

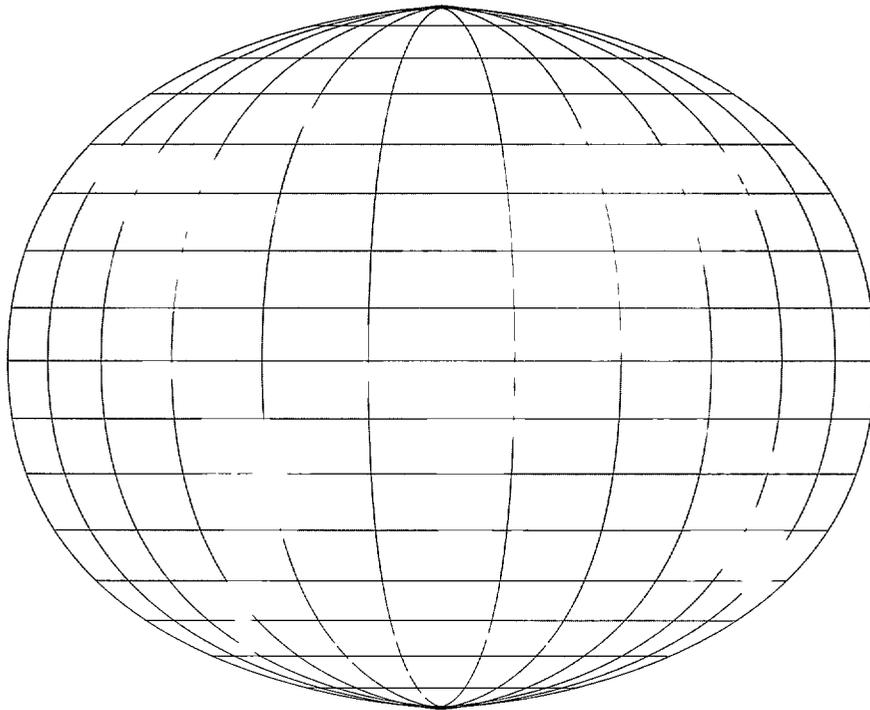
# **Report of Audit**

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## **Audit of USAID/Mozambique's Monitoring of its Host Country Contracting Activities**

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**Report No. 4-656-99-005-P  
August 5, 1999**



**REGIONAL INSPECTOR GENERAL/PRETORIA  
OFFICE OF INSPECTOR GENERAL  
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT**

PD-ARR-564

# **Audit of USAID/Mozambique's Monitoring of its Host Country Contracting Activities**

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**REGIONAL INSPECTOR GENERAL/PRETORIA**



Regional Inspector General  
Pretoria

# Memorandum

August 5, 1999

MEMORANDUM FOR USAID/MOZAMBIQUE DIRECTOR, Cynthia Rozell

FROM Regional Inspector General/Pretoria, Joseph Fainella

SUBJECT Audit of USAID/Mozambique's Monitoring of its Host Country Contracting Activities, Report No 4-656-99-005-P

This memorandum is our report on the Audit of USAID/Mozambique's Monitoring of its Host Country Contracting Activities, Report No 4-656-99-005-P We have received your comments on the draft report and have included them in their entirety as an appendix to this report (see Appendix II) The report does not contain any recommendations, therefore, no action is required by the Mission

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

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## Background

Since the signing of the Mozambique peace accord in 1992 and the subsequent elections in 1994, the Government of Mozambique (GRM) has embarked on rebuilding the country's economy and infrastructure which was devastated after years of civil war Critical to this rebuilding effort has been the rehabilitation and development of the country's road system which the GRM considered a national priority Rural roads represent an integral part of Mozambique's economic and social infrastructure since the agriculture sector, responsible for producing 60 percent of the country's GDP and 80 percent of its export earnings, relies heavily on these roads in order to transport food to markets The poor condition of these roads, however, has made it difficult for farmers to have access to local markets, thereby posing a major impediment to rural economic activity

To address this problem, the GRM signed an agreement with USAID in November 1995 under the Rural Access Project (RAP), a \$53.0 million, seven-year activity intended to increase access and reduce transport costs in targeted agricultural areas Major inputs under RAP included the rehabilitation of selected roads to provide links to national and regional transport networks This coincided with the Mission Strategic Objective of promoting "increased income for rural households in targeted areas" Road rehabilitation financed under

the project was planned to take place in two, three-year phases and cover 1,400 kilometers of rural roads in key provinces in central Mozambique where it supported other local road activities proposed under the Roads and Coastal Shipping project, a multi-donor road sector program coordinated by the World Bank

The road work, the largest component under RAP, involved the rehabilitation of (1) tertiary roads using labor-intensive methods funded through grants to PVOs and (2) selected primary and secondary roads through host country contracts (HCCs) with road construction firms and also USAID-direct contracts for architectural and engineering services. Through the period of our field work in May 1999, USAID/Mozambique had financed two HCCs, with a combined value of \$6.7 million, which were for the rehabilitation of two roads covering a total distance of 102 kilometers. The Mission was also monitoring the procurement of a third HCC, valued at \$21 million, which was still in the process of being tendered at the time of our field work. This latest contract involved the rehabilitation of a 240-kilometer section (Caia-Gorongosa) along Mozambique's main north-south road considered to be a critical link between USAID's target geographic areas and the major markets to the south. In procuring these construction services, HCCs are awarded through the National Directorate of Roads and Bridges (DNEP) under the Ministry of Public Construction and Housing, the implementing agency within the GRM. As of May 1999, combined cumulative commitments under the two initial HCCs totaled \$6.7 million with expenditures totaling \$4.7 million.

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## **Audit Objective**

The audit reviewed USAID/Mozambique's monitoring of its host country contracting activities, focusing particularly on the two initial host country contracts described above, and was designed to answer the following question:

**Did USAID/Mozambique follow prescribed USAID policy and procedures in monitoring the procurement and implementation of its host country contracts?**

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

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## **Audit Findings**

**Did USAID/Mozambique follow prescribed USAID policy and procedures in monitoring the procurement and implementation of its host country contracts?**

USAID/Mozambique followed prescribed USAID policies and procedures in monitoring the procurement and implementation of its host country contracts (HCCs). In reviewing the Mission's oversight of these activities, the audit focused on the Mission's monitoring of two HCCs awarded in August 1996 for road construction services—the only active HCCs at the time of our field work. The HCCs had a combined value of \$6.7 million and were both awarded to the same construction contractor, Cooperativa Muratori e Cementisti-Ravenna or

CMC, for the rehabilitation of two roads (Mutarara-Villa Nova da Fronteira and Caia-Sena). We also reviewed the procurement (through the bid opening phase) of a third HCC which was in the process of being tendered at the time we completed our fieldwork in June 1999. This contract, estimated to be valued at \$21 million, involved the construction of the 240-kilometer Caia-Gorongosa road. The results of our review of the Mission's monitoring of both (1) the procurement of the three aforementioned HCCs and (2) the implementation of the two initial HCCs are summarized below.

### **Procurement of Host Country Contracts**

Prior to assigning procurement actions expected to exceed \$250,000 to a host country, missions are required under ADS 301.5.2 to (1) conduct an assessment of the host country contracting agency's procurement system to assess the agency's contracting capabilities and (2) obtain the Mission Director's certification, in writing, that the contracting agency has the capability to undertake the procurement action. In addition, ADS E305 provides that HCCs for construction services shall normally be awarded under formal competitive bidding procedures. To ensure that this bidding is undertaken in compliance with USAID policies, prior USAID approval of interim steps in this process is required for contracts exceeding \$250,000; this involves Mission approval of the list of prequalified offerors, solicitation document (Invitation for Bids), selection method, selected contractor and the final contract.

We determined that USAID/Mozambique complied with USAID policies and procedures in monitoring the procurement of its HCCs. In accordance with prescribed policies, for example, the Mission (1) assessed and certified whether the host country contracting agency, the National Directorate of Roads and Bridges (DNEP), had the capability to procure USAID-funded contracts, (2) approved interim steps in the contracting process and (3) ensured that appropriate provisions were included in the HCCs requiring compliance with USAID's nationality and audit requirements. These are discussed in further detail below.

- ▶ **Assessment and Certification of Contracting Capabilities** In February 1995, as part of the project design process, the Mission conducted an assessment of DNEP's capability for procuring HCCs which involved a review of the contracting agency's procurement system. The assessment, which updated an earlier one done in 1993, found that DNEP was still incapable of independently handling the financial management and administrative functions required under USAID's HCC procedures. The assessment, however, concluded that DNEP could undertake the procurement of HCCs with project-financed technical support. Based on this conclusion, the Mission Director certified that host country contracting could be utilized by DNEP. Technical assistance was later provided under a \$3.5 million USAID-direct contract with Morrison Knudsen International (MKI) for architectural and engineering (A&E) services.
- ▶ **Involvement in Contracting Process** Records contained in the contract files showed that the Mission closely monitored the procurement of its HCCs and approved critical steps during the entire contracting process. We noted, for example, that Mission staff

- (a) reviewed and edited the text contained in the public notices used to advertise the planned construction work to prospective offerors,
  - (b) reviewed and approved the prequalification document prior to issuance,
  - (c) reviewed the prequalification evaluation results [Note Concurrent with this evaluation, the Mission performed its own evaluation (“shadow review”), independent of the review done by the prequalification evaluation panel, which was later compared with the results of the panel evaluation and used as a basis for approving the list of prequalified offerors],
  - (d) reviewed and approved the Invitation for Bids (IFB) and other tender documents prepared by the A&E contractor as well as the contractor selection method,
  - (e) participated in the pre-qualification and pre-bid meetings to offer guidance on outstanding issues relating to the tender documents and ensure that USAID procedures were followed,
  - (f) attended the bid opening ceremony as “observers”,
  - (g) analyzed the bid proposals for the lowest bidders to assess the validity of the bids by verifying the reasonableness and accuracy of the cost details, and
  - (h) formally approved the contractor selected and the award of the contract based on the bid evaluation results and the Mission’s participation throughout the tender process
- **Compliance with Nationality and Audit Requirements** We also verified that the two initial HCCs included provisions to ensure that services under the contracts complied with USAID’s nationality eligibility policies (i.e., the firm awarded the HCC was eligible under these policies) and that audits were permitted to be performed on the two contracts

### **Implementation of Host Country Contracts**

The Project Officers’ Guidebook on Host Country Contracting, a supplement to Section 301 of the Agency Directive System (ADS), describes the specific tasks and responsibilities involved in monitoring USAID-financed HCCs. In monitoring the implementation of HCCs, the Guidebook discusses a number of methods commonly used by Project Officers to provide effective oversight of the contractor’s activities. These methods include (1) meeting periodically with the contracting agency and the contractor to review progress and any problems, (2) making site visits to the work site to observe on-going activities, (3) reviewing progress reports required from the contractor, (4) administratively approving vouchers submitted by the contractor for payment, (5) ensuring that all correspondence, reports and other relevant documents are maintained in the Mission’s contract files and (6) resolving problems hampering completion of the contract

Our review found that the Mission had performed the above tasks and generally complied with USAID policies and procedures in monitoring the implementation of its two HCCs. These contracts were awarded in August 1996 to a single construction contractor (CMC) for the rehabilitation of two rural roads (Mutarara-Villa Nova da Fronteira and Caia-Sena) located in central Mozambique. Despite the myriad of problems and delays experienced in the design and construction of both of these roads, we determined that the Mission actively monitored the progress of activities under the two contracts as evidenced by the following:

- ▶ **Attendance at Meetings** Project staff met regularly with officials from DNEP and the A&E contractor (MKI) at weekly coordination meetings where the group discussed various issues, including the status of the road construction work as well as MKI's progress in developing the design work for the new Caia-Gorongosa road. In early-1998, as it became more apparent that MKI was not making adequate progress in developing this design work, records reflect that the Mission placed increasing pressure on MKI to get the work done by establishing revised deadlines for key aspects of the design effort in order to avoid further delays.
- ▶ **Site Visits** Trip reports on-file at the Mission showed that project staff made site visits to the construction site on a regular basis, visiting the site on a quarterly and sometimes even monthly basis. During these visits, project staff toured the construction areas and attended the monthly site meetings to get an update from the MKI field engineer on the progress of work at the site. In examining the Mission's trip reports, we noted that the reports documented not only the progress made to date at the site, but also described problems at the site that were causing delays (e.g., lack of operational equipment) and listed follow-up actions that needed to be taken by the project staff to facilitate appropriate corrective measures. These reports, for example, indicated that the Mission was well apprised of the problems at the site associated with the chronic breakdown of the gravel crusher which caused substantial delays in the completion of the Caia-Sena road.
- ▶ **Review of Progress Reports** The project staff also relied on progress reports, prepared by the MKI field engineer, in keeping apprised of the status of activities at the construction sites. We found MKI initially had trouble furnishing these reports to the project office in a timely manner, but eventually started submitting them on a monthly basis as required. Each report provided an update of the progress at the construction site along with a series of charts to track different aspects of the work effort as well as a discussion of problems or pending issues that needed to be addressed [Note: MKI initially reported on a quarterly basis, but was later required to submit reports monthly to improve the Mission's oversight]. In examining these reports, on file at the project office, we often found notes annotated in the documents providing evidence that project staff reviewed the reports to keep abreast of the progress of work at the construction sites and to identify issues to be discussed during future site visits.
- ▶ **Review and Approval of Payment Vouchers** In addition to reviewing progress reports, we verified that the activity manager had reviewed and administratively approved the interim payment requests received from the construction contractor. This was evidenced by the signed administrative approval forms as well as the comments annotated on the vouchers showing that they had been reviewed prior to payment.

We encountered one case, however, where this approval was being temporarily withheld to prompt corrective action from the construction contractor to address deficiencies in its performance. According to the activity manager, the Mission was withholding a \$500,000 payment from CMC due to the contractor's failure to make satisfactory progress in completing the construction of the Caia-Sena road. This payment represented the final installment to be paid to CMC under the terms of a \$2 million negotiated settlement to resolve an earlier claims dispute between CMC and DNEP (USAID).

We also noted that the project office was not maintaining a payment schedule, listing amounts requested and actually paid to date, to track payments under the two HCCs and did not have one prepared until January 1999 when one of the HCCs was approaching completion. Although no financial errors were found, we believe a schedule should be maintained, particularly with the large number of interim payments expected under the new HCC for the Caia-Gorongosa road. Therefore, we suggest that the project office, in conjunction with the controller's office, develop and maintain a schedule for tracking payment requests received from the contractor and the payments made against those requests as reported under MACS. Such a schedule would serve as a useful monitoring tool in tracking cumulative payments and minimize the chance of duplicate payments being made while also serving as a basis for reconciling the Mission's balances with those maintained by DNEP and the field engineer.

- ▶ **Contract Files** The Mission's contract files, maintained by the project office, were found to be extremely well organized, current and fully documented with all relevant reports, project implementation letters (PILs), correspondence and contract documents on-file. In familiarizing ourselves with the project, we reviewed documents from these files which provided us with a valuable institutional record of the numerous problems and issues that arose since the start of the project and reflected, to some degree, the extent to which the Mission was monitoring the entire activity.
- ▶ **Approval of Contract Administration Actions** Records in the contract files also showed that administrative actions under the two HCCs, which included extensions and scope modifications, were formally approved by the Mission, through PILs, prior to being incorporated into the contracts. This approval was based, in part, on discussions held with DNEP and MKI to review the validity of the proposed extensions or amendments.
- ▶ **Resolution of Problems/Disputes** In addition to approving changes to the contracts, the project office was actively involved in assisting DNEP in resolving a series of problems and disputes that arose throughout the course of this activity to protect USG interests and assure the completion of the construction effort as illustrated in the following examples:
  - 1 **Delayed Hiring of A&E Contractor** In early-1996, after experiencing repeated delays in the hiring of the A&E contractor which in turn delayed the procurement of the HCCs and threatened to prevent construction from proceeding in 1996 as planned, the Mission contracted with a local engineering firm as a temporary measure to get the design work initiated pending the arrival of the A&E contractor. Although the actual construction work was still delayed until late-1997 and stalled soon after due to design problems, this example illustrates the Mission's efforts to start this activity and avoid further delays.

- 2 Claims Dispute with Construction Contractor** The Mission also worked closely with DNEP during the latter's negotiations with CMC over a contentious claims dispute that arose soon after construction work began in early-1997 and which threatened to bring construction under both HCCs to a complete halt. In February 1997, heavy rains caused major flooding of the Zambezi River which disrupted construction work when sections of the road became submerged preventing materials and supplies from reaching the construction sites. Progress was also hampered by the quality of the road design furnished by the local engineering firm which required further work, in part, because key design issues still needed to be sorted out (e.g., type of surfacing method to use). CMC claimed that these factors forced its work crews to remain idle at the site and caused the contractor to incur expenses above those originally agreed upon. To recover these costs, CMC submitted a series of expense claims, totaling over \$4 million, which the MKI Field Engineer considered unreasonable and refused to certify in light of the fact that the \$4 million in claims represented 60 per cent of the \$6.7 million contract price at a time when CMC had completed only 10 per cent of the work. In response, CMC threatened to stop working and "walk away" from the contracts if the claims were not paid.

In an effort to resolve this issue, the Mission tasked MKI to review the expense claims to assess the validity of the claims as well as to analyze the pros and cons associated with alternative courses of action. The Mission relied on the results of this analysis in reaching a final decision, but only after it held a series of meetings to discuss the matter both internally and with DNEP. It also conferred with Agency officials to obtain legal opinions. After considering the costs associated with pursuing other options, such as appointing a new contractor, the Mission concluded that the settlement would be the least costly alternative. Therefore, the Mission approved a negotiated settlement for \$2 million to be paid to CMC in four installments as part of the \$6.7 million contract price. The settlement was included in a Variation Order, approved by the Mission and issued in December 1997, which also specified major changes in the scope of work.

- 3 Delays in Completion of Caia-Sena Road** Following the issuance of the variation order, project officials made visits to the construction site and observed that work at the site was still progressing at a slow rate. This was due, in part, to CMC's failure to correct existing problems at the site associated with the lack of qualified supervisory personnel as well as the poor condition of the equipment used on-site and lack of spares available, all of which contributed towards causing chronic delays in the completion of the overall work plan. In light of these continuing deficiencies in CMC's performance, despite the monetary settlement agreed-upon earlier, the Mission formally advised DNEP that it would not make further payments if progress did not improve and corrective actions were not taken. During a subsequent site visit, in May 1999, the auditors were informed by the field engineer that progress had since improved with the road expected to be substantially completed by August 1999. Mission officials added that this work would also be finished within budget. As a precaution, however, the Mission planned to continue withholding the final payment of its settlement from CMC pending completion of the construction work.

**4 Non-Performance by A&E Contractor** Following the arrival of the MKI field team, in mid-1997, both the Mission and DNEP experienced problems with the contractor's performance which resulted in major delays in the start-up of construction on the new Caia-Gorongosa road. Upon its arrival, MKI was responsible for not only supervising the on-going construction work under the two initial HCCs, but also completing the design work and tendering documents for the Caia-Gorongosa road since the initial design, done by a local engineering firm, required substantial revision. MKI, however, was unable to meet the design schedule, failing to submit the design documents within 90 days after it mobilized in-country, which resulted in a loss in confidence in MKI on the part of DNEP and the Mission. With little progress being made, the Mission conveyed its concerns regarding the team's performance to MKI's head office in November 1997. This led to the replacement of most of the team members, including the Chief of Party, in December 1997. The Mission kept apprised of the new team's work by holding weekly meetings with MKI and DNEP to discuss the team's progress in developing a work plan and assessing the resources required to complete the design.

In the ensuing months, however, it became apparent to the Mission and DNEP that the new MKI team was incapable of mobilizing the necessary resources to complete the design work so as to allow construction to start as planned. After receiving a letter from DNEP reiterating its concerns over MKI's inability to meet its targets in completing the required design work, the Mission worked with the Office of Procurement to review viable options. Based on this review, the Mission elected to negotiate a reduction in the scope of work done under the contract, retaining the field engineer on-site to continue supervising the on-going construction work, while procuring the other necessary technical services. By early-1999, a new A&E firm was on-board and had successfully developed the design work and tendering documents in time to allow construction of the new Caia-Gorongosa road to start-up later that year.

The above examples collectively demonstrate that USAID/Mozambique maintained an active role in monitoring its HCCs through its participation, and periodic intervention, in the entire contracting process and close monitoring of the construction activities. As a result, we conclude that USAID/Mozambique followed USAID policies and procedures in monitoring the procurement and implementation of its HCCs and make no formal recommendations.

### **Management Comments and Our Evaluation**

In responding to our draft audit report, the Mission concurred with the findings contained in the report. The Mission also agreed earlier during the exit conference to implement our suggestion on developing and maintaining a schedule for tracking individual and cumulative progress payments made to the construction contractor. The complete text of the Mission's comments is included in Appendix II.

## SCOPE AND METHODOLOGY

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### Scope

We audited USAID/Mozambique's monitoring of its host country contracts (HCCs) in accordance with generally accepted government auditing standards. Field work was performed from February 9, 1999 through June 9, 1999 and involved a review of host country contracting activities under the Mission's Rural Access Project, a \$53.0 million, seven-year long activity supporting the rehabilitation of selected roads. The audit covered contracting activities since the start of the project in November 1995 through the conclusion of the field work in June 1999.

Specifically, the audit focused on the Mission's monitoring of both the procurement and implementation of two HCCs awarded in August 1996 for road construction services. These were the only HCCs awarded under the project through the time of our field work. The HCCs had a combined value of \$6.7 million and were both awarded to the same construction contractor, Cooperativa Muratori e Cementisti-Ravenna or CMC, for the rehabilitation of two roads (Mutarara-Villa Nova da Fronteira and Caia-Sena). We also reviewed the procurement of a third HCC (through the bid opening phase) which was in the process of being tendered at the time we completed our field work. This contract, estimated to be valued at \$21 million, involved the construction of the 240-kilometer Caia-Gorongosa road.

Because our audit objective involved a review of USAID/Mozambique's monitoring of its host country contracting activities, we concentrated our audit work on examining existing contract documents and records on-file at the USAID Mission in Maputo, Mozambique.

In addition, site visits were made to the following locations:

- Office of the National Directorate of Roads and Bridges (DNEP), the implementing agency under the Ministry of Public Construction and Housing in Maputo
- Road construction sites near the town of Sena located in central Mozambique

Audit work during these visits was confined to interviewing staff at the site and making general observations on the progress and quality of construction operations.

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## Methodology

The audit objective was to determine if USAID/Mozambique adequately monitored the procurement and implementation of its host country contracting activities in accordance with USAID policies and procedures

To accomplish this audit objective, we interviewed officials from the Mission, DNEP, the A&E contractor and the field engineer at the project site. In addition, we examined and analyzed correspondence, progress reports, financial vouchers, site visit reports, PILs, tendering documents and other contract-related records contained in the Mission's contract files. These documents were reviewed to assess the extent to which the Mission was monitoring the procurement and implementation of its HCCs and to determine whether the Mission provided the level of oversight required by USAID policy. In addition, contract files were examined to obtain background information on some of the problems that arose in connection with this activity. Information was also gathered through observations made during two separate field visits to the construction sites where we had an opportunity to talk with the field engineer. Additionally, we accompanied Mission staff in attending the bid opening ceremony, held on June 1, 1999, for the tendering of the Caia-Gorongosa road contract at which time we observed as the bids were being opened and announced.

As part of the audit, we also obtained written representations from cognizant Mission officials for all essential assertions relating to the audit objective.

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Memorandum

**To** Joseph Farinella – Regional Inspector General for Audit  
USAID/Pretoria

**From** Cynthia Rozell, Mission Director 

**Date** July 14, 1999

**Subject** Audit of USAID/Mozambique's Monitoring of Host  
Country Contracting Activities

Dear Mr Farinella,

We refer to RIG/A/Pretoria's recent audit of USAID/Mozambique's monitoring of host country contracting activities, as well as to the draft report received by the Mission on July 09, 1999. Please be advised that we have nothing further to add to the report.

We would like to thank you for the opportunity of commenting on the draft report.

Thank you