reviewed, these estimates did not contain the required details because USAID/Sri Lanka inappropriately relied on the A.I.D. Regional Contracting Officer to obtain the details in the course of contact negotiations. The lack of detailed cost estimates not only does not comply with U.S. Government and A.I.D. requirements, but also inhibits A.I.D.'s ability to evaluate the reasonableness of cost proposals.

Recommendation No. 2: We recommend that USAID/Sri Lanka establish procedures requiring that independent U.S. Government cost estimates be prepared with the details required by the Federal Acquisition Regulation and A.I.D. policies and procedures.

The Federal Acquisition Regulation, Subpart 15.805-3(c), requires Contracting Officers to compare costs proposed by prospective contractors with independent U.S. Government cost estimates. A.I.D. Handbook 3, Supplement A (Appendix D), states that the development of an independent Government cost estimate is an essential element in the procurement process. First, it provides a basis for determining whether a requirement can be fulfilled within available funding. Second, it provides a benchmark against which technical and cost proposals can be evaluated. The Handbook further requires the estimates to be broken down into several line items such as home and field salaries, allowances, fringe benefits, international and local travel, and transportation.

The independent Government cost estimates for the four technical assistance contracts reviewed lacked the required line item details. For example:

- Field and home office salaries should be differentiated, and salary ranges should be established for each area of expertise and expressed in terms of the equivalent A.I.D. direct-hire salary scale for the levels of expertise required. However, none of the cost estimates included the equivalent A.I.D. direct-hire salary scale. Furthermore, in preparing U.S. Government cost estimates, USAID/Sri Lanka did not always separate costs for salary, fringe benefits, travel and transportation, overhead, and other costs. Rather, USAID/Sri Lanka combined these costs into one broad category—"Salaries"—for two contracts in our sample. Therefore, the Contracting Officer had little basis to negotiate these costs, which for salaries alone were negotiated at \$464,884 and \$287,417, respectively.

- **Travel and transportation costs should be broken down into domestic and international categories, and should be presented in terms of individual round trips. The Government cost estimates for three of four contracts reviewed did not provide breakdowns indicating the number of trips required or the trips' respective costs. Two cost estimates did not even have a line item for travel and transportation, although a total of \$435,561 were earmarked for travel in the contracts. The cost estimate for the third contract broke-down the number of non-work related trips, such as home leave, but did not breakdown work-related travel and costs, negotiated at \$308,919.**

These cost estimates lacked the required details because of the USAID/Sri Lanka position that it relies on the Contracting Officer to obtain specific cost information in the course of negotiations with contractors, a position also held by the A.I.D. Regional Contracting Officer. This Officer did not believe that the Government cost estimates provided by USAID/Sri Lanka were needed. The Officer said that the lack of details did not impair his ability to negotiate contracts. However, as discussed later in this report (see page 13), the A.I.D. Regional Contracting Officer did not document the reasonableness of the prices negotiated for the four contracts.

Besides not complying with U.S. Government and A.I.D. requirements, the lack of detailed cost estimates inhibits A.I.D.'s ability to evaluate the reasonableness of contractor cost proposals. Therefore, USAID/Sri Lanka should establish procedures for preparing detailed U.S. Government cost estimates in accordance with the Federal Acquisition Regulation and A.I.D.'s implementation guidelines to provide the A.I.D. Regional Contracting Officer with a reliable tool for evaluating the reasonableness of contractor cost proposals.

Management Comments and Our Evaluation

USAID/Sri Lanka did not fully concur with the finding. Mission officials believe that they developed cost estimates, on the whole, in accordance with A.I.D. guidance and that our assertion that the cost estimates were not sufficiently detailed was judgmental. Nevertheless, Mission officials said that they will prepare a standard format for use in estimating contractor costs.

According to Handbook 3, Supplement A (Appendix D), cost estimates should be broken down into 13 line items, including allowances, fringe benefits, international and local travel, indirect cost, transportation, and fixed fee. As mentioned, the contracts reviewed clearly did not include all such items. Based on USAID/Sri Lanka's planned actions, Recommendation No. 2 is resolved and will be closed when the Mission provides documentary evidence that procedures have been developed to ensure that independent U.S. Government cost estimates are prepared as required by the Federal Acquisition Regulation and A.I.D. policies and procedures.

Did the A.I.D. Regional Contracting Office follow U.S. Government and A.I.D. policies and procedures in procuring technical assistance at a fair price, selecting the appropriate type of contract, providing for full and open competition, and selecting qualified contractors?

The A.I.D. Regional Contracting Office followed U.S. Government and A.I.D. policies and procedures in selecting the appropriate type of contract and providing for full and open competition. However, the A.I.D. Regional Contracting Office did not always follow these policies and procedures to ensure that technical assistance was procured from qualified contractors and at a fair price.

The Federal Acquisition Regulation (Subpart 16.301-2) and A.I.D. Handbook 1, Supplement B (Section 12B 2h), allow cost reimbursement-type contracts when uncertainties in contract performance do not permit costs to be estimated to the same degree of accuracy as fixed-price contracts. In the four contracts reviewed for this aspect, the services could not be sufficiently defined to form a basis for a fixed-price contract. Therefore, the A.I.D. Regional Contracting Officer appropriately selected cost reimbursement-type contracts.

The Federal Acquisition Regulation (Subpart 6.101) and A.I.D. Handbook 1, Supplement B (Section 12B 2c), require Contracting Officers to promote and provide for full and open competition in soliciting offers from prospective contractors. The A.I.D. Regional Contracting Officer satisfied these requirements for the four contracts reviewed. For example, evaluation factors for making selections and their relative importance were provided in Requests for Proposals; Requests for Proposals were published in the Commerce Business Daily; the technical evaluation committee evaluated each proposal based on the evaluation criteria and submitted reports to the A.I.D. Regional Contracting Officer; and the A.I.D. Regional Contracting Officer prepared the required memoranda of negotiations.

The A.I.D. Regional Contracting Officer, however, needs to (1) obtain indirect cost rates from the proper office, (2) obtain necessary data and prepare documentation to support the reasonableness of negotiated contract costs, and (3) better support determinations that technical assistance is procured from responsible contractors.

**Provisional Indirect Cost Rates
Were Not Properly Established**

The Federal Acquisition Regulation and A.I.D. policy require that each contractor's indirect cost rates be established by the U.S. Government contracting office having cognizance for that contractor and be based on reliable data or experience. The

A.I.D. Regional Contracting Officer did not obtain provisional indirect cost rates for three of five contractors reviewed in accordance with these requirements because (1) the A.I.D. Regional Contracting Officer established the rates without coordinating with the cognizant contracting office, and (2) A.I.D. did not establish clear procedures for implementing the A.I.D. policy. As a result, A.I.D. paid the three contractors \$2.3 million of \$2.9 million in estimated indirect costs without knowing whether the billing rates for those costs were correct.

Recommendation No. 3: We recommend that the Associate Administrator for Finance and Administration establish clear procedures for obtaining the proper indirect cost rates for U.S. - based contractors. These procedures should clearly define how A.I.D. Contracting Officers should obtain current provisional indirect cost rates when the cognizant contracting office is (a) A.I.D.'s Office of Overhead and Special Cost and Contract Close-Out or (b) another U.S. Government agency.

Recommendation No. 4: We recommend that the A.I.D. Regional Contracting Officer, in coordination with A.I.D.'s Office of Overhead and Special Cost and Contract Close-Out, review the indirect cost rates approved under all USAID/Sri Lanka direct contracts with U.S. - based contractors and:

- 4.1 Obtain evidence that the approved rates are consistent with current rates established by cognizant contracting agencies; and**
- 4.2 Adjust the rates and contractor progress payments for those rates which are inconsistent with the current rates established by cognizant contracting agencies.**

When the U.S. Government enters into a cost-reimbursement contract with a U.S. - based contractor, the contract normally provides for payment of indirect costs—such as overhead, fringe benefits, and other administrative expenses—through the application of an indirect cost rate. An indirect cost rate is a rate, expressed in percentage terms, which represents the ratio of indirect costs incurred in a given period to direct labor cost or another appropriate base for the same period. The indirect cost rate for all U.S. Government contracts with a U.S. - based contractor is supposed to be established by a single U.S. Government office to ensure (1) uniformity of approach with the contractor when more than one contract or agency is involved and (2) economy of administration. To this end, the Federal Acquisition Regulation (Subpart 42.704) establishes the following requirements:

The cognizant contracting officer (usually with the Government agency having the most business with the respective contractor) is responsible for determining the provisional indirect cost rates to be billed under

contracts. These rates shall be established on the basis of information resulting from recent review, previous audits or experience, or similar reliable data or experience of other contracting activities.

To implement this U.S. Government regulation, A.I.D. policy—as enumerated in Contract Information Bulletin (CIB) 90-21—requires a single office to establish indirect cost rates. It states that responsibility for establishing a contractor’s indirect cost rate is specifically assigned to the one Government agency which has cognizance for the contractor. When A.I.D. has cognizance, the CIB states that A.I.D.’s Procurement Support Division, Overhead and Special Cost and Contract Close-Out Branch is the only office in A.I.D. responsible for establishing the rate.

To evaluate compliance with the Federal Acquisition Regulation and A.I.D. policy, we selected five contracts—each with estimated costs of more than \$1 million—which represent (1) the last four contracts awarded and (2) one contract which was previously audited. For three of the five contracts, other U.S. Government agencies had cognizance, while A.I.D. had cognizance for the remaining two contracts.

Although the indirect cost rates of the two contracts for which A.I.D. had cognizance were established in accordance with the above requirements, the rates for the other three contracts¹ were not. For these three contracts, the A.I.D. Regional Contracting Officer established provisional indirect cost rates without consulting the cognizant U.S. Government contracting agencies or obtaining other assurance that these rates were consistent with the current rates established by the cognizant contracting agencies. Moreover, in using his own authority to establish these rates, the Contracting Officer did not support whether recent reviews, previous audits or experience, or similar reliable data provided the required justification for the rates.

The A.I.D. Regional Contracting Officer said that the files provided appropriate justification to support his actions. However, the files did not support this position as illustrated by the following examples:

- **For one contract executed in 1985, the A.I.D. Regional Contracting Officer established a provisional overhead rate of 105 percent of direct salaries of field staff. However, the Defense Contract Audit Agency, not A.I.D., was the cognizant contracting office responsible for establishing the rate. Also, the A.I.D. Regional Contracting Officer’s files contained no evidence of recent reviews, previous audits or experience, or similar reliable data to support the overhead rate. Furthermore, in 1988, the A.I.D. Regional Contracting Officer**

¹ **For these three contracts, A.I.D. had paid \$2.3 million of \$2.9 million in estimated indirect costs as of March 31, 1991.**

increased the provisional overhead rate to 118 percent of direct salaries of field staff. In this instance, the A.I.D. Regional Contracting Officer did receive a rate for this contractor which the Defense Contract Audit Agency established in 1988. However, the indirect cost rate agreement did not specify a field staff overhead rate, and the rate used was a final rate for calendar year 1983, nearly five years prior to the contract amendment. The A.I.D. Regional Contracting Officer did not coordinate with the Defense Contract Audit Agency to (1) determine whether there was a recent field-staff overhead rate, (2) request the establishment of a field-staff overhead rate, or (3) obtain recent reliable data on this contractor. As a result, for the period April 1985 through March 1991, A.I.D. paid this contractor \$2 million for indirect costs without knowing whether these costs were reasonable.

- For another contract, the contractor proposed separate indirect cost rates for "full time" and "intermittent" staff. Although the A.I.D. Regional Contracting Officer again did not coordinate with the cognizant contracting agency, he did consult with A.I.D.'s Office of Overhead and Special Cost and Contract Close-Out on the appropriateness of the rates. That office responded that the cognizant contracting agency had not yet established rates of the kind which the contractor was proposing and that the "various indirect rates being proposed to you appear to be very low" and should only be accepted if the contract defined the rates as both provisional and a ceiling. The A.I.D. Regional Contracting Officer did not request or receive any additional documentation (e.g. a pre-award audit or other reliable data) to support the rates he established, rates which resulted in the budgeting of \$275,131 for the indirect costs.

A major reason for the A.I.D. Regional Contracting Officer not complying with the Federal Acquisition Regulation and A.I.D. policy is that A.I.D. did not establish clear procedures for implementing the requirements. Indeed, while A.I.D. Handbook 17, Chapter 18, states that A.I.D.'s Overhead and Special Cost and Contract Close-Out Branch of the Procurement Support Division is responsible for indirect cost rates and CIB 90-21 emphasized and clarified this policy in 1990, there still exists considerable confusion on how to implement the policy and, what the policy is.

A.I.D. lacks procedures to identify the cognizant contracting agency and to coordinate with that agency when it is identified. At present, the A.I.D. Regional Contracting Officer relies on contractors to tell him which agency has cognizance and, in the case of USAID/Sri Lanka contracts, the Contracting Officer assumed cognizance when no cognizant contracting agency was specified. Even when the Contracting Officer knew which agency had cognizance, he had no procedures for coordinating with that agency to obtain a current indirect cost rate.

In addition to the lack of procedures, confusion over the definition of A.I.D. policy creates a high risk of similar problems occurring at A.I.D. offices worldwide. For example, Washington is the logical location for coordinating coverage among A.I.D./Washington offices, overseas A.I.D. Missions, and other U.S. Government agencies. However, the chief of the Overhead and Special Cost and Contract Close-Out Branch said that this office was responsible only if the contracts were awarded by A.I.D./Washington offices. Thus, in addition to the A.I.D. Regional Contracting Officer, even this A.I.D./Washington office was confused about A.I.D.'s policy, a policy intended to promote uniformity of approach with a contractor when more than one contract or agency is involved and economy of administration.

Because of this confusion, the problems in Sri Lanka are indicative of an Agency-wide problem. Thus, A.I.D. needs to establish clearer procedures for obtaining the proper current provisional indirect costs rates. Also, the A.I.D. Regional Contracting Officer for Sri Lanka should obtain support for the rates established under USAID/Sri Lanka contracts.

Management Comments and Our Evaluation

The Associate Administrator for Finance and Administration concurred with Recommendation No. 3. However, the Associate Administrator believes that our assertion that A.I.D. is not certain of the reasonableness of indirect costs billed by the three contractors is misleading. The Associate Administrator said that the contractor's provisional indirect cost rates were established, and the contracting officer considered them reasonable but only failed to contact A.I.D./Washington to verify these rates. The Associate Administrator believes that the U.S. Government's interests are protected because the rates are subject to adjustment when final rates are negotiated. Nonetheless, the Associate Administrator agreed to issue a revised Contract Information Bulletin emphasizing that Contracting Officers must contact the Overhead and Special Cost and Contract Close-Out Branch in A.I.D./Washington prior to the incorporation of provisional rates into awards with U.S. - based firms and organizations.

Overhead rates do not remain constant. Also, as mentioned, the rates used were outdated, were not being finalized annually, and were not being periodically audited. Therefore, the action which the Associate Administrator plans to take is needed.

The A.I.D. Regional Contracting Officer concurred with Recommendation Nos. 4.1 and 4.2, and will verify provisional indirect cost rates, modify the contracts if required, and adjust contractor progress payments for all current USAID/Sri Lanka contracts.

Based on the Associate Administrator's and A.I.D. Regional Contracting Officer's planned actions, Recommendation Nos. 3, 4.1 and 4.2 are resolved and will be closed when the planned actions have been completed.

Documentation Was Not Sufficient to Support the Reasonableness of Negotiated Prices

The Federal Acquisition Regulation requires the Contracting Officer to evaluate the reasonableness of costs in prospective contractor proposals. The A.I.D. Regional Contracting Officer approved technical assistance contracts for USAID/Sri Lanka without documenting the basis for negotiated costs. The Contracting Officer said that he based determinations of reasonableness on his own experience but, due to time constraints, did not prepare formal cost analyses or otherwise document support for the determinations. As a result, A.I.D. did not have sufficient documentation to substantiate the reasonableness of \$13.1 million of the \$19.7 million negotiated in the four contracts reviewed.

Recommendation No. 5: We recommend that the A.I.D. Regional Contracting Officer establish procedures to:

- 5.1 Obtain necessary data (e.g. field pricing reports) for substantiating the reasonableness of contractor cost proposals; and**
- 5.2 Ensure that cost analyses are documented for each cost element (comparing cost proposals with U.S. Government cost estimates as appropriate) of contractor proposals for negotiated A.I.D. - direct contracts.**

The Federal Acquisition Regulation, Subparts 15.805-1 and 15.805-3, requires the U.S. Government Contracting Officer to make a cost analysis in evaluating the reasonableness of contractor cost proposals. This analysis should compare costs proposed by prospective contractors for individual cost elements with actual cost history, previous cost estimates from the offeror, cost estimates received from other prospective contractors, and independent U.S. Government cost estimates. The cost analysis should also verify cost or pricing data provided by the prospective contractor and analyze subcontract costs. Subpart 15.805-5 requires that:

... contracting officers shall request a field pricing report (which may include an audit review [pre-award survey] by the cognizant contract audit activity) before negotiating any contract or modification resulting from a proposal in excess of \$500,000, except as otherwise authorized under agency procedures, unless information available to the contracting officer is considered adequate to determine the reasonableness of the proposed cost or price. When available data are

considered adequate for a reasonableness determination, the contracting officer shall document the contract file to reflect the basis of the determination.

Subparts 4.801 and 4.803 require that documentation in contract files be sufficient to constitute a complete background for the basis of decisions at each step in the acquisition process. Examples of these documents include pre-award survey reports, references to previous and reliable pre-award survey reports, and cost or price analyses.

The A.I.D. Regional Contracting Officer did not fully comply with the above requirements. As shown in Appendix II, the A.I.D. Regional Contracting Officer did not ensure that sufficient documentation was available to substantiate the reasonableness of \$13.1 million of \$19.7 million negotiated for the four contracts reviewed. For example, the negotiated cost for one contract was \$8.2 million. With the exception of \$3.3 million for salaries and indirect costs, the A.I.D. Regional Contracting Officer did not have documentation (e.g. a pre-award audit report) to substantiate the reasonableness of the remaining \$4.9 million, including such costs as \$2.8 million for subcontracts, \$626,000 for travel and transportation, and \$512,000 for allowances.

The A.I.D. Regional Contracting Officer did not request or obtain field pricing reports for the four contracts reviewed, even though each contract was negotiated at more than \$500,000. Nor did the Officer prepare sufficient documentation to support the reasonableness of negotiated costs. A contributing factor for the lack of supporting documentation were vague work statements developed in the Project Implementation Order/Technical Services (see page 3). If the Mission does not determine during planning what contractors are to do, there is very little basis for determining what the technical assistance should cost. Nonetheless, the Contracting Officer said that the determinations of reasonableness were based on his own experience, but due to time constraints these determinations were not documented.

The A.I.D. Regional Contracting Officer needs to establish procedures to ensure that documentation is available to substantiate the reasonableness of negotiated costs for technical assistance as required by the Federal Acquisition Regulation.

Management Comments and Our Evaluation

The A.I.D. Regional Contracting Officer concurred with Recommendations Nos. 5.1 and 5.2, but said that Contracting Officers' workload frequently make it difficult to comply with administrative requirements for preparing documentation related to substantiation processes and determinations made. Nevertheless, the A.I.D. Regional Contracting Officer agreed that the Federal Acquisition Regulation requires such

documentation and agreed to provide it in accordance with the existing regulations, policies, and procedures. Therefore, the Officer requested that Recommendation Nos. 5.1 and 5.2 be closed upon issuance of the Audit Report.

Recommendations 5.1 and 5.2 are resolved and will be closed when the A.I.D. Regional Contracting Officer has provided documentary evidence to show that the procedures have been implemented, evidence which shows that the necessary data for substantiating the reasonableness of contractor cost proposals have been obtained, and that cost analyses are documented for each cost element.

Documentation Was Not Sufficient to Substantiate Contractor Responsibility

The Federal Acquisition Regulation requires U.S. Government Contracting Officers to determine if a prospective contractor is responsible before awarding a contract and to include supporting documents in the contract file. The A.I.D. Regional Contracting Officer did not comply with these requirements because he believed that he was required to verify responsibility only when doubts about a particular contractor's past performance came to his attention. Without conducting a routine verification to determine if prospective contractors are responsible, A.I.D. is vulnerable to hiring contractors who lack the necessary level of responsibility.

Recommendation No 6: We recommend the A.I.D. Regional Contracting Officer document determinations of responsibility or non-responsibility of prospective contractors and retain this documentation in the contract file as required by the Federal Acquisition Regulation (Subparts 9.104-1, 9.105-2[b] and 9.106-1).

The Federal Acquisition Regulation, Subpart 9.103 (a) requires that contracts be awarded only to responsible contractors. To be determined responsible, Subpart 9.104-1 states that a prospective contractor must:

- Be able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and governmental business commitments;
- Have a satisfactory performance record;
- Have a satisfactory record of integrity and business ethics; and
- Have the necessary organization, experience, and accounting and operational controls, or the ability to obtain them.

If the information on hand is not sufficient to make a determination regarding responsibility, Subpart 9.106-1 states that a pre-award survey is normally required. Subpart 9.105-2(b) states that documents and reports supporting a determination of responsibility or nonresponsibility must be included in the contract file.

The contract files for the four contracts reviewed did not include documents indicating that the A.I.D. Regional Contracting Officer had made proper determinations as to the responsibility of contractors. The A.I.D. Regional Contracting Officer said that he investigates a prospective contractor's responsibility only if he is not familiar with that contractor or has heard negative reports from outside sources. The Officer said that he has never requested a pre-award survey for USAID/Sri Lanka contracts. He added that his signing of the contract is sufficient evidence to show that he has made a determination as to the responsibility of the contractor.

Without conducting a check on prospective contractors, USAID/Sri Lanka may be hiring contractors who lack the necessary level of responsibility. If the checks are not considered necessary because of the contractor's reputation, the Contracting Officer should still document such a decision. Accordingly, we believe that the A.I.D. Regional Contracting Officer should comply with the requirements of the Federal Acquisition Regulation to document the basis for determinations of responsibility.

Management Comments and Our Evaluation

The A.I.D. Regional Contracting Officer believes that determinations of responsibility are self-evident from documentation submitted by offerors as part of the proposal/negotiation process, and that the Officer's signing of the contract can be viewed as an expression of the determination that a potential contractor is responsible. Nevertheless, the Officer said that a Contracting Officer's determination regarding responsibility, along with any documents collected in support of the determination, should be included in the contract negotiation file in accordance with existing regulations, policies, and procedures. Thus, the Officer believes that Recommendation No. 6 should be closed upon issuance of the Audit Report.

Recommendation No. 6 is resolved and will be closed when the A.I.D. Regional Contracting Officer has provided documentary evidence to show that the procedures have been implemented.

Did USAID/Sri Lanka and the A.I.D. Regional Contracting Office follow U.S. Government and A.I.D. policies and procedures in monitoring contractor performance?

USAID/Sri Lanka and the A.I.D. Regional Contracting Office did not follow U.S. Government and A.I.D. policies and procedures in monitoring contractor performance. USAID/Sri Lanka did not enforce requirements that contractors (1) prepare adequate work plans and progress reports to enable A.I.D. to objectively measure contractor performance, and (2) establish adequate controls for non-expendable property purchased under the contracts. Also, the A.I.D. Regional Contracting Officer did not ensure that three of the four contractors complied with subcontracting requirements for procuring goods and services.

Technical Assistance Contractor Work Plans and Progress Reporting Need Improvement

A.I.D. policies and procedures require Missions to monitor contractor performance by clearly defining work requirements and obtaining proper work plans and reports. USAID/Sri Lanka required the four contractors reviewed to prepare work plans setting forth a strategy for meeting project objectives and to report progress. However, the Mission did not obtain work plans and reports with sufficient data to measure contractor performance. This occurred because the Mission did not require contractors to include measurable performance standards in work plans and to report progress against these standards. As a result, USAID/Sri Lanka could not adequately assess the effectiveness of \$4.8 million spent for technical assistance.

Recommendation No. 7: We recommend that USAID/Sri Lanka:

- 7.1 Establish procedures requiring technical assistance contractors to include measurable targets and time frames in work plans to enable an objective assessment of contractor performance;**
- 7.2 Establish procedures to ensure that technical assistance contractors include in quarterly progress reports an assessment as to whether activities are progressing according to the agreed-upon work plan or are ahead or behind schedule for reasons to be specified in the report; and**
- 7.3 Require Project Officers to document reviews of contractor work plans and progress reports and to notify contractors in writing when the reports do not comply with reporting requirements stipulated in the contract.**

Technical assistance contractors assist A.I.D. in assuring the effective and timely implementation of projects. Considering the scope and complexity of activities and functions carried out by contractors, an important responsibility is their periodic progress reports. Consequently, to measure contractor performance, the reporting requirements should be well-defined in the contracts, and reports should include information on achieving established targets. Although in some cases the responsible A.I.D. Project Officer may be fully aware of contractor performance, good reporting by contractors is still needed to enable all interested parties (e.g. external evaluators and other A.I.D. officials) to objectively measure performance.

To ensure good contractor reporting, A.I.D. Handbook 3, Supplement A, stipulates that the A.I.D. Project Officer must monitor contract implementation and ensure that contractor performance is evaluated. The Project Officer should review each progress report and comment upon the report's adequacy, particularly with regard to discussions of progress toward planned targets and identification of actual or potential problem areas. The Project Officer should also bring any deficiencies in the reports (e.g. failure to measure progress toward identified targets) to the contractor's attention along with suggestions to rectify the problems. These cases should be documented in the project file and, if appropriate, brought to the attention of Mission management.

Contract Information Bulletin 85-17 also requires A.I.D. Project Officers to prepare written comments on contractor performance under any contract assigned to him/her for technical cognizance. The Bulletin requires Project Officers to bring any instances of poor performance immediately to the attention of both the contractor and the Contracting Officer.

The standard contract clause, A.I.D. Acquisition Regulation (AIDAR) 752.7026, as modified for each USAID/Sri Lanka contract, requires contractors to prepare quarterly or yearly work plans outlining steps to accomplish contract objectives and to prepare periodic substantive reports indicating progress with recommendations regarding the needs of contract activities.

Our audit of USAID/Sri Lanka's monitoring of work plans and progress reports included the review of four technical assistance contracts with estimated costs totalling \$21.5 million. For only one contract (an \$8.2 million contract under the Mahaweli Enterprise Development Project) did a USAID/Sri Lanka Project Officer document reviews of work plans and progress reports and formally suggest actions to the contractor for improving these documents. These reviews and comments resulted in a 1991 annual work plan which included specific targets and time frames. However, even for this contract, there was no life-of-contract work plan which would enable USAID/Sri Lanka to evaluate whether achievements planned for one year were sufficient to fully accomplish the contract objectives during the remaining years of this five-year contract.

The work plans for the other three contracts reviewed did not include specific targets and time frames needed to objectively monitor and evaluate contractor performance because USAID/Sri Lanka did not require that work plans and progress reports include this information. For example, the work plans and progress reports for a \$2.2 million contract under the Private Sector Policy Support Project did not include specific targets and time frames to measure contractor progress in accomplishing the contract objectives. To measure the contract objective of "encouraging more companies to seek listings on the Exchange," the work plan merely stated that the increasing number of equity holders would be monitored. This indicator is inadequate because targets and time frames projecting numbers of newly listed companies were not established. As for the quarterly progress reports, there was no information indicating how much work remained to be done or what had been accomplished to date on the objectives. The reports merely provided a chronology of events that occurred during the period.

Another example of inadequate work plans and reporting is a \$9.5 million contract under the Mahaweli Agricultural and Rural Development Project. To accomplish the task of efficiently managing a main irrigation system, the calendar year 1990 work plan identified only two subtasks: reducing recurrent costs and reducing water consumption. Although the work plan identified a 5-year goal of reducing recurrent costs by 50 percent, there were no interim targets for achieving this goal and there were no targets established for reducing water consumption. Contractor progress reports for calendar year 1990 did not discuss what specific actions had been taken to reduce water consumption, nor did the reports specify by how much water consumption had been reduced; the reports only stated that training had been provided.

A contributing factor for the lack of detailed work plans and progress reports were the vague work statements developed in the Project Implementation Order/Technical Services and resultant contract (see page 3). If USAID/Sri Lanka does not clearly define life-of-contract objectives, there is very little basis for contractors to prepare annual work plans and periodic progress reports.

In conclusion, USAID/Sri Lanka could not objectively measure contractor performance and, therefore, could not evaluate the effectiveness of technical assistance for which A.I.D. has already paid \$4.8 million. USAID/Sri Lanka should require that work statements and work plans are better defined by including specific indicators to measure contractor progress. USAID/Sri Lanka should also require that contractors provide progress reports which track progress toward meeting these quantified indicators.

Management Comments and Our Evaluation

USAID/Sri Lanka concurred with Recommendation No. 7 and has already implemented the recommended actions. USAID/Sri Lanka strengthened the procedures for managing and monitoring technical assistance contracts. For example, Project Officers are now required to ensure the adequacy of the life-of-project work plans; to receive, evaluate and comment on all quarterly progress reports; and to document the project files.

Based on USAID/Sri Lanka actions, Recommendation No. 7 is closed upon issuance of this report.

Controls Over Non-Expendable Property Need Improvement

A.I.D. policies require Missions to monitor contractor performance by clearly defining contract requirements and confirming that these requirements are fulfilled. USAID/Sri Lanka required contractors to prepare programs, subject to A.I.D. approval, outlining controls over non-expendable property costing \$500 or more. The Mission's Project Officers, however, neither obtained nor approved such programs for the four contractors reviewed because the Mission did not establish procedures to do so. As a result, USAID/Sri Lanka did not have adequate control over \$334,000 worth of A.I.D. - funded property, thereby increasing the vulnerability of the property to waste and abuse.

Recommendation No. 8: We recommend that USAID/Sri Lanka establish procedures to ensure that contractors implement acceptable programs for the receipt, use, maintenance, protection, custody, and care of non-expendable property purchased under contracts.

A.I.D. Handbook 3, Supplement A (Appendix C), requires that contracts clearly define contractor work and reporting requirements, and Handbook 3, Appendix 11E requires Project Officers to monitor the fulfillment of these requirements. Contract clause, AIDAR 752.245, which the Contracting Officer included in all USAID/Sri Lanka contracts reviewed, states that it is A.I.D. policy to vest title with the cooperating country for contractor-acquired non-expendable property costing \$500 or more. The contracts require the contractors to:

... prepare and establish a program to be approved by the Mission, for the receipt, use, maintenance, protection, custody, and care of non-expendable property for which it has custodial responsibility, including the establishment of reasonable controls to enforce such a program.

None of the four contractors reviewed prepared and submitted the required property control program. These contracts had estimated costs of \$730,000 for property, of which \$334,000 had been purchased as of March 31, 1991.

Although the requirement to provide the property programs was incorporated in the contracts, Mission officials said that they were not aware of the requirement to approve these property programs. Therefore, USAID/Sri Lanka had not established procedures to implement the requirement. During the audit, Mission officials said that they were putting into place a new Commodity Management System which would improve controls over contractor-acquired non-expendable property.

As a result of not obtaining and approving property control programs, A.I.D. - funded property may be vulnerable to waste and abuse. For example, our review of property costing \$41,000 purchased by one contractor showed that \$6,600 of this property may not have been required or may have been improperly used. This contractor had claimed reimbursements for six desk-top computers costing \$4,200 each. During our visit to the contractor's main office, we found 4 of the 6 computers. A contractor official said that one computer was located at a field site and the other at his residence. There were no documents indicating why the computer was at the official's residence or that the official had accepted temporary custody of the equipment. Additionally, the contractor's inventory records did not include an A.I.D. - funded portable telephone that cost \$2,400.

Although this example may not be significant in relation to the total cost of technical assistance, it illustrates the control deficiencies of non-expendable property procured by USAID/Sri Lanka contractors. Therefore, USAID/Sri Lanka should ensure that contractors prepare and establish programs, to be approved by USAID/Sri Lanka, for the receipt, use, maintenance, protection, custody, and care of non-expendable property.

Management Comments and Our Evaluation

USAID/Sri Lanka concurred with the recommendation and has initiated the recommended action. USAID/Sri Lanka is putting into place a commodity management system for all project-financed commodities and intends to have the system fully functional by the end of 1992.

Recommendation No. 8 is resolved and will be closed when USAID/Sri Lanka provides documentary evidence that the system has been installed for all of the Mission's direct contracts for technical assistance.

Controls Over Subcontracting Need Improvement

The Federal Acquisition Regulation requires Contracting Officers to monitor contractor performance concerning subcontracting by clearly defining contract requirements and confirming that these requirements are fulfilled. In accordance with the Federal Acquisition Regulation, the four contracts reviewed required contractors to provide certain documentation and to obtain the A.I.D. Regional Contracting Officer's approval prior to the award of subcontracts. However, the requirements were not enforced because the A.I.D. Regional Contracting Officer did not believe that the information was needed to ensure that negotiated prices for subcontracts were reasonable and that proper procurement procedures were followed. As a result, the A.I.D. Regional Contracting Officer did not have documentation to substantiate the reasonableness of approximately \$6 million in costs negotiated for subcontracts under the four prime contracts reviewed. Also, one contractor spent \$135,000 for equipment of questionable origin.

Recommendation No. 9: We recommend that the A.I.D. Regional Contracting Officer:

- 9.1 Require contractors to provide the information required by the Federal Acquisition Regulation contract clause 52.244-2 prior to approving subcontracts for goods and services; and**
- 9.2 Determine whether the \$135,000 of equipment identified in this report complies with the origin requirements of the contracts and, if not, obtain a refund from the contractor.**

The A.I.D. Regional Contracting Officer included the Federal Acquisition Regulation clause 52.244-2, in each contract reviewed. The clause requires the contractor to notify the U.S. Government Contracting Officer reasonably in advance of entering into subcontracts. The contractor shall obtain the Contracting Officer's written consent before procuring any subcontract if the subcontract is cost-reimbursement; time-and-materials or labor-hour type; fixed-price and exceeds either \$25,000 or five percent of the total estimated cost of the contract; the subcontract has experimental, developmental or research work as one of its purposes; and if the subcontract is not a facilities contract and the proposed subcontract provides for the fabrication, purchase, rental, installation, or other acquisition of special test equipment valued in excess of \$10,000.

When the subcontract is to exceed \$10,000, the advance notification should include the following information:

- **Description of the supplies or services to be subcontracted;**
- **Identification of the type of subcontract to be used;**
- **Identification of the proposed subcontractor and an explanation of why and how the proposed subcontractor was selected, including the competition obtained (the Federal Acquisition Regulation, Subpart 13.106, and each contract requires competitive procedures in awarding any subcontract in excess of \$1,000);**
- **Proposed subcontract price and the prime contractor's cost or price analysis; and**
- **Negotiation memorandum.**

The four contractors reviewed had awarded a total of 10 subcontracts totalling \$6.2 million. Although the contracts included the above requirements, the contractors did not provide the required documentation for any of the subcontracts. For example, no cost or price analyses and negotiation memoranda were provided for these subcontracts. The only documents submitted by the contractors were copies of the subcontracts along with requests for approval.

According to the A.I.D. Regional Contracting Officer, subcontracts for technical assistance were included as a part of the prime contractors' cost proposals. Therefore, he only required the contractors to submit, for approval, copies of the negotiated subcontracts when the subcontracts were finalized.

The subcontract information, however, provided in contractor cost proposals did not contain all the information required by the Federal Acquisition Regulation. The proposals contained descriptions of the supplies or services to be subcontracted, lists of key personnel, and the total proposed subcontract prices. None of the proposals, however, included a breakdown of cost elements (e.g. salaries, allowances, and travel and transportation) for the subcontracts. Furthermore, as shown in Appendix II, of the total \$6 million in subcontract costs included in the four negotiated prime contracts reviewed, less than \$100,000 was substantiated by supporting documentation obtained or prepared by the A.I.D. Regional Contracting Officer.

One contractor also procured \$135,000 worth of equipment of questionable origin. A.I.D. Handbook 1, Supplement B (Chapter 5), defines the "origin" of a commodity as the country or area in which the commodity is produced. This contractor was required to ensure that the "origin" of equipment was either the United States or Sri Lanka.

The procurement in question was for the purchase of computer equipment and software. The contractor requested approval from the A.I.D. Regional Contracting Officer in December 1990, and the request was approved in January 1991 based on the Contracting Officer's belief that the origin of the equipment was the United States.

During our visit to the contractor's work site, we were told that the origin of equipment was Brazil and Taiwan. In response to our referral of this matter, A.I.D.'s Procurement Support Division (located in Washington, D.C.) followed up with the U.S. equipment manufacturer and determined that "it is doubtful" the equipment met the "origin" requirements of the contract. The U.S. company had only "assembled" the equipment in the United States. Most of the parts came from Brazil, Taiwan, and Japan.

Based on the above, the A.I.D. Regional Contracting Office should (1) ensure that contractors provide information required by both the Federal Acquisition Regulation and each prime contract prior to approving subcontracts for goods and services, and (2) determine whether the \$135,000 of equipment identified in this report complied with the origin requirements.

Management Comments and Our Evaluation

The A.I.D. Regional Contracting Officer concurred with Recommendation No. 9.1 and said that since the requirement to submit subcontracting information is already a part of the contracts, Recommendation No. 9.1 should be closed upon issuance of the Audit Report. In addition to just concurring with the recommendation, specific action is needed to close the recommendation. Accordingly, this recommendation is resolved and will be closed when the A.I.D. Regional Contracting Officer provides evidence showing that required subcontractor information is being provided.

The A.I.D. Regional Contracting Officer, however, did not concur with Recommendation No. 9.2 and said the following:

There was no determination that the equipment did not meet the origin requirements, the contract to procure the equipment included the clauses related to origin requirements, the equipment which was procured is the equipment that was desired and requested by USAID, the procurement was approved by technical officer and by the A.I.D. Regional Contracting Officer, the equipment was in fact provided, and has met the requirements and expectations of the project. Further, the equipment under question is on the GSA Schedule. The A.I.D.

Regional Contracting Officer has also established that due to the need for the particular equipment procured, the Mission would have issued a source/origin waiver, as appropriate, had one been required.

We realize that there was no determination that the subject equipment did not meet the origin requirements, and recommend that the Contracting Officer find out whether or not those requirements were met. The fact that the equipment was needed, was provided, met project requirements and expectations, etc. does not waive the origin requirements. Accordingly, Recommendation No. 9.2 is unresolved. It will be resolved when the A.I.D. Regional Contracting Officer proposes a definite action plan for making a determination on the allowability of the equipment and for obtaining a refund if the equipment is determined to be unallowable.

Did USAID/Sri Lanka and the A.I.D. Regional Contracting Office follow U.S. Government and A.I.D. policies and procedures in reviewing contractor vouchers for reimbursement, processing contractor progress payments in a timely manner, and ensuring that contractor final indirect cost rates were promptly negotiated?

USAID/Sri Lanka and the A.I.D. Regional Contracting Office generally did not follow U.S. Government and A.I.D. policies and procedures in reviewing contractor vouchers for reimbursement, ensuring that final indirect cost rates were promptly negotiated, and processing contractor progress payments in a timely manner.

USAID/Sri Lanka's Office of Financial Management established a comprehensive voucher review system which has detected questionable claims for which reimbursement was denied. Of 15 vouchers reviewed, USAID/Sri Lanka's Office of Financial Management denied reimbursement for claims totaling \$109,000—10 percent of the total claims of \$1.1 million. All vouchers were also properly approved by authorized Mission officials and processed within sufficient time to avoid interest penalties—the average payment period for 20 invoices reviewed was 22 days, ranging from 11 to 36 days after the invoice was received by the Mission.

Notwithstanding the comprehensive voucher review procedures implemented by the Office of Financial Management, better controls are needed over payments to contractors, prompt negotiation of final indirect cost rates, and taking discounts.

Controls Over Payments to Contractors Need Improvement

Auditing contractors and monitoring contractor costs are essential internal control techniques to ensure that payments are made for allowable costs and that contractors receive timely notification of costs considered to be unallowable as required by the Federal Acquisition Regulation. USAID/Sri Lanka did not obtain periodic audits of U.S. - based contractors because A.I.D. had not established requirements or procedures for obtaining such audits². As a result, A.I.D. does not have reasonable

² A distinction needs to be drawn between performing audits and obtaining audits. While the Inspector General Act, Federal Acquisition Regulation, and Office of Management and Budget policy assign responsibility for performing audit related services to Federal audit agencies, this finding deals with responsibilities assigned to Agency management for obtaining necessary audit coverage.

assurance of paying for only allowable costs. Also, USAID/Sri Lanka could improve its monitoring by more closely examining the support for claimed costs—our limited tests of information available disclosed questionable costs of \$148,768.

Recommendation No. 10: We recommend that the Associate Administrator for Finance and Administration require periodic audits of contractors with A.I.D - funded cost reimbursement contracts and establish implementing procedures.

Recommendation No. 11: We recommend that USAID/Sri Lanka:

- 11.1 Instruct voucher examiners to verify that costs claimed for non-expendable equipment, fringe benefits, overhead, and travel are proper; and**
- 11.2 Determine whether the \$148,768 of costs questioned in this report are allowable and, if not, issue a bill of collection.**

The Federal Acquisition Regulation (Subpart 31.201) requires (1) that payments to contractors be made only for allowable costs and (2) that, to provide for timely resolution of any disagreement, contractors be provided notice as early as practicable during contract performance when costs are considered unallowable under contract terms (Subpart 42.801). To ensure compliance with the Federal Acquisition Regulation, periodic audits of contractors and monitoring of contractor costs are essential internal control techniques.

As discussed below, USAID/Sri Lanka does not have reasonable assurance that payments are made for only allowable costs and that contractors receive timely notification of unallowable costs because (1) it does not obtain periodic audits of U.S. - based contractors, and (2) its voucher examiners do not sufficiently review the support for claimed costs.

Periodic Audits - A.I.D. Controllers commonly certify grantee and contractor vouchers for periodic payments under cost-type contracts without requiring or obtaining full documentation to support the costs claimed. Such vouchers are essentially unaudited except for arithmetical and cumulative cost checks and the review of those documents which are submitted. The vouchers are accepted provisionally, being subject to adjustment upon subsequent audit.

When such procedures are employed by U.S. Government agencies, the Comptroller General of the United States (Decisions B-180264 and B-201408) has ruled that based on 31 U.S.C. 3528 (which governs certifying officer responsibility for the information contained in vouchers and supporting records), to protect the certifying officer from liability, audits should be performed periodically to disclose any overpayment as a result of periodically paying provisional vouchers under cost-type contracts.

Furthermore, periodic audits of grantees and contractors is a primary internal control technique because: (1) many grantee and contractor records are not readily available for review by overseas Missions, records being located in the home offices; (2) A.I.D., rather than waiting for final audits, must provide timely notification to contractors of costs considered unallowable; and (3) A.I.D. must have reasonable assurance that grantees and contractors can account for A.I.D. funds and that these funds are used for intended purposes.

While A.I.D. has established requirements and procedures for obtaining periodic audits of grantees, it has not established requirements and procedures for obtaining periodic audits of contractors. Therefore, such audits were not always obtained.

In 1991, A.I.D./Washington took some important steps toward assuring audit coverage of grantees and contractors. For example, A.I.D. established new audit requirements for non - U.S. grantees in Handbook 13. Also, on June 13, 1991, senior Agency management met with the Office of the Inspector General to discuss improvements needed in the Contract Information Management System. Seven items concerning audit requirements were listed as needing some action by A.I.D. management. Some of the main points discussed at the meeting concerned the absence of accountability over U.S. Government funds provided to grantees and contractors for carrying out authorized programs and the fact that it is A.I.D. management's responsibility to ensure that internal control systems are in place to account for U.S. Government funds provided to grantees and contractors. Subsequent to this meeting, various actions were taken by A.I.D. management to improve controls. For example, A.I.D./Washington drafted a policy on the "Audit Management and Resolution Program" and circulated it for comment. The most recent version of this policy is dated October 10, 1991. While these actions are steps in the right direction for improving controls, specific requirements and procedures have not yet been developed for obtaining periodic audits of A.I.D. contractors.

We realize the complications involved with establishing such requirements and procedures because A.I.D. is not the cognizant U.S. Government agency for all contractors. Other U.S. Government agencies such as the Environmental Protection Agency, Health and Human Services, and the Defense Contract Audit Agency have cognizance for certain contractors. Additionally, priorities and budgetary constraints could, at times, prevent timely audits. In such cases, obtaining compliance with an

audit requirement becomes more complicated. However, until A.I.D. establishes requirements and procedures for obtaining periodic audits, A.I.D. will continue to lack the necessary assurances over the use of its funds. Accordingly, the Associate Administrator for Finance and Administration should establish requirements and procedures for obtaining periodic audits of contractors.

Voucher Reviews - As part of the procedures for implementing the Federal Acquisition Regulation, A.I.D. Handbook 19, Chapter 3 states that the Project Officer is administratively responsible for approving vouchers because he/she is familiar with the projects and can prevent significant errors. Mission Controllers (certifying officers) are responsible for checking vouchers for arithmetical accuracy and for consistency with the contract, grant, or cooperative agreement as necessary before processing payment. The Mission Controller should review all billing items not encompassed in Project Officer reviews, such as home office costs, travel and transportation charges, communication costs, and miscellaneous personnel costs, including housing and education allowances.

To test the adequacy of USAID/Sri Lanka's voucher reviews, we selected 15 vouchers valued at \$1.1 million from five contractors. While USAID/Sri Lanka's reviews identified and eliminated many questionable items, our tests of the 15 vouchers disclosed additional questionable costs totalling \$46,305. Moreover, expanded testing of one contractor's vouchers disclosed an additional \$102,463 in questioned costs. Examples of the questioned costs are noted below:

- Receipts submitted to USAID/Sri Lanka to support the purchase of equipment did not match the \$12,500 claimed. USAID/Sri Lanka's financial management staff attributed the payment of this claim to oversight. The contractor could not provide us the receipt for payment nor the canceled check supporting the payment.
- A contractor claimed an unauthorized field fringe benefit and overhead rate of 48 percent. This "field" rate had neither been approved by the A.I.D. Regional Contracting Officer nor included in the negotiated contract. The amount claimed in the vouchers initially reviewed was \$7,643. Our review of all vouchers submitted by this contractor showed that total payments (as of June 30, 1991) for this field rate were an additional \$102,463. The USAID/Sri Lanka Controller said that these costs were paid because the 48 percent rate claimed was significantly lower than the home office rate. However, this was not adequate justification because most field expenses are charged as direct costs and no field rate had been approved.

- **A short-term advisor on the way to Colombo stopped at another destination for eight days on an assignment not related to A.I.D. business. Because this assignment was not related to the project, the travel costs should have been apportioned and applied to the other organization he was working for. The amount in question was \$778.**
- **One contractor claimed travel and transportation costs incurred under the selected project which should have been claimed under another project or charged against subcontracts. Our limited review of supporting documents for three vouchers identified inappropriate claims for travel and transportation amounting to \$8,209.**

In 1990, USAID/Sri Lanka's financial management staff began scheduling periodic on-site financial reviews of contractor records. The reviews were scheduled on a three-year cycle. Five contractors were scheduled to be reviewed during calendar year 1990, but USAID/Sri Lanka said that only two reviews were performed due to time constraints. Furthermore, Mission officials were only able to provide us with one of these two reports, claiming that the other had been misplaced.

As shown above, our limited testing of payments disclosed questioned or unsupported payments totalling \$148,768. USAID/Sri Lanka should instruct its voucher examiners to more carefully review costs claimed for non-expendable equipment, fringe benefits, overhead, and travel to ensure claims are authorized and supported by required documentation. USAID/Sri Lanka should also determine whether the \$148,768 identified in this report are allowable.

Management Comments and Our Evaluation

The Associate Administrator for Finance and Administration concurred with Recommendation No. 10. The Associate Administrator pointed out that some Contracting Officers even identified their inability to obtain audit support as a serious vulnerability in past internal control assessments. Furthermore, budgetary constraints, including those of the IG's office, have at times prevented timely audits. In conclusion, the Associate Administrator said the following:

As the Office of Procurement assumes responsibility from the Office of the Inspector General for the tracking of the audit status for all U.S. contractors and grantees during FY 1992 (the transfer is to be effective on October 1, 1992), requirements and procedures will be put in place which address the need for periodic audits.

USAID/Sri Lanka concurred with the Recommendation Nos. 11.1 and 11.2. Concerning Recommendation 11.1, Mission officials questioned the assertion that there was not reasonable assurance that payments were made only for allowable

costs. Mission officials said that USAID/Sri Lanka voucher examiners give considerable time and careful attention to the function of reviewing vouchers. But due to a multiplicity of requirements and a heavy workload, the Mission does not have the staff time to give the vouchers the in-depth review conducted by the audit team which inevitably identified some additional questionable costs. Mission officials did say that a training session for all voucher examiners focusing on contractor vouchers will be scheduled. As for Recommendation No. 11.2, Mission officials said that they have resolved some of the question costs and were still examining others.

Base on the above response, Recommendation No. 10 is resolved and will be closed when the audit requirements and procedures are put in place. Also, based on USAID/Sri Lanka's plan to provide additional training for voucher examiners, Recommendation No. 11.1 is resolved and will be closed upon receipt of evidence that the training has been provided to voucher examiners. Recommendation No. 11.2, is also resolved. However, according to Agency procedures, USAID/Sri Lanka and the Office of the Inspector General must still reach agreement on the amounts of questioned costs and the estimated target dates for completing corrective actions. Therefore, in responding to this final report, the Mission should provide (1) supporting information on the costs which the Mission has found to be allowable and (2) target dates for completing planned corrective actions.

Final Indirect Cost Rates Were Not Promptly Negotiated

The Federal Acquisition Regulation requires that contractors submit proposed final indirect cost rates along with supporting cost data within 90 days after the end of the contractor's fiscal year. The Regulation also requires that the appropriate U.S. Government representative and contractor establish the final indirect rate in a timely manner. However, none of the six contractors reviewed submitted the documents as required, and final indirect cost rates were not negotiated in a timely manner. This occurred, in part, because adequate procedures had not been established to emphasize and track the submissions and the negotiations of final indirect cost rates. As a result, indirect costs payments were made to contractors without reasonable assurance that the rates being claimed were proper.

Recommendation No. 12: We recommend that the Associate Administrator for Finance and Administration establish procedures which would:

12.1 Emphasize the need for contractors to provide timely documentation on proposed final indirect cost rates;

12.2 Track contractor submissions to help ensure timely establishments of final rates; and

12.3 Provide for suspension of provisional billing payments if required documentation is not submitted.

Recommendation No. 13: We recommend that the A.I.D. Regional Contracting Officer, in coordination with A.I.D.'s Procurement Support Division:

13.1 Obtain up-to-date final indirect cost rates for USAID/Sri Lanka's direct contracts with U.S. - based contractors; and

13.2 Adjust contractor payments according to applicable clauses, terms, and conditions of affected USAID/Sri Lanka contracts.

The Federal Acquisition Regulation and the six contracts reviewed require the following:

- The contractor shall, within 90 days after the expiration of each of its fiscal years, or by a later date approved by the cognizant contracting officer, submit to the cognizant contracting office (usually with the U.S. Government agency having the most business with the respective contractor) proposed final indirect cost rates for that period and supporting cost data specifying the contract and/or subcontract to which the rates apply. The proposed rates shall be based on the contractor's actual costs experience for that period (FAR clause 52.216-7[d] [2] incorporated in each contract reviewed).
- The appropriate U.S. Government representative and contractor shall establish final indirect cost rates as promptly as practical after receipt of the contractor's proposal (FAR clause 52.216-7[d] [2] incorporated in each contract reviewed).

We concluded that the above requirements were not met. The A.I.D. Regional Contracting Officer did not know if the contractors submitted the proposed final indirect cost rates and supporting cost data within 90 days of each fiscal year. As illustrated by the following, final indirect cost rates were not established in a timely manner:

- A.I.D.'s Procurement Support Division has assumed the role of cognizant U.S. Government contracting office for three of the contractors. In response to our inquiry on whether these contractors submitted the required documents within the 90 day period, the responsible A.I.D. official told us in March 1991 that two contractors

had submitted the documents to the wrong U.S. Government agency for the past two years and the third contractor promised to submit the documents (due September 30, 1990) in the "very near future." Also, final indirect cost rates covering the past two to three fiscal years have not been established for these three contractors. Total estimated indirect costs included in these three contracts amounted to \$4.5 million, of which USAID/Sri Lanka had paid \$1.6 million.

- There was confusion within A.I.D.'s Procurement Support Division and the A.I.D. Regional Contracting Office concerning which, if any, U.S. Government contracting office had accepted cognizance for the other three contracts. These officials also did not know if the contractors had submitted the required documents or whether final rates had been negotiated. These contracts were awarded between 1985 and 1990. Total estimated indirect costs for the three contracts amounted to \$2.9 million, of which USAID/Sri Lanka had paid \$2.3 million.

The above examples are indicative of confusion within A.I.D. on who is responsible for identifying and coordinating with the cognizant U.S. Government contracting office to ensure that the required documents are submitted by contractors, and final indirect cost rates are negotiated in a timely manner.

Although A.I.D. Handbook 17 (Chapter 18) states that A.I.D.'s Procurement Support Division is responsible for establishing indirect cost rates for A.I.D. - financed contracts, officials from that office said that they were only responsible for contractors to whom A.I.D./Washington had awarded contracts and for whom their office had accepted cognizance. They said that A.I.D. Regional Contracting Offices were responsible for identifying and coordinating with cognizant U.S. Government offices in all other cases. They added that, if no other U.S. Government contracting office assumes cognizance, the appropriate A.I.D. Regional Contracting Office is then responsible for ensuring that the contractor submits the required documents and that final indirect cost rates are negotiated in a timely manner.

We realize that coordinating contractor submissions is a complicated issue. There are many different contractors and no one U.S. Government office has cognizance over all contractors. Additionally, some U.S. contractors deal directly with A.I.D. Missions overseas without going through A.I.D./Washington. Also, cognizant audit agencies cannot always provide timely information to support indirect cost rate determinations. However, USAID/Sri Lanka has paid contractors millions of dollars for indirect costs based on provisional rates without full assurance that the provisional rates are proper. Accordingly, A.I.D. needs to establish procedures for obtaining the required documentation on indirect cost rates from contractors and for ensuring that those rates are established in accordance with the Federal Acquisition Regulation. Also, the A.I.D. Regional Contracting Office, in coordination with the

Procurement Support Division, needs to ensure that USAID/Sri Lanka's contractors have provided up-to-date documentation to the cognizant U.S. Government contracting office, and that applicable indirect cost rates are finalized.

Management Comments and Our Evaluation

The Associate Administrator for Finance and Administration said that since the beginning of 1991, A.I.D. management has been working closely with the staff of the Office of the Inspector General to devise a program to address the deficiencies identified in Recommendation No. 12. The program will require the Office of Procurement to track audits of all U.S. - based contractors. Missions will maintain an inventory and track required audits of all non - U.S. contractors. Fiscal year 1992 is to be a transitional period wherein Office of Inspector General and Office of Procurement personnel will work together to define and establish the Agency's audit tracking system. This system is to contain data on the audit and indirect cost rate status for all U.S. firms and organizations with A.I.D. contracts and grants. The system will also include information identifying the cognizant agency for each firm.

Based on the above, Recommendation No. 12 is resolved and will be closed when the Associate Administrator provides documentary evidence that: (1) the need for contractors to provide timely documentation on proposed final indirect cost rates has been emphasized; (2) the audit tracking system has been put in place; and (3) provisions have been made for suspending progress payments when required documentation is not submitted.

The A.I.D. Regional Contracting Officer concurred with Recommendation No. 13.1 and 13.2, and said that all current USAID/Sri Lanka contracts will be reviewed to determine the currency of final indirect cost rates and obtain evidence on the validity of these rates. Also, the A.I.D. Regional Contracting Officer requested that Recommendation No. 13.1 and 13.2 be consolidated with Recommendation No. 3.

Recommendation No. 13.1 and 13.2 are resolved and will be closed when evidence is provided that the planned actions are completed. To facilitate administering recommendation closure, we prefer to keep the recommendations separate. Although the subject matter is related, the recommendations require dissimilar actions at different occasions and by different offices.

Controls Over the Timing of Payments Need Improvement

USAID/Sri Lanka did not take available cash discounts as required by A.I.D. policies and procedures because Mission officials did not know how to compute the discount period. Based on the estimated costs for two contracts reviewed, we estimate that future discounts would save the U.S. Government \$62,400.

Recommendation No. 14: We recommend that USAID/Sri Lanka:

- 14.1 Document the Mission's process for ensuring that cash discounts are taken when offered by contractors and, if not taken, report such instances to A.I.D./Washington; and**
- 14.2 Take the discounts offered by the contractors identified in this report.**

The Federal Acquisition Regulation (Subpart 32.9) requires each U.S. Government agency to establish policies and procedures for implementing the Prompt Payment Act (Public Law 97-177). A.I.D. implementing guidance is prescribed in A.I.D. Handbook 19 (Chapter 3) which requires that:

- Payment procedures be designed to automatically take advantage of cash discounts when offered by contractors. The computation of the discount period should be based on the date the contractor's invoice is received or such other date identified in the contract or invoice. All discounted payments will be scheduled for check issuance on the last day of the discount period.
- Checks for all other payments be scheduled for issuance to the payee as close as administratively possible to the thirtieth (30th) day from receipt of the invoice or acceptance of goods or services, whichever is later. If payment is not made within 15 days after this due date, interest penalties should be automatically paid to the payee.
- Missions submit reports to A.I.D./Washington on available discounts not taken and penalties paid for late payments to contractors.

USAID/Sri Lanka complied with the above requirements for processing payments in a timely manner—the average payment period for 20 invoices reviewed was 22 days, ranging from 11 to 36 days after the invoice was received by USAID/Sri Lanka.

Discounts offered under two contracts (one contractor), however, were not taken and no reports were made to A.I.D./Washington. For example, one contractor allowed a discount of three quarters of one percent if paid within 15 days. In our sample of eight invoices from this contractor, all were administratively approved within six days of receipt by USAID/Sri Lanka and could have been scheduled for payment within the discount period. But no discounts were taken.

Mission officials said that they did not take the discounts because they were not sure whether the discount period started on the invoice date or when the invoice was

received. The cash discounts not taken were not reported to Washington because they were confused about the reporting requirements. However, Mission officials said that they would ensure that discounts were taken in the future.

Based on future estimated payments under the two contracts, the cash discounts (savings to the U.S. Government) over the remaining life of the contracts will total \$62,400. Thus, we believe that USAID/Sri Lanka should develop procedures to ensure that cash discounts are taken when offered by contractors.

Management Comments and Our Evaluation

USAID/Sri Lanka concurred with Recommendation Nos. 14.1 and 14.2. Mission officials said that they are now taking the discounts offered and have established procedures for ensuring that cash discounts are taken. Accordingly, Recommendation Nos. 14.1 and 14.2 are resolved and will be closed when the Mission provides evidence of the discounts taken and a copy of the procedures.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of internal controls for the audit objectives, as well as recommendations to improve reporting under the Federal Managers' Financial Integrity Act.

Scope of Our Internal Control Assessment

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

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

We limited our assessment of internal controls to those controls applicable to the audit objectives and not to provide assurance on the auditees' overall internal control structure.

For the purposes of this report, we have classified the significant internal control policies and procedures applicable to each audit objective by categories. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether the policies and procedures had been placed in operation—and we assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable section heading for each audit objective.

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act and Office of Management and Budget implementing policies, A.I.D. management is responsible for establishing and maintaining adequate internal controls. The General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining internal controls.

The objectives of internal controls for U.S. foreign assistance are to provide management with reasonable—but not absolute—assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether internal controls will work in the future is risky because (1) changes in conditions may require additional procedures, or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusion for Audit Objective One

The first audit objective was to determine if USAID/Sri Lanka planned for technical assistance in accordance with A.I.D. policies and procedures. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 3 (Chapter 3 and Supplement A). For the purposes of this report, we have classified the relevant policies and procedures into the following categories: identifying technical assistance needs, developing an implementation plan, preparing work statements, and preparing independent U.S. Government cost estimates.

Our tests showed that the Agency's controls were consistently applied except:

- USAID/Sri Lanka did not prepare work statements in sufficient detail to enable Mission officials and others to monitor and evaluate contractor performance.**
- USAID/Sri Lanka did not prepare detailed independent U.S. Government cost estimates.**

Conclusion for Audit Objective Two

The second audit objective was to determine whether the A.I.D. Regional Contracting Office followed U.S. Government and A.I.D. policies and procedures in procuring technical assistance. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 1, Supplement B (Section 12B), and A.I.D. Acquisition Regulations (A.I.D. Handbook 14). For the purposes of this report, we have classified the relevant policies and procedures into the following categories: procuring technical assistance at a fair price, selecting the appropriate type of contract, providing for full and open competition, establishing provisional indirect cost rates, and selecting responsible contractors.

Our test showed that the Agency's controls were consistently applied except:

- **The A.I.D. Regional Contracting Officer did not ensure that provisional indirect cost rates billed to A.I.D. were established by the cognizant U.S. Government contracting office or based on reliable data or experience.**
- **The A.I.D. Regional Contracting Officer did not support the reasonableness of prices negotiated for technical assistance contracts.**
- **The A.I.D. Regional Contracting Officer did not properly document that contractors were responsible.**

Also, A.I.D. did not design adequate controls over obtaining indirect cost rates.

Conclusion for Audit Objective Three

The third audit objective was to determine if USAID/Sri Lanka and the A.I.D. Regional Contracting Office monitored contractor performance in accordance with A.I.D. policies and procedures. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks 1, 3, and 14. For the purposes of this report, we have classified the relevant policies and procedures into the following categories: contractor work plans and reporting, contractor subcontracting practices, and controls over A.I.D. - funded property.

Our tests showed that the Agency's controls were consistently applied except:

- **USAID/Sri Lanka did not ensure that technical assistance contractors prepared detailed work plans and progress reports to enable USAID/Sri Lanka and others to objectively measure contractor performance.**
- **USAID/Sri Lanka did not ensure that technical assistance contractors established approved programs for controls over A.I.D. - funded property.**
- **The A.I.D. Regional Contracting Officer did not ensure that technical assistance contractors followed required procedures when subcontracting for goods and services.**

Conclusion for Audit Objective Four

The fourth audit objective was to determine if USAID/Sri Lanka and the A.I.D. Regional Contracting Office followed A.I.D. and U.S. Government policies and procedures to account for technical assistance funds. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks 14 and 19. For the purposes of this report, we have classified the relevant policies and procedures into the following categories: reviewing contractor claims for reimbursement, ensuring the timely payment of contractor invoices, and finalizing indirect cost rates.

Our tests showed that the Agency's controls were consistently applied except:

- USAID/Sri Lanka did not obtain periodic audits to ensure that payments made to contractors were for allowable costs only.
- USAID/Sri Lanka and the A.I.D. Regional Contracting Officer did not ensure that the contractors provided required financial data on indirect cost rates and that final indirect cost rates were negotiated in a timely manner.
- USAID/Sri Lanka did not ensure that discounts were taken when offered by contractors.

Also, A.I.D. did not design adequate controls over obtaining audits of contractors and ensuring timely establishment of final indirect cost rates.

Reporting Under Federal Managers' Financial Integrity Act

USAID/Sri Lanka and the A.I.D. Regional Contracting Office³ did not report any of the internal control weaknesses identified in this report in internal control assessments. Therefore, to improve reporting under the Federal Managers' Financial Integrity Act, we are providing the following two recommendations.

Recommendation No. 15: We recommend that USAID/Sri Lanka, for use in preparing the next report under the Federal Managers' Financial Integrity Act, perform an assessment addressing the internal control weaknesses identified in this report.

³ The A.I.D. Regional Contracting Officer provides input for the preparation of USAID/India's internal control assessments.

Recommendation No. 16: We recommend that A.I.D. Regional Contracting Officer, in providing support to USAID/India's next report under the Federal Managers' Financial Integrity Act, address the internal control weaknesses identified in this report.

Management Comments and Our Evaluation

USAID/Sri Lanka concurred with Recommendation No. 15. Mission officials said that they will perform a comprehensive assessment addressing the internal control weaknesses identified in the report during the next six months. Recommendation No. 15 is resolved and will be closed when the internal control assessment has been completed.

The A.I.D. Regional Contracting Officer concurred with Recommendation No. 16. The recommendation will be closed when the A.I.D. Regional Contracting Officer has provided documentary evidence that the internal control assessment has been completed.

REPORT ON COMPLIANCE

This section summarizes our conclusions on USAID/Sri Lanka's and the A.I.D. Regional Contracting Office's compliance with applicable laws and regulations.

Scope of Our Compliance Assessment

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

- **Assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives); and**
- **Report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.**

We tested USAID/Sri Lanka's and the A.I.D. Regional Contracting Office's compliance with the Federal Acquisition Regulation, A.I.D. Acquisition Regulations, and A.I.D. Handbook 1, Supplement B, Procurement Policy, as the regulations could affect our audit objectives.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants and binding policies and procedures governing entity conduct. Noncompliance constitutes an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition of noncompliance, and is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with laws and regulations applicable to the technical assistance contracts is the overall responsibility of USAID/Sri Lanka's management and the A.I.D. Regional Contracting Officer.

Conclusions on Compliance

The A.I.D. Regional Contracting Officer did not comply with certain requirements of the Federal Acquisition Regulation as discussed in detail below:

- **Audit Objective No. 2 - The A.I.D. Regional Contracting Officer did not:**

Establish provisional indirect cost rates for three of five contracts reviewed as required by the Federal Acquisition Regulation, Subpart 42.704, and A.I.D. policy (See page 8);

Obtain or prepare sufficient documentation to support that prices negotiated for four contracts reviewed were reasonable as required by the Federal Acquisition Regulation, Subparts 4.801, 4.803, and 15.805 (See page 13); and

Obtain or prepare sufficient documentation to support determinations that contractors reviewed were responsible as required by the Federal Acquisition Regulation, Subparts 9.104, 9.105, and 9.106 (See page 15).

- **Audit Objective No. 3 - The A.I.D. Regional Contracting Officer did not ensure that prime contractors awarded subcontracts in accordance with the Federal Acquisition Regulation (Part 44) and the general provisions of the contracts (See page 22).**
- **Audit Objective No. 4 - The A.I.D. Regional Contracting Officer did not ensure that the contractors included in our audit submitted proposed final indirect cost rates to the cognizant U.S. Government contracting office along with supporting cost data as required by the Federal Acquisition Regulation clause 52.216, incorporated in each contract reviewed. Also, the A.I.D. Regional Contracting Officer did not coordinate with A.I.D.'s Procurement Support Division to establish final indirect costs rates "as promptly as practical after receipt of the contractor's proposal" as required by the Federal Acquisition Regulation clause 52.216, incorporated in each contract reviewed (See page 31).**

Except as described, the results of our tests of compliance indicate that, with respect to the items tested, USAID/Sri Lanka and the A.I.D. Regional Contracting Officer complied in all significant respects with the provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that these parties had not complied, in all significant respects, with those provisions.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Sri Lanka and the A.I.D. Regional Contracting Office's controls over A.I.D. - direct contracts for technical assistance in accordance with generally accepted government auditing standards. We conducted the audit from December 10, 1990 through July 19, 1991, and covered the systems and procedures relating to A.I.D. - direct contracts that were active as of March 31, 1991. As noted below, we conducted our field work in the offices of USAID/Sri Lanka, the A.I.D. Regional Contracting Office (in New Delhi, India), and five technical assistance contractors located in Sri Lanka.

Additionally, we held discussions with officials of A.I.D.'s Directorate for Finance and Administration in Washington as this Directorate is responsible for establishing indirect cost rates for U.S. - based technical assistance contractors for which A.I.D. has cognizance. The Directorate is also responsible for formulating, reviewing, issuing and evaluating A.I.D. policies and regulations relating to A.I.D. - direct contracts.

The audit objectives did not cover the closeout of expired A.I.D. - direct contracts for technical assistance. This area was previously reviewed and reported on in our Audit Report No. 5-383-91-02, dated April 19, 1991.

Methodology

The methodology for each audit objective follows:

Audit Objective One

The first audit objective was to determine if USAID/Sri Lanka followed A.I.D. policies and procedures, found in A.I.D. Handbook 3 (Supplement A), in planning for technical assistance. To accomplish this objective, we selected 4 of the 10 A.I.D. - direct contracts that were active as of March 31, 1991. These four contracts represent all USAID/Sri Lanka direct contracts in excess of \$1.2 million. The total

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estimated costs of these four contracts was \$21.5 million--representing 47.5 percent of the \$45.3 million estimated costs for active direct technical assistance contracts as of March 31, 1991.

We analyzed the project papers applicable to the four contracts to determine if the work statements included in the contracts were related to project objectives and if project designs (i.e., project papers) identified such information as kinds of goods and services to be procured, contracting modes and procedures to be used, and implementation plans. We also reviewed planning documents (Project Implementation Order/Technical Services) to determine if USAID/Sri Lanka prepared work statements and U.S. Government cost estimates as required by A.I.D. Handbook 3 (Chapter 3 and Supplement A). We interviewed Mission officials and the A.I.D. Regional Contracting Officer to obtain their views on the adequacy of the planning process.

Audit Objective Two

The second audit objective was to determine if the A.I.D. Regional Contracting Office followed U.S. Government and A.I.D. policies and procedures in procuring technical assistance in support of USAID/Sri Lanka's development assistance program. To accomplish this objective, we selected the same four contracts as used for Audit Objective One. We determined whether the A.I.D. Regional Contracting Officer followed the Federal Acquisition Regulation (Parts 4, 6, 9, 15, 16, and 42), A.I.D. Handbook 1, Supplement B (Section 12B), and the A.I.D. Acquisition Regulations (A.I.D. Handbook 14): (1) to ensure the reasonableness of negotiated prices, including provisional indirect cost rates; (2) to select the appropriate type of contract; (3) to provide for full and open competition; and (4) to select qualified contractors. Regarding procedures for establishing provisional indirect cost rates, we expanded our review to cover a total of five contractors representing the last four contracts awarded with estimated costs of more than \$1 million and one contractor previously audited by us.

We reviewed the respective contract files and documents maintained by the A.I.D. Regional Contracting Officer. Examples of documents reviewed include notices to prospective offerors, lists of qualified offerors, requests for technical and cost proposals, technical selection panel results, prospective contractor cost proposals, biographical data sheets of key contractor personnel, memoranda from cognizant U.S. Government contracting offices concerning indirect cost rates, cost analysis work sheets prepared by the A.I.D. Regional Contracting Officer, and memoranda of

negotiations. We obtained support from selected contractor personnel for previous salaries identified on biographical data sheets. We also interviewed the A.I.D. Regional Contracting Officer and Mission officials.

Audit Objective Three

The third audit objective was to determine if USAID/Sri Lanka and the A.I.D. Regional Contracting Office followed U.S. Government and A.I.D. policies and procedures cited in the Federal Acquisition Regulation (Subparts 42.11 and 52.244), and A.I.D. Handbooks 1, 3, and 14. To accomplish this objective, we selected the same four contracts as used for Audit Objective One. We determined whether: (1) contract work statements were well-defined and technical assistance contractor work plans and progress reporting complied with contract requirements and were adequate for measuring contractor performance in achieving contract and related project objectives; (2) USAID/Sri Lanka ensured that contractors had adequate controls over A.I.D. - funded property and submitted required reports on those controls to USAID/Sri Lanka; and (3) the A.I.D. Regional Contracting Officer approved prime contractor subcontracts for goods and services in accordance with the Federal Acquisition Regulation and contract requirements.

At USAID/Sri Lanka and the A.I.D. Regional Contracting Office, we interviewed responsible officials and reviewed applicable files and records including project papers, contract files and related documents, and work plans and progress reports submitted to USAID/Sri Lanka by contractors. We also asked the A.I.D. Procurement Support Division (Commodity Division) to determine if equipment procured by a contractor met the source and origin requirements of the respective contract.

Audit Objective Four

The fourth audit objective was to determine if USAID/Sri Lanka and the A.I.D. Regional Contracting Office followed U.S. Government and A.I.D. procedures in reviewing contractor vouchers for reimbursement, processing contractor progress payments in a timely manner, and ensuring that contractor final indirect cost rates were promptly negotiated. We selected the four contracts used for Audit Objective One and another contract which we audited previously (Report No. 5-383-89-2; dated February 20, 1989). The total estimated costs of these five contracts and payments made as of March 31, 1991 were \$28.8 million and \$10.9 million, respectively.

We determined if USAID/Sri Lanka followed the controls cited in the Federal Acquisition Regulation (Subparts 31.201 and the applicable contract clause) and A.I.D. Handbooks 14 and 19 to administer payments to contractors. We judgmentally selected 15 vouchers (three vouchers from each contractor) with total A.I.D. payments of \$1.1 million. We performed limited tests of supporting documents available at USAID/Sri Lanka and contractor offices in Sri Lanka. The primary purpose of our tests was to identify USAID/Sri Lanka's vulnerability to making payments for unallowable costs and the need for better controls (e.g. periodic audits) to ensure the propriety of A.I.D. payments—not to determine the extent of questionable payments. The selected claims were primarily for travel and transportation, equipment, indirect costs and fringe benefits (verified to rates approved in the contracts), subcontractors, and consultants (verified to the required approval by the A.I.D. Regional Contracting Officer or Mission officials). One contractor claimed and was paid a field fringe benefit and overhead rate of 48 percent which had not been approved by the A.I.D. Regional Contracting Officer. We determined the total A.I.D. payments and examined all vouchers submitted by this contractor as they pertain to this rate. We also determined if contractors submitted indirect cost data and if indirect cost rates were negotiated in a timely manner (e.g. within one year after the end of the contractor's fiscal year) as required by the Federal Acquisition Regulation. To determine if payments were made promptly, as required by the Prompt Payment Act, we randomly selected a total of 20 vouchers for the five contractors (four vouchers per contractor).

We interviewed officials and reviewed project and contract files maintained at the A.I.D. Regional Contracting Office and at USAID/Sri Lanka. We also obtained documents and interviewed officials at A.I.D.'s Procurement Support Division to determine if contractors provided required documents on indirect cost rates and if those rates were finalized as required by the Federal Acquisition Regulation. Concerning indirect costs, we expanded our review to include a sixth contractor so that the audit covered all contracts awarded after July 1, 1988 for \$1 million or more in addition to one contractor included in a previous audit.

ANALYSIS OF COSTS FOR CONTRACTS

<u>Contract*</u>	<u>Government Estimate</u>	<u>Negotiated Price</u>	<u>Substantiated Costs</u>	<u>Unsubstantiated Costs</u>
Number 1	\$1,900,000	\$2,247,530	\$1,345,322	\$902,208
Number 2	1,322,000	1,597,412	215,000	1,382,412
Number 3	7,000,000	8,166,417	3,292,467	4,873,950
Number 4	<u>8,403,059</u> <u>\$18,625,059</u>	<u>7,673,541</u> <u>\$19,684,900</u>	<u>1,697,612</u> <u>\$6,550,401</u>	<u>5,975,929</u> <u>\$13,134,499</u>

* See following pages for details on each contract.

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ANALYSIS OF COSTS FOR CONTRACT NO. 1

<u>Cost Element</u>	<u>Government Estimate</u>	<u>Negotiated Contract Costs</u>	<u>Substantiated Costs</u>	<u>Unsubstantiated Costs</u>
Salaries	\$1,200,000	\$464,884	\$464,884	-0-
Allowances	(1)	185,869	86,869	\$99,000 (2)
Fringes & Overhead	(1)	243,881	86,452	157,429 (3)
Travel, Transportation	(1)	205,811	-0-	205,811 (4)
Other Direct	700,000	661,699	406,699	255,000 (5)
Consultants	(1)	47,629	19,530	28,099 (6)
General & Admin Costs	(1)	227,488	227,488	-0-
Subcontracts	(1)	53,400	53,400	-0-
Fixed Fee	(1)	156,869	-0-	156,869 (7)
Inflation Factor	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
	<u>\$1,900,000</u>	<u>\$2,247,530</u>	<u>\$1,345,322</u>	<u>\$902,208</u>

- (1) These costs were not identified in the U.S. Government cost estimate. The salary costs included allowances, fringe benefits, travel and transportation, and other costs.
- (2) Rent & Utilities - No documentation to support how the rates were derived.
- (3) Field Fringes - No Negotiated Indirect Cost Rate Agreements to support provisional rate.
- (4) No correspondence or evidence to indicate that A.I.D. Regional Contracting Officer had checked the reasonableness of this rate.
- (5) Several items: Defence Based Act insurance, home office cost and local office cost -No breakdown on these items.
- (6) Lump sum amount for third country nationals and local consultants - No breakdown or Biographical Data sheets.
- (7) No discussion or explanation as to how the fixed fee was derived.

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ANALYSIS OF COSTS FOR CONTRACT NO. 2

<u>Cost Element</u>	<u>Government Estimate</u>	<u>Negotiated Contract Costs</u>	<u>Substantiated Costs</u>	<u>Unsubstantiated Costs</u>
Salaries	\$1,150,000	\$287,417	\$215,000	\$72,417 (2)
Allowances	(1)	183,694	-0-	183,694 (3)
Fringes & Overhead	(1)	274,121	-0-	274,121 (4)
Travel, Transportation	(1)	229,750	-0-	229,750 (5)
Field Support	(1)	91,118	-0-	91,118 (6)
Other Direct	172,000	71,576	-0-	71,576 (7)
Consultants	(1)	58,994	-0-	58,994 (8)
Subcontracts	(1)	280,742	-0-	280,742 (9)
Fixed Fee	(1)	120,000	-0-	120,000(10)
General & Admin	(1)			
	<u>\$1,322,000</u>	<u>\$1,597,412</u>	<u>\$215,000</u>	<u>\$1,382,412</u>

- (1) These costs were not identified in the U.S. Government cost estimate. The salary cost is to include allowances, fringe benefits, travel and transportation, and other costs.
- (2) No Biographical Data Sheets to support salary cost.
- (3) Includes airfares, housing allowance, temporary lodging - no breakdown of how many trips, rate for housing, and cost of temporary lodging.
- (4) No Negotiated Indirect Cost Rate Agreement to support these indirect costs.
- (5) No breakdown as to destination of trips, and no indication of what the rate represents.
- (6) Includes Defence Based Act insurance, medical exams, telephone, etc, - no documentary evidence to support these amounts.
- (7) No documentary evidence to support this amount.
- (8) No Biographical Data sheets.
- (9) No analysis of subcontractor costs.
- (10) No discussion as to how the fixed fee derived.

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ANALYSIS OF COSTS FOR CONTRACT NO. 3

<u>Cost Element</u>	<u>Government Estimate</u>	<u>Negotiated Contract Costs</u>	<u>Substantiated Costs</u>	<u>Unsubstantiated Costs</u>
Salaries	\$1,750,000	\$1,724,167	\$1,701,443	\$22,724 (2)
Allowances	1,476,235	511,916	-0-	511,916 (3)
Fringes Overhead	2,444,725	1,071,157	1,071,157	-0-
Travel, Transportation	379,000	625,964	-0-	625,964 (4)
Other Direct	124,000	284,238	-0-	284,238 (5)
Equipment	190,000	262,500	-0-	262,500 (6)
General & Admin Cost	(1)	519,867	519,867	-0-
Subcontracts	(1)	2,755,412	-0-	2,755,412 (7)
Fixed Fee	391,018	411,196	-0-	411,196 (8)
Contingency/Admin	<u>245,022</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
	<u>\$7,000,000</u>	<u>\$8,166,417</u>	<u>\$3,292,467</u>	<u>\$4,873,950</u>

- (1) These were not provided for in the U.S. Government cost estimate.
- (2) No Biographical Data Sheets to support salary cost.
- (3) Several items included housing, home leave, rest and relaxation, shipment of personnel effects - No evidence to support or indicate that the Contracting Officer verified cost to trips, etc.
- (4) No support to indicate that the A.I.D. Regional Contracting Officer verified cost of trips.
- (5) Includes office rental, and other office expenses - no evidence of verification.
- (6) Nothing done to verify market price of these items.
- (7) No Biographical Data sheets or analysis of subcontractor costs.
- (8) No discussion or explanation as to why this fixed fee is appropriate.

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ANALYSIS OF COSTS FOR CONTRACT NO. 4

<u>Cost Element</u>	<u>Government Estimate</u>	<u>Negotiated Contract Costs (2)</u>	<u>Substantiated Costs</u>	<u>Unsubstantiated Costs</u>
Salaries	\$3,097,866	\$1,311,095	\$687,962	\$623,133 (3)
Allowances	730,378	592,839	-0-	592,839 (4)
Fringes & Overhead	2,835,287	1,009,650	1,009,650	-0-
Travel, Transportation	492,544	214,045	-0-	214,045 (5)
Other Direct	395,571	100,152	-0-	100,152 (6)
Project Costs	(1)	989,665	-0-	989,665 (7)
Subcontracts	(1)	2,946,555	-0-	2,946,555 (8)
Commodities	90,000	109,540	-0-	109,540 (9)
Fixed Fee	611,413	400,000	-0-	400,000(10)
Contingency	<u>150,000</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
	<u>\$8,403,059</u>	<u>\$7,673,541</u>	<u>\$1,697,612</u>	<u>\$5,975,929</u>

- (1) These were not provided for in the U.S. Government cost estimate.
- (2) The amount reviewed does not include contact amendments of \$1.8 million.
- (3) No Biographical Data Sheets to support salary cost.
- (4) Included housing, education allowance, etc - No evidence to support or indicate that the A.I.D. Regional Contracting Officer verified cost.
- (5) No support to indicate that the A.I.D. Regional Contracting Officer verified cost of trips.
- (6) Includes medical examination, Defence Based Act insurance, etc, - no evidence of verification.
- (7) Office rent and expenses, etc - Nothing done to verify market price of these items.
- (8) No Biographical Data sheets or analysis of subcontractor costs.
- (9) No verification of reasonableness of cost.
- (10) No discussion or explanation as to why this fixed fee is appropriate.

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U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

FEB 18 1992

MEMORANDUM

*Associate
Administrator
for Finance and
Administration*

TO: John P. Competello, AIG/A

FROM: Richard A. Ames ~~RAA~~
Associate Administrator for Finance and
Administration

SUBJECT: Draft Technical Assistance Audit Report

As requested by your memorandum dated January 14, 1992, we have reviewed the draft report titled "Audit of USAID/Sri Lanka". Our comments to Recommendation Nos. 3, 10 and 12 are provided below.

We also appreciate this opportunity to provide comments concerning other findings and recommendations in the report.

Recommendation No. 3

We agree with Recommendation No. 3. Contract Information Bulletin (CIB) 90-21, "Negotiation of Overhead Rates by A.I.D. Missions," dated October 10, 1990 addresses the issue of who is responsible for the establishment of indirect cost rates when A.I.D. is the cognizant agency. We will issue a revised Contract Information Bulletin emphasizing that the missions must contact the Overhead and Special Cost and Contract Close-Out Branch in AID/W prior to the incorporation of provisional rates into their awards with U.S. firms and organizations. This requirement will apply regardless of whether A.I.D. or another Federal Agency has audit cognizance responsibility.

We suggest that a change be made in the last sentence in paragraph one on page 9 which states, "A.I.D. is not certain of the reasonableness of the indirect costs billed by the three contractors to whom A.I.D. has already paid \$2.3 million of \$2.9 million estimated for contract costs". We believe this statement is misleading since

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these contractors had officially established provisional indirect cost rates in effect. The mission Contracting Officer may have failed to contact AID/W for verification of these rates, but this failure does not negate the fact that the contractor's provisional rates were established and considered reasonable. As with all agreed to provisional rates, these rates are subject to adjustment when final rates, for the periods covered, are agreed to between the government and the contractor. As a result, the government's interests are protected.

Recommendation No. 10

The Agency supports audit Recommendation No. 10 requiring periodic audits of contractors. Agency contracting officers have specifically identified their inability to obtain adequate and timely audit support as a serious vulnerability in past internal control assessments. Agency Contracting Officers in AID/W and overseas have requested numerous periodic audits in past years, but in many cases timely audits have not been performed due to budgetary constraints.

Page 27 of the draft report includes a statement that periodic audits were not performed because A.I.D. had not established the necessary requirements and procedures. We suggest that these statements be expanded to explain that lack of funding or other reasons have prevented your office from arranging timely audits in response to Contracting Officer requests.

As stated in your report, audits should be performed in a timely manner to facilitate the early finalization of indirect cost rates which would then allow for an expeditious closure of the contacts and grants. As the Office of Procurement assumes responsibility from the Office of the Inspector General for the tracking of the audit status for all U.S. contractors and grantees during FY 1992 (the transfer is to be effective on October 1, 1992), requirements and procedures will be put in place which address the need for periodic audits.

Recommendation No. 12

Since the beginning of 1991, A.I.D. management officials have been working closely with the staff of the Office of the Inspector General to devise a program to address the deficiencies identified in Recommendation No. 12. As of October 25, 1991, the Audit Management and Resolution Program Action Memorandum to the Administrator identified a more active management role in the audit process. The Office of Procurement (FA/OP) will have expanded responsibilities to track audits of all U.S. contractors and grantees. Missions will be required to maintain an inventory and track required audits of all non-U.S. contractors and grantees. The IG will maintain a quality

review program to ensure that the audits performed will meet appropriate standards. As the planning now stands, the Office of the Inspector General will also continue to be responsible for arranging for the performance of the required audits which must be completed before the finalization of indirect cost rates can occur.

Past experience indicates that once a request for an audit is submitted it will take at least several months before the completed audit is received. This delay in the performance of requested audits must be considered in any assessment of whether "final indirect cost rates are established as promptly as practical". The statement at the middle of page 31 that "final indirect cost rates were not established 90 days after the end of the contractors' fiscal years" is not in accord with the FAR and does not reflect the time delays in obtaining audits.

FY 1992 will be a transitional period wherein the IG and FA/OP personnel will work together to define and establish the Agency's audit tracking system. This system will contain data on the audit and indirect cost rate status for all U.S. firms and organizations with A.I.D. contracts and grants. The system will also include information identifying the cognizant agency for each firm.

Other Concerns:

1. Field Pricing Support (Pre-award audits): The lack of pre-award audits is discussed on page 14 of the draft report and elsewhere. While FAR paragraph 15.805-5 relates to the use of pre-award audits, the Contracting Officer is responsible for determining whether such an audit is necessary or whether there is sufficient information available to determine the reasonableness of the proposed cost or price. Pre-award audits are needed within 30 days of the request if they are to be of use. This short response time is not always possible because of (1) other commitments of the audit staff or (2) budgetary constraints. In such a case, the Contracting Officer may find it necessary to proceed with the available information in order that the procurement not be unduly delayed. We recognize that this is not the ideal situation envisioned by the FAR.

2. Use of FAR and AIDAR citations: At numerous points in the draft report (such as on pages 18, 20 and 22) FAR and AIDAR contract clause citations and their contents are used as the basis for saying that a contractor should have taken some action. The requirements of these clauses apply to a contractor only if they are incorporated in the contract; the draft report does not show that this was the case. The report should be revised to indicate if these clauses were included in the contracts and thereby their applicability to the contractors. With that knowledge, plans for appropriate corrective action can be formulated.

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3. Recommendation No. 13: As noted elsewhere in the report, the final indirect cost rates for U.S. firms are the responsibility of the single U.S. Government agency cognizant Contracting Officer. The A.I.D. Regional Contracting Officer should not, therefore, be called upon to finalize the rates for U.S. firms as in Recommendation No. 13.1 but to obtain the established final rates through coordination with the Procurement Support Division staff. The Regional Contracting Officer is responsible for establishing final (and provisional) indirect cost rates for any non-U.S. firms under contract with the mission.

Further, in the discussion of this recommendation a statement is made that the Procurement Support Division was "not sure which, if any, U.S. Government contracting office had accepted cognizance for the other three contracts reviewed". The information identifying the cognizant agency for each of the three contractors was provided to the auditor by the Procurement Support Division when it was requested. The statement on page 31 of the draft should be changed to avoid misleading readers of the report.

4. Compliance Section of the Report: In the "Conclusions on Compliance" discussion on page 40 of the draft report, the statement is made that the Regional Contracting Officer "did not identify or effectively coordinate with the cognizant U.S. Government contracting office when establishing provisional indirect cost rates". The proper course of action for a mission Contracting Officer is to obtain any necessary information through the Overhead, Special Costs and Contract Close-out Branch of the Procurement Support Division in AID/W. This support mechanism has been established in the Procurement Support Division because it would be unreasonable to expect overseas Contracting Officers to directly contact other government agency contracting offices to obtain the required information. The result of such a process would further delay the procurement process in the missions.

UNITED STATES GOVERNMENT

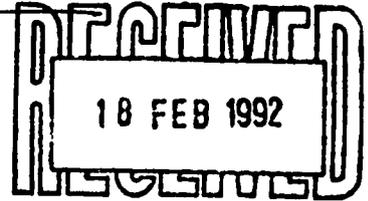
memorandum

DATE: February 13, 1992

REPLY TO
ATTN OF: Richard Brown, Director, USAID/Sri Lanka *Richard Brown*

SUBJECT: Response to Draft Audit Report of USAID/Sri Lanka's and the
A.I.D. Regional Contracting Office's Control Over
A.I.D. - Direct Contracts for Technical Assistance

TO: James B. Durnil, RIG/A/Singapore



Given the commitment of our project officers and this Mission to manage its projects in the most effective and professional manner possible, we are pleased no statutory or legal violations were found in the review of our controls and procedures in managing "Direct Contracts for Technical Assistance". Most of the contracts have serviced projects which been favorably reviewed by external technical evaluations as accomplishing the objectives envisaged in the original project documents. Your review did raise some issues which were judgmental in nature in areas where Agency guidance is not altogether clear. While we believe we have some flexibility and professional responsibility to decide procedures to achieve the intended results, our staff has given the issues raised by your team careful consideration. We wish to reiterate that we appreciate your constructive suggestions on how our mutual goal, that of making sure that the U.S. taxpayers' resources are being effectively used for the development objectives specified, can be accomplished.

There are a few issues raised in this audit where we do not fully agree with the opinions expressed by the audit team. One issue is the question of adequacy of work statements and of work plans. Your staff strongly feels that work statements must be detailed blueprints with specific timetable and measures to accomplish objectives. If we were involved with projects in which design issues are clear and there is universally agreed upon approaches such as the building of roads or bridges, I would agree. However, this kind of blueprint is not so clear-cut in new fields of endeavor where we are dealing with innovative development concepts and policy changes. We can describe in our work statements the objectives and the proposed design to the extent possible, but we can benefit also from design options proposed by competing contractors. Upon selection of the contract team we can work out more specific details on tasks and timing as the work plan evolves. This, I believe, is a major rationale for using cost reimbursable contracts.

While your staff also questions specificity of our work plans, we have been in the process of strengthening these documents as a result of RIG findings in an earlier audit conducted at our Mission. The MED documentation reflects this emphasis. All of our work plan meetings (recently with MARD, MDS and ISM) are incorporating these recommendations. The audit report, however, does not include comments on having been responsive to this earlier finding or recognize the improvements the Mission is making in this regard. All of our staff are working diligently to ensure that all rules and regulations are properly and carefully followed. Many of the suggestions by your staff are helpful in ensuring that the mechanisms are in place and are properly followed so that USG resources are appropriately managed and expended.

Specific comments on recommendations addressed to our Mission follows:

Recommendation No. 1: USAID/Sri Lanka considered the guidance contained in AID Handbook 3, Supplement A, Appendix C, for each of its contracts. This appendix is most appropriate for contracts where the end result is easily quantifiable, and no new processes or technologies are involved (i.e. construction, commodity procurement, etc). However, where contracts involve activities which lack clear precedents (building a country's capital market) or will clearly require regular adjustments, the appendix C guidance is less helpful. In these cases USAID Sri Lanka has two options.

As proposed in the audit, USAID Sri Lanka could increase the scope and cost of the design team and develop a detailed master plan for each project which includes specific methodologies, interim targets and timetables. The success of this approach still cannot be assured as the design might have to be altered as the activity evolves. Acknowledgedly, however, the match up between the methodologies, interim targets and timetables would be easier to make.

An alternative approach to the audit team's suggestion is to establish clear objectives for the contract in an open bidding process and allow U.S. contractors to privately design alternative approaches and technical solutions. In this situation, contractors are required to compete both on the quality and cost effectiveness of the design as well as its implementation. USAID/Sri Lanka then has the benefit not only of its own technical expertise and insight but also the information generated by the competitive process on which to ensure the USG gets the best design and expertise. Based on the successful proposal USAID/Sri Lanka negotiates detailed methodologies, interim targets, and timetables with the contractor. Indeed, the referenced guidance says "in research development projects and other projects where the end products itself cannot be deferred with precision, but the objective can be a level of effort contract may be preferable in that it provides more flexibility for the conduct of the contractor's effort".

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In summary, we propose to make our Mission Order on Direct Procurement more explicit on including more detailed methodologies, interim targets and timetables to the extent possible. However, we believe that circumstances still exist where the best interests of the USG are served by our interpretation of the guidance as noted above.

Based on this action we request that this recommendation be considered resolved and considered closed when the Mission Order is modified.

Recommendation No. 2: USAID/Sri Lanka considers independent government estimates essential for all contracts. Such estimates were in place for all of the eight contracts reviewed by the audit. We believe that our cost estimates were developed, on the whole, in accordance with AID guidance. However, they were not sufficiently detailed enough in the judgment of the audit team. In order to avoid combining different categories of costs and better describing travel costs, USAID Sri Lanka will prepare standard budget formats for our staff to use. In addition, we will develop standard costs for inclusion in these budget formats which will provide estimates based on our experience with existing Mission contracts.

Based upon this response we request that this recommendation be considered resolved and considered closed at the time of the report is presented.

Recommendation No. 7: All USAID/Sri Lanka technical assistance contractors prepare annual workplans and submit quarterly progress reports. In addition to these documents, the Mission monitors the progress and activities of contractors through regular field visits, quarterly implementation reviews, and scheduled evaluations. Over the last 18 months, this audit and two others have touched upon most of our ongoing projects providing yet another contract monitoring element to the Mission program.

Based upon the Mission's own review and the findings of this audit, we have strengthened our monitoring and evaluation Mission Order to improve the documentation of contract management and monitoring. Specifically, as of August 28, 1991 each project officer is required to ensure the adequacy of the life-of-project workplan for each contract, to receive, evaluate and comment on all quarterly progress reports, and to adequately document the above in project files. These procedures were judged to be satisfactory by the IG to resolve and close a similar recommendation for the DARP audit.

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The Mission believes the existing Mission Order which has already been judged to be satisfactory by your office is sufficient to resolve and close these audit recommendations at this time.

Recommendation No. 8: As noted in the audit, USAID/Sri Lanka is already putting into place a commodity management system for all of our project-financed commodities. The design and operation of this system was reviewed with IG audit staff in July 1991. The operation of this system for the Diversified Agriculture Research Project was considered satisfactory by your office to resolve and close the recommendation to improve the control of contractor property under that project. The recent GAO management assessment team reviewed the system and commented very favorably on its operation. The Mission intends to have the system fully functioning for all bi-lateral projects by the end of 1992.

The Mission believes that this newly established internal control system and continued progress on its coverage of all technical assistance contracts is sufficient to resolve and close the audit recommendation at this time.

Recommendation No. 11: As noted in the audit, USAID/Sri Lanka's paying office does identify and eliminate a number of questionable items in contractor billings. Given time pressures placed on voucher processing, particularly compliance with the Prompt Payment Act, as well as the volume of payment vouchers processed by our staff, we question the assertion that USAID/Sri Lanka does not have "reasonable" assurance that payments are made only for allowable costs. Experienced RIG staff spent weeks extensively reviewing a sample of vouchers to identify the additional questioned cost cited in this audit report. While we give considerable time and careful attention to this function and have successfully helped project officers to identify questionable costs, we regrettably do not have the staff time to give the vouchers the indepth review conducted by the audit team which inevitably identified some additional questionable costs. We appreciate the help given to identify these costs and have worked to resolve the questions raised.

As stated in the audit, \$110,106 of the \$148,768 costs questioned relate to an indirect costs field rate claimed by one contractor. The contract in question is currently under negotiation for amendment by our Regional Contracting Officer. This issue of an allowable field rate will be settled soon when the contract amendment is signed. We will conduct a review of all vouchers processed under this contract at that time and will make necessary adjustments. This exercise may well result in additional payments to the contractor beyond the \$110,000 identified by the audit team as the contractor may have billed less than its entitlement.

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On another questionable cost identified by the audit team, the contractor submitted receipts for approximately \$15,000 to support the purchases of equipment which did not match the \$12,659 claimed. The differences between the billed and claimed amount was the tax amount which the contractor would obtain from the Government. This also occurred with regard to a \$5,738 questioned cost under a different contract. In both cases these discrepancies were identified by the Mission Controller and approved after obtaining clarification by telephone. However, these clarifications was not documented in the files.

Of the remaining costs questioned: \$1,114.00 has been refunded by two contractors, supporting documentation has been presented or explanation provided and costs accepted for \$10,942, and we are still waiting for the response from one contractor to justify \$8,209 costs claimed.

From a Mission Management perspective, with a senior voucher examiner's departure, attention is being given to newer voucher examiners to upgrade their skills to process more complicated voucher submissions, particularly contractor billings. In order to resolve and close this audit recommendation, we will formalize this process and schedule a training session for all voucher examiners focusing on contractor vouchers. We will inform RIG once this training session has been completed and forward a copy of the session's outline.

Based on the actions taken and explanation provided, we request that this recommendation be considered resolved and considered closed once the \$8,209 costs are resolved and training session completed.

Recommendation No. 14: Only one contractor is currently offering a discount to USAID/Sri Lanka for early payment of its voucher submissions. This is the contractor cited in this audit report. We appreciate the audit team's bringing this issue to our attention. We are experiencing problems with the computer discs sent to the USDO in Bangkok where U.S. Treasury checks are issued as well as a not totally reliable time schedules for mail sent to Bangkok which includes our check requests. Discounts were not being taken previously given the problems and timing experienced which could not guarantee disbursement during the period offered.

We are, however, currently taking the discount from the contractor as a result of discussions with RIC during the course of this audit. This action will save \$62,400 in contract costs over the remaining project period assuming the voucher receipt and approval process allows us to take all future discounts and the total estimated contract costs are billed. These funds would then be available for reprogramming in the project or for deobligation. Our new Cash Management Mission Order documents our process for ensuring that cash discounts are taken where offered by contractors and the reporting to AID/Washington requirement if not taken.

Based on this action and our Mission Order we request that this recommendation be considered resolved and closed.

Recommendation No. 15: USAID/Sri Lanka will perform a comprehensive assessment addressing the internal control weaknesses identified in this report during the next six months and report the material weaknesses when preparing the next report under the Federal Manager's Financial Integrity Act. This assessment will be broader in scope than our thorough assessments conducted when preparing our last report.

Based on this plan of action we request that this recommendation be considered resolved, with closure once that assessment is completed.

AID:CTR:JWB:rs:2/13/92.
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63.



NEW DELHI, INDIA

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

February 7, 1992

FAX

FAX NO: 65-3342540

FAX TO: James Durnil, RIG/A/Singapore

FAX FROM: Leonard Kata, RCO, USAID/India *LK*

SUBJECT: Draft Audit Report, Your 1/9/92 Memorandum to me.

Attached are my point by point responses to those recommendations which you indicated require RCO action. I would appreciate the responses being printed verbatim in the Final Report.

Please let me know if you have any questions.

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4.1 RCO Response to Recommendation No. 4.1

RCO believes that indirect cost rates for contractors under USAID direct contracts should be kept consistent with current rates established by cognizant rate setting agencies and thus will review all current USAID contracts to determine the currency of rates included in USAID's affected contracts. RCO will obtain evidence of the currency of the rates as part of this exercise.

RCO requests that Recommendation 4.1 should be resolved or closed based on this response.

4.2 RCO Response to Recommendation 4.2

For any affected contract where an indirect cost rate is shown to be different from the contractor's current indirect cost rate per the exercise carried out under Recommendation No. 4.1, RCO will modify the contract to include the current rate and adjust contractor progress payments accordingly.

RCO believes that the Recommendation 4.2 should be resolved or closed based on this response.

5.1 RCO Response to Recommendation No. 5.1

Cost analysis under AID procurements is a highly complex subject area where based on the circumstances of a given procurement, the cognizant Contracting Officer would carry out, as appropriate and as indicated in RIG's draft audit report, comparison between offerors' proposed cost with actual cost history, previous cost estimates from the offeror, cost estimates received from other offerors, independent U.S. Government cost estimates etc. RCO agrees to obtain necessary data including, where applicable, field pricing support. Requirements for obtaining such data are called for in various regulations including FAR subparts 4.801, 4.803, 15.805-1 and 15.802-3 cited in the RIG's Audit Report.

In view of RCO's agreement to obtain data called for in the Audit Report and in that the directives for obtaining such data are already part of the formal Federal Acquisition Regulations governing the procurement process, RCO requests that Recommendation 5.1 should be closed with issuance of the Final Audit Report.

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5.2 RCO Response to Recommendation 5.2

FAR 4.801 and 4.803 require that contract files include documentation of the cost analysis carried out in the procurement process. The work schedule and work demands of Contracting Officers, especially Regional Contracting Officers, frequently make it difficult to comply with administrative requirement i.e., preparing documentation related to substantiation processes they follow and determinations which they make. Nevertheless, the regulations, including FAR 15.808 "Price Negotiation Memorandum" which calls for documentation of negotiation, require the documentation and RCO agrees that the documentation should be provided.

In view of RCO's agreement to provide documentation to substantiate the reasonableness of negotiated costs and in that this requirement already exists in the Federal Acquisition Regulations governing the procurement process cited above, that Recommendation 5.2 be closed upon issuance of the Audit Report.

6.0 RCO Response to Recommendation No. 6.0

RCO believes that the Contracting Officer for a particular procurement should document the contract negotiation file regarding a decision related to the responsibility of the successful contractor. Determinations of responsibility are frequently self-evident from documentation submitted by offerors as part of the proposal/negotiation process; offerors' submit organizational financial statements prepared by CPA firms, negotiated indirect cost agreements which require a financial review by a cognizant U.S. Government Agency, various organizational policies such as personnel policies in response to RFP requirements, standard representation and certifications including certifications on lobbying and compliance with Procurement Integrity Act requirements. Reference checks, when appropriate, are obtained as part of the negotiation/evaluation process. In addition, experienced Contracting Officers and other AID officers participating in proposal evaluation frequently have direct personal knowledge regarding the responsibility of potential contractors based on their having their monitored the performance under other AID projects. Signing a contract, as indicated by the incumbent Regional Contracting Officer at the time of the audit can be viewed as an expression of the Contracting Officer's determination that a potential contractor is a responsible contractor. Offerors proposals which often contain the documents referenced are kept as part of the contracting file. Nevertheless, USAID agrees that the

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Contracting Officer's determination regarding responsibility, along with whatever documents collected in support of the determination should be documented as part of the negotiation file.

In that the Federal Acquisition Regulations already require the Contracting Officer to make a determination regarding contractor responsibility and in that RCO agrees that this should be documented, RCO requests that Recommendation 6.0 be closed in the Final Audit Report.

9.1 RCO Response to Recommendation 9.1

RCO notes that the reference under Recommendation 9.1 to subpart 52.224-2 is an incorrect reference; Subpart 52.224-2 is a clause pertaining to the Privacy Act. Subpart 52.244.2 is the clause for "Subcontracts Under Cost Reimbursement and Letter Contracts".

RCO also notes that the discussion portion of the Audit Report pertaining to Recommendation 9.1 refers to an Appendix IV. However, the draft report does not include an Appendix IV. This is apparently a typographical error for Appendix II.

RCO agrees that the Regional Contracting Officer should require contractors to submit the information called for in FAR subpart 52.224-2 before providing consent.

In that RCO agrees with the recommendation and in that the requirement for contractors to submit such information is already a part of Federal Acquisition Regulations applicable to subcontracting processes, RCO requests that Recommendation No. 9.1 be closed with issuance of the Final Audit Report.

9.2 RCO Response to Recommendation 9.2

RCO believes that the draft audit recommendation to obtain a refund from the contractor should be changed. Contracting Officers are authorized to make determinations regarding the allowability of costs. Accordingly, USAID believes that upon examining the origin issues the matter would be one of the cognizant Contracting Officer making a determination regarding the allowability of costs. Accordingly, USAID believes that upon examining the origin issues the matter would be one of the cognizant Contracting Officer making a determination regarding the allowability of the expenditure and then, if appropriate, obtaining a refund. Thus, USAID believes that Recommendation 9.2 should be revised to read "9.2 Determine whether the \$135,000 of equipment identified

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in this report complies with the origin requirements and if not, make a determination regarding the allowability of the cost of the equipment".

Based on USAID's consultations with procurement officials within AID and other cognizant U.S. Government officials outside of AID, RCO believes that the recommendation should be closed. There was no determination that the equipment did not meet the origin requirements, the contract to procure the equipment included the clauses related to origin requirements, the equipment which was procured is the equipment that was desired and requested by USAID, the procurement was approved by technical officer and by the Regional Contracting Officer, the equipment was in fact provided, and has met the requirements and expectations of the project. Further, the equipment under question is on the GSA Schedule. RCO has also established that due to the need for the particular equipment procured, the Mission would have issued a source/origin waiver, as appropriate, had one been required. Accordingly, RCO requests that Recommendation No. 9.2 be closed.

13.1 RCO Response to Recommendation 13.1

RCO believes that final indirect cost rates for contractors under USAID direct contracts should be kept consistent with current rates established by cognizant rate setting agencies and thus will review all current USAID contracts to determine the currency of rates included in USAID's contracts. RCO will obtain evidence of the currency of the rates as part of this exercise.

RCO requests that Recommendation No. 13.1 be resolved or closed based on this response.

13.2 RCO Response to Recommendation 13.2

RCO believes that, in addition to bills of collection for any excessive payments to contractors resulting from any possible overpayment of indirect costs, other adjustments including possible payment of under-payment may be necessary, in accordance with the clauses and any other applicable terms and conditions of the contract. Thus RCO recommends that Recommendation 13.2 be revised to read; "Based on obtaining final indirect cost rates USAID should make appropriate adjustments to contractor payments according to applicable clauses and terms and conditions of affected USAID contracts"

RCO requests that Recommendation 13.2 be resolved or closed based on this response.

NOTE : RCO believes that Recommendations 3., 4.1, 4.2, 13.1 and 13.2 are related subject matter and would best be consolidated under one Recommendation No. 3 with sub-recommendations 3.1, 3.2, etc. RCO requests that this change be made in the Final Audit Report.

16.0 RCO Recommendation No. 16.0

The recommendation calls for the RCO to carry out a "comprehensive assessment". However, a "comprehensive assessment" is a judgemental description for which there is no known definition or standard. RCO therefore requests that the recommendation be revised in the Final Audit Report to read "Recommendation 16. We recommend that the AID Regional Contracting Officer, in providing support to USAID/India's next report under the Federal Manager's Financial Integrity Act, address the internal control weaknesses identified in this report and report any material weaknesses."

RCO requests, in that it cannot be predicted that there would be material weaknesses to report, that the recommendation be closed upon issuance of the Final Audit Report.

h9.

APPENDIX VI**REPORT DISTRIBUTION**

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