

Regional Inspector General for Audit
Singapore

**AUDIT OF A.I.D.'s IMPLEMENTATION OF
AGENCY GUIDANCE ON HOST COUNTRY
CONTRACTING
USAID/PHILIPPINES**

**Audit Report No. 5-492-93-15
September 3, 1993**



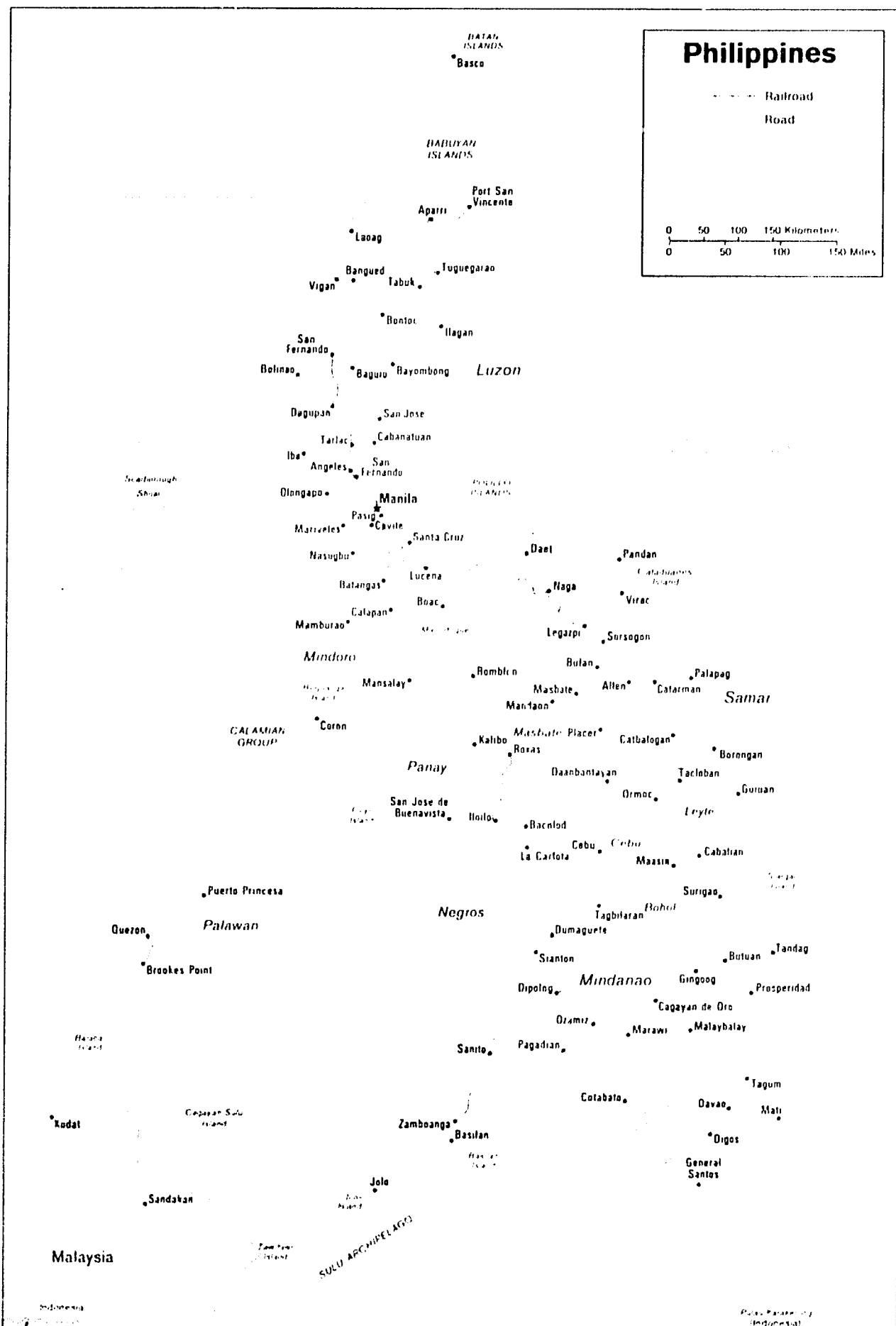
REGIONAL INSPECTOR
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U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

September 3, 1993

MEMORANDUM

TO: Thomas W. Stukel, USAID Mission Director

FROM: Richard C. Thabet, RIG/A/Singapore *Richard C. Thabet*

SUBJECT: Audit of A.I.D.'s Implementation of Agency Guidance on Host Country Contracting -- USAID/Philippines
(Audit Report No. 5-492-93-15)

Enclosed are five copies of the subject audit report. This audit confirmed USAID/Philippines generally followed Agency guidance on host country contracting, but that there were areas where compliance could be strengthened. For example, while the Mission had carried out the required assessments of host country agencies, the assessment involving the host government agency which carried out all of the contracting did not contain all of the information specified in the guidance. Nor was one of the assessments updated as required. Furthermore, while the Mission did comply with new guidance requiring the Contract Officer's clearance in the most significant steps in the host country contract procurement process, it did not ensure that clearance was obtained in all instances. Out of forty-one required clearance actions in our sample, thirty-three had not been cleared by the Contracting Officer.

We have made three recommendations to improve Mission compliance, and the first two are considered resolved on issuance of the report. The third recommendation is partially addressed by the issuance of a Mission Order. However, while the Mission Order will clearly establish the Contracting Officer's authority and responsibility to be involved in the clearance process, it will not ensure, per se, that the relevant documents will be forwarded to him for clearance. We suggest that some formal mechanism for accomplishing this necessary step be implemented. Thus, recommendation number three remains unresolved.

Thank you for your comments to the draft report. Please respond to this report within thirty days, giving the progress which the Mission has made on closing the recommendations. We appreciate the cooperation extended to our staff during this, the last audit carried out in the Philippines by the RAO/M staff prior to their relocation to Singapore.

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EXECUTIVE SUMMARY

Background

In November 1990, A.I.D. issued guidance for A.I.D. Handbook 11 host country contracts exceeding \$250,000 in value. The guidance, which was effective immediately, contained measures designed to strengthen A.I.D.'s oversight of the host country contracting process. It was issued in response to criticism expressed by the Inspector General, the General Accounting Office, and the U.S. Congress. These measures include: (1) a more rigorous Mission assessment of the Host Country contracting agency's capacity to properly manage the procurement process, (2) additional Mission approvals of interim steps leading to Host Country Contracting awards, and (3) greater Mission involvement in the evaluation and contractor selection processes.

Audit Objectives

The Regional Inspector General for Audit/Singapore audited USAID/Philippines' implementation of Agency guidance on host country contracting to answer the following two audit objectives:

- Did USAID/Philippines assess and certify host country contracting agencies' capabilities in accordance with A.I.D.'s November 1990 host country contracting guidance?
- Did USAID/Philippines comply with A.I.D.'s November 1990 host country contracting guidance in approving interim procurement steps and contract administration actions, in using observers on proposal evaluation panels, in assigning new responsibilities to Mission contracting and commodity management officers, and in planning and funding contract audits?

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

Summary of Audit

The audit concluded that USAID/Philippines: assessed the capabilities of host country agencies to award contracts over \$250,000; certified the assessments of the host country agencies' ability to undertake procurement; approved most of the interim procurement steps taken by the host country agencies; and assigned new responsibilities to the Contracting Officer.

We found, however, that: the assessment report did not contain information required by the guidance (see pages 4 to 8); USAID/Philippines did not repeat or update any of the assessments that were over three years old (see pages 8 to 9); and the Contracting Officer was not always included in the host country contract clearance process (see pages 10 to 13).

Summary of Recommendations

The report has three recommendations. These recommendations require USAID/Philippines to establish or strengthen procedures to ensure that: the required assessments meet the standards set forth in the guidance (see page 5); the required host country assessments are repeated or updated every three years (see page 8); and the Contracting Officer is included in all recommended phases of the clearance process (see page 11).

Management Comments and Our Evaluation

USAID/Philippines agreed with the audit findings. To ensure that the required assessments meet the November 1990 guidance standards, USAID/Philippines has revised the questionnaire used as a guide in determining the contracting capabilities of host country agencies. The Mission is also reviewing which of the host country agencies certified in June 1991 need to be reassessed. Also, the capability assessment of the Department of Public Works and Highways is currently being updated. The Mission will advise RIG/A/Singapore of the outcome of the actions.

The Mission has issued a Mission Order delegating approval authority to the Contracting Officer. However, we believe the problem is not only a matter of formalizing the Contracting Officer's authorities, but of ensuring that he is included by other Mission offices in the clearance process.

Office of the Inspector General

Office of the Inspector General
September 3, 1993

INTRODUCTION

Background

In November 1990, A.I.D. issued guidance for A.I.D. Handbook 11 host country contracts exceeding \$250,000 in value (State cable 399975 entitled "Final Host Country Contracting Guidance"). As of December 31, 1992, there were 18 active host country contracts amounting to approximately \$48.2 million. Our audit of USAID/Philippines' implementation of the guidance covers the period from November 27, 1990 to December 31, 1992. During this period, USAID/Philippines certified no less than 38 host country agencies as having the capability to undertake procurement actions over \$250,000. During the same period, USAID/Philippines funded 34 host country contracts worth at least \$250,000 each. These contracts totaled \$58.2 million and were awarded by one Government of Philippines agency.

The November 1990 guidance, which was effective immediately, contained the following:

- Missions must perform a capability assessment before assigning contracting responsibility to a host government agency for contracts whose values exceed \$250,000;
- Mission Directors must certify in writing, on a case-by-case basis, that the host government agency has the capability to undertake the procurement before a host country contract can be used;
- Capability assessments must be performed at least once every three years;
- The assessment team, whether formed using Mission or outside staff, must have knowledge and expertise in procurement matters and should have the necessary qualifications to review an organization's accounting systems and payment procedures;
- Formal A.I.D. approvals must be given for nine internal procurement steps: (1) notices to prospective offerors (e.g., Commerce Business Daily Notices); (2) lists of pre-qualified offerors, if any, prior to issuance of the solicitation documents; (3) the

complete solicitation document prior to issuance; (4) the contractor selection method; (5) the selected contractor or supplier; (6) a host country action to terminate negotiations with the highest ranked offeror or to reject all bids; (7) the contract prior to execution; (8) signed contract documents, before financing; and (9) contract administrative actions such as subcontracts, amendments, and change orders as determined by the Mission and as specified in a Project Implementation Letter;

- Missions must ensure through mission orders or other directives that contracting and/or commodity management officers' reviews and recommendations are included in (a) the process for host agency assessments; (b) the project review committee, whenever procurement planning is at issue; (c) approvals of host country contracts and interim procurement steps; (d) the development of procedures to observe host agency evaluations of proposals; and (e) contract administration actions including review and approval of subcontracts, change orders and contract amendments;
- Missions must include a representative as an observer on the host government agency's proposal evaluation panel, when such panels are used, to ensure the evaluation is done fairly in accordance with the stated method and criteria in the solicitation document when the contract is expected to exceed \$250,000; and
- Missions should ensure that audits of host country contracts are planned at the project paper stage and that project or trust funds are set aside for the performance of such audits.

The Inspector General's Fiscal Year 1993 Annual Audit Plan called for an assessment of A.I.D. Missions' progress in implementing the above guidance. Lead office responsibility for the audit was assigned to RIG/A/Cairo with participation by RIG/A/Singapore and RIG/A/Nairobi.

Audit Objectives

The Regional Inspector General for Audit in Singapore audited USAID/Philippines' implementation of Agency guidance on host country contracting to answer the following two audit objectives:

- Did USAID/Philippines assess and certify host country contracting agencies' capabilities in accordance with A.I.D.'s November 1990 host country contracting guidance?

- Did USAID/Philippines comply with A.I.D.'s November 1990 host country contracting guidance in approving interim procurement steps and contract administration actions, in using observers on proposal evaluation panels, in assigning new responsibilities to Mission contracting and commodity management officers, and in planning and funding contract audits?

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

REPORT OF AUDIT FINDINGS

Did USAID/Philippines assess and certify host country contracting agencies' capabilities in accordance with A.I.D.'s November 1990 host country contracting guidance?

USAID/Philippines assessed the capabilities of host country agencies to award contracts over \$250,000. The Mission Director also certified all of the assessments of the host country agencies' ability to undertake procurement. However, the assessments and certification did not meet certain requirements specified in the November 1990 guidance on host country contracting.

The Mission performed the required capability assessments of host country agencies to award contracts over \$250,000. From August 1989 to January 1991, the Mission contracted with local public accounting firms to perform the assessments. USAID/Philippines provided the accounting firms with a questionnaire to guide them in determining the host country agencies' capabilities. In June 1991, the Mission Director certified no less than 38 host country agencies as having the capabilities to undertake procurement actions over \$250,000. It turned out, however, that all host country contracts over \$250,000 were awarded by one Government of Philippines agency, the Department of Public Works and Highways. The language in the Director's certification met the requirements of the November 1990 guidance except that the certification did not state that the determination would be reviewed again as appropriate and would be repeated or updated by limited reviews within three years from the date signed.

Assessment Report Did Not Meet the November 1990 Guidance

The assessment report on the Department of Public Works and Highways (DPWH) did not contain the required information about DPWH's decision-making authority and procurement procedures and policies. This occurred

because the assessment, which was performed in October 1989 (13 months before the issuance of the guidance), was not updated to include all requirements. Even so, in June 1991, the Mission Director certified that the report met the guidance standards. As a result, not only was an improper certification provided, but the Mission did not have the necessary assurance that the one and only agency that had awarded host country contracts over \$250,000 followed proper contracting procedures to undertake procurement.

Recommendation No. 1: We recommend that USAID/Philippines establish a review procedure that will ensure that the required assessments meet the standards set forth in the November 1990 guidance.

Paragraph 3B(5) of the guidance stipulates the information that should be included in the assessment report for the Director's certification. The guidance states:

Typically, the assessment report will include organizational diagrams and flow-charts to illustrate the decision making process, flow of documents and sequence of procedures to be followed in the solicitation, negotiation, award, monitoring and payment of contracts. The contractor or assessment team should test the practical application of these policies and procedures by examining actual performance through a sample selection of completed procurement actions.

Except for some flow-charts and a sequence of procedures that related only to voucher and check preparations, DPWH's assessment report did not adequately address the above information. For example, the report briefly described the procurement process for technical assistance but failed to illustrate the flow of documents, did not describe the type of documents prepared, and did not describe the document review process. Also, the report did not explain the decision-making process such as who reviews and approves the documents and how the duties were segregated. There was no indication that any completed procurement action was reviewed for compliance. The report referred to certain tests carried out, but the tests were not described in specific terms.

The reason DPWH's assessment report did not contain the required information is because it was performed in October 1989, using then current guidance. This was 13 months prior to the issuance of the new guidance. Nevertheless, in June 1991, the Mission Director certified that the report met the guidance standards.

One possible effect of not carefully reviewing the host government agencies' flow of documents and procedures concerns delays. We noted several cases of either road construction delays, or (in at least two of the contracts in our universe) outright cancellations of the contract wherein "right-of-way" problems were cited as a contributing factor in field reports. The photograph below illustrates this problem.

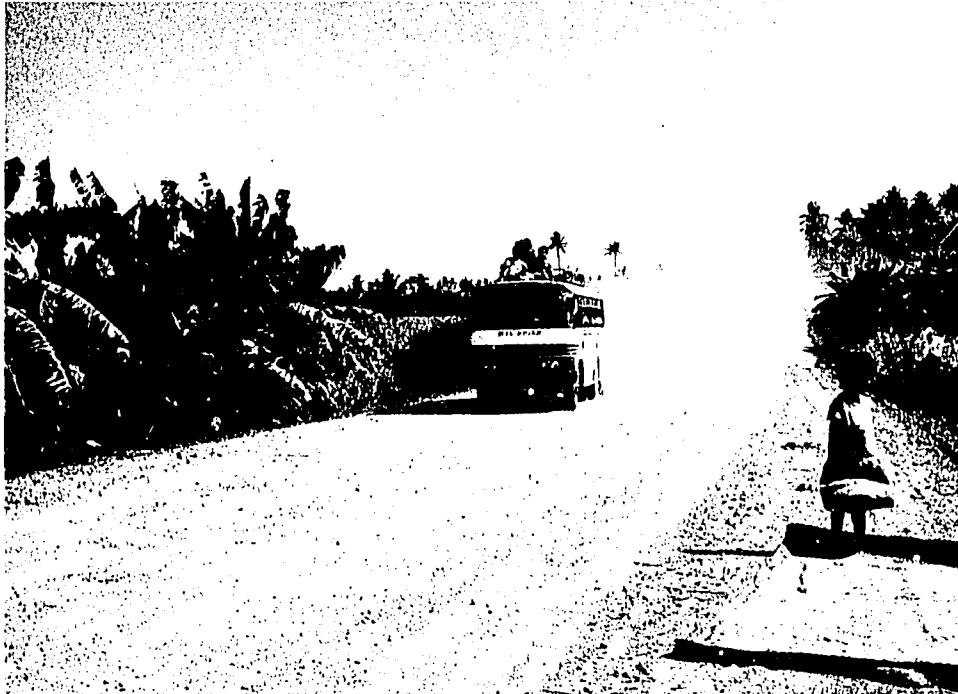


This section of road is typical of the many cases where right-of-way for widening the road was not obtained by DPWH from residents prior to construction. Picture taken at the Kalibo road project.

We observed first-hand many serious right-of-way problems on the Ajuy-Estancia road project. Hundreds of residents along the road are now and have been, for over two years, subject to unrelenting and hazardous dust conditions from vehicles passing over an unpaved and incomplete road bed. Other residents are refusing to allow construction to proceed until they receive what they believe is an adequate settlement. The photograph on the next page illustrates these conditions.

We asked how construction could have begun prior to resolution of right-of-way problems (as it is a reported DPWH policy and procedure not to give a go-ahead until and unless a certification is received from the DPWH Engineering Office that all right-of-way problems have been resolved). We were informed that a "verbal" go-ahead was given to the contractor when, in

fact, there were a large number of remaining right-of-way problems. A thorough review of DPWH procedures should have uncovered both the requirement for such a certification as well as the fact that none were on file. This situation might then have been remedied prior to signing the contract.



Delays attributable to right-of-way problems have caused hundreds of residents along several kilometers of road to experience unhealthy dust conditions for several years. The contractor has not complied with the requirement to water the roads daily. Picture taken at the Ajuy-Estancla road project.

In our opinion, the assessment report on DPWH did not meet the November 1990 guidance and did not provide sufficient basis for the Mission Director to certify DPWH's capability. Mission officials stated that they had been dealing with DPWH for a long time and did not think there were any significant weaknesses. The guidance specifically states, however, that "a record of successful performance cannot, of itself, substitute for the initial assessment". The intent of the guidance was to strengthen A.I.D.'s oversight of the host country contracting process; the certification of assessment reports that do not have the information required by the guidance would defeat its purpose. Accordingly, the Mission needs to ensure that the required assessments meet the standards set forth in the guidance.

Management Comments and Our Evaluation

In response to Recommendation 1, the Mission revised the questionnaire used as a guide in determining the contracting capabilities of host country agencies. Specifically, the questionnaire now includes procedures to ensure that the assessment will meet the November 1990 guidance standards by: (1) including organizational diagrams and flow-charts to illustrate the decision-making process, flow of documents and sequence of procedures to be followed in the solicitation, negotiation, award, monitoring and payment of contracts; and (2) examining the actual performance of the agency reviewed through a sample of completed procurement actions.

Based on the above action taken by the Mission, Recommendation No. 1 is resolved and closed upon issuance of this report.

Capabilities Assessments Need To Be Repeated or Updated

USAID/Philippines did not repeat or update any of the assessments that were over three years old as required by the November 1990 guidance. This situation occurred, in part, because the Mission did not issue any Mission Order or directive to ensure compliance with the requirement, as suggested by the guidance. Without a repeated or updated review, the Mission is not certain whether the host country agency still follows proper contracting procedures when undertaking procurement or whether any organizational changes have diminished its capability to do so.

Recommendation No. 2; We recommend that USAID/Philippines:

- 2.1 take the necessary steps to ensure that required host country assessments are repeated or updated every three years; and**
- 2.2 repeat or update the capability assessment of the Department of Public Works and Highways.**

The November 1990 guidance states:

Assessments should be repeated, or updated by limited reviews, at three year intervals or when staff, organization or legal changes suggest the need for a more current assessment of contracting procedures and capabilities.

The capability assessment for the Department of Public Works and Highways (DPWH) was performed in October 1989. As of February 1993, neither a repeat nor updated assessment was performed or planned, even though as of December 31, 1992, there were 18 DPWH active host country contracts amounting to approximately \$48.2 million. DPWH also accounted for all 34 host country contracts (\$250,000 or more) awarded during the period in audit, November 27, 1990 to December 31, 1992. These 34 contracts were valued at approximately \$58.2 million.

The Mission was reluctant to issue a Mission Order to ensure compliance, as suggested by the guidance. Mission officials stated that a Mission Order only repeats what is already in the guidance and that there are too many Mission Orders already. We can understand that issuing a Mission Order might not be the best way to ensure compliance; however, there are other alternative methods. With DPWH being the only agency accounting for all host country contracts (\$250,000 or more) with the Mission, the Mission should ensure that DPWH still follows proper contracting procedures to undertake procurement and that staff organizational or legal changes, if any, have not diminished its capability to do so.

Since three years have passed since some of the early assessments were performed in 1989, the Mission should institute procedures to ensure that the assessments are repeated or updated to provide for a current picture of host country agencies' contracting procedures and capabilities, particularly in the case of agencies with active or proposed contracts.

In conclusion, before certifying a host country agency, USAID/Philippines should ensure that the assessment reports adequately contain all of the required information. Also, assessments should be updated or repeated as required to ensure that the host country agency still follows proper contracting procedures and that any organizational changes have not affected its capability to do so.

Management Comments and Our Evaluation

USAID/Philippines stated that it is currently reviewing which of the host country agencies certified in June 1991 need to be reassessed. The capability assessment of DPWH is being updated by the Mission. Mission officials will inform RIG/A/Singapore as to the outcome of these actions.

Based on these actions, Recommendation No. 2 is resolved upon report issuance and will be closed when we receive evidence of completion of the described actions.

Did USAID/Philippines comply with A.I.D.'s November 1990 host country contracting guidance in approving interim procurement steps and contract administration actions, in using observers on proposal evaluation panels, in assigning new responsibilities to Mission contracting and commodity management officers, and in planning and funding contract audits?

USAID/Philippines complied with the most significant aspects of the November 1990 host country contracting guidance in approving the interim procurement steps and contract administrative actions. The Mission also planned and funded contract audits as required by the guidance. However, because the appropriate Mission staff were not made aware of the new responsibilities assigned to the Contracting Officer, many of the approvals did not have clearances from the Contracting Officer.

The November 1990 Guidance requires that Mission approval be obtained for each of nine interim procurement steps to ensure the reasonableness and integrity of the procurement of host country contracts. Our review of seven host country contracts disclosed that Mission approvals were obtained for the required procurement steps and contract administrative actions. The guidance also states that the Mission should ensure that audits of host country contracts are planned at the project paper stage and that project or trust funds are set aside for the performance of such audits. We reviewed the project paper and have concluded that USAID/Philippines complied with this requirement of planning and setting aside funds for contract audits. As for the requirement of using observers on proposal evaluation panels, the host country contracts in the sample used a formal competitive bid method of procurement and observers were not required.

In reviewing the number of host country contracts, we noted a considerable difference between data reported in the Contract Information Management System (CIMS) in AID/Washington and the figures for the same period reported by USAID/Philippines. There were also smaller differences between the figures reported by the Controllers Office and the Contracts Office. The A.I.D. Handbooks are silent on where the reporting responsibility for host country contracts lies. We were told by mission officials that the responsibility for reporting on host country contracts had been shifted from field Controllers to Contracting Officers, who in turn issued requests to Project Officers to keep them informed about host country contracts so they could be reported. According to the USAID/Philippines Contracts Office, the Technical Offices have not always reported all contracts, which accounts for

the discrepancies between CIMS and USAID/Philippines records. Now that the Contracting Officer must be actively engaged in the host country contracts process, the quality of the reporting should improve. Thus, we are not making a recommendation at this time, although the Mission does need to ensure that host country contracts are properly reported.

The November guidance requires the Mission to assign new responsibilities to the Contracting Officer. It also requires the Mission Director to ensure that the Contracting Officer participates significantly in the host country contract clearance process before any approval is conveyed to the host country agency. Such participation is to ensure that procurement actions performed by the implementing agencies meet the professional standards for solicitation, negotiation, selection, award, and administration. Although the Mission assigned new responsibilities to the Contracting Officer, as discussed below, it did not fully implement the requirement to obtain clearances from the Contracting Officer.

Contracting Officers Need to be Included in Mission Clearance Process

The Mission did not always include the Contracting Officer in the clearance process as required. This happened because some officials were not aware of the requirement. As a result, the Mission was not assured that the contracting standards were met since the most knowledgeable person in contracting procedures was not consulted.

Recommendation No. 3: We recommend that USAID/Philippines circulate all directives which formally assign these new responsibilities to the Contracting Officer as required by the November 1990 guidance, and take steps to ensure that the Contracting Officer is included in all recommended phases of the clearance process of host country contracting.

The November 1990 Guidance on host country contracting states that the Contracting Officer should have new responsibility to ensure that procurement actions performed by host country contracting agencies meet professional standards for solicitation, negotiation, selection, award, and administration. In particular, clearance by the Contracting Officer is needed for nine interim procurement steps before approvals are conveyed to the host country agencies. These nine steps are: (1) notices to prospective offerors or bidders; (2) list of pre-qualified offerors, if any, prior to issuance of the

solicitation document; (3) complete solicitation document prior to issuance; (4) contractor selection method; (5) the selected contractor; (6) actions to terminate negotiations with the highest ranked offeror or reject all bids; (7) contract prior to execution; (8) signed contract documents before financing; and (9) contract administrative actions such as amendments, subcontracts, change orders, etc.

There were 63 possible clearances required from the Contracting Officer in the seven contracts reviewed. Twenty-two of these clearances were not required either because they were taken prior to the November 1990 guidance or were not applicable. Out of the remaining 41 required clearances, USAID/Philippines did not include the Contracting Officer in the clearance process in 33 cases. The table below summarizes the required clearances.

CLEARANCES REQUIRED FOR THE SEVEN HOST COUNTRY CONTRACTS

STEPS	CONTRACTS						
	Ajuy	Lipa	Santa Fe	Abo Abo	Kalibo	Cawit	Sagnay
1. Notices to bidders	NC	NC	NC	NO	NO	NO	NO
2. Pre-qualified offerors	NC	NC	NO	NO	NO	NO	NO
3. Solicitation document	NC	NC	NO	YES	NO	NO	NO
4. Contractor selection method	NC	NC	NO	YES	NO	NO	NO
5. Selected contractor	NC	NC	NO	NO	YES	NO	NO
6. Actions to terminate negotiations	N/A	N/A	N/A	N/A	N/A	N/A	N/A
7. Contract document prior to execution	NC	NO	NO	NO	YES	NO	NO
8. Signed contract document	NC	NO	NO	NO	YES	NO	NO
9. Contract administrative actions	YES	NO	NO	N/A	N/A	YES	YES

Legend: NC = Action taken prior to the November 1990 guidance. N/A = Not applicable.

Thirty-three out of 41 required clearances were not cleared by the Contracting Officer.

The approval of contract administration actions such as contract amendments, subcontracts, and change orders, was especially important. Our review revealed that five out of the seven contracts had change orders. Although these were approved by some Mission officials and such approvals were relayed to the host country agencies, two change orders were not

cleared by the Contracting Officer. The three other change orders implied the Contracting Officer's clearance, but this was not documented. Moreover, one of these three change orders was for over \$250,000 and should, therefore, have also had the Mission Director's approval. There was no evidence of this approval as well.

Since a consultant for a Philippine Senate Committee has specifically criticized the DPWH for using the tactic of deleting key portions of work from proposals prior to bidding and then recommending the deleted portions be restored as change orders after contract signature, such change orders should receive unusually intense scrutiny. In one case, a USAID Project Officer originally refused to approve a change order that included an escalation of costs; a few months later the change order was approved, following submission of additional documentation. We were concerned because when visiting the actual site it was difficult to see the difference between the work as originally planned and the "increased elevation" for which the change order was justified. These situations indicate a need to carefully review all change orders.

The failure to obtain clearances occurred because not everyone was aware of the requirement to obtain clearance from the Contracting Officer even though he was assigned these new responsibilities. The guidance was not given priority. At least one Project Specialist was not aware of the Contracting Officer's clearance requirement for the interim procurement steps. We do believe that a wider circulation of the directive assigning new responsibilities to the Contracting Officer is needed, as well as a system to ensure that the Contracting Officer is included in all required actions.

The Contracting Officer is the most knowledgeable person in the contracting process. Therefore, if he is not consulted about actions or decisions regarding host country contracts, the Mission is not assured that the host country contracting process meets all professional standards, as required and intended by the guidance.

Management Comments and Our Evaluation

Based on our recommendation, the Mission issued a Mission Order delegating approval authority to the Contracting Officer. However, this action only addressed the first part of the recommendation and not the second part. The second part of the recommendation asked the Mission to take steps to ensure that the Contracting Officer is included in the clearance process. While issuing a Mission Order formalizes the Contracting Officer's responsibilities and will probably increase the awareness among Mission staff that the

Contracting Officer now has approval authority, it does not ensure per se that the Contracting Officer's name will be part of the clearance process. Some additional procedures (making the contract officers one of the official clearance signatures required in the approval memoranda drafted by the Project offices, for example) would be needed to accomplish this. Therefore, Recommendation 3 remains unresolved.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General for Audit/Singapore audited USAID/Philippines' implementation of A.I.D.'s guidance on host country contracting in accordance with generally accepted government auditing standards. We conducted this audit from December 28, 1992 to April 7, 1993. We conducted our field work in the USAID/Philippines office in Manila and seven project sites throughout the Philippines. We obtained a representation letter from Mission management confirming in writing information which we considered essential for answering our audit objectives and for assessing internal controls and compliance. The Mission's representations have been included as part of the Mission comments in Appendix II.

In answering the audit objectives, we tested whether USAID/Philippines implemented and followed the internal controls prescribed by the November 1990 guidance. Our audit tests were designed to provide reasonable assurance in answering the audit objectives. In those instances where problems were found, we identified the cause and made recommendations to correct the cause and/or the problems.

For objective one, the universe consists of the 38 host country agencies certified by USAID/Philippines as having the capability to undertake procurement actions of at least \$250,000. From November 27, 1990 to December 31, 1992, USAID/Philippines funded 34 host country contracts of at least \$250,000 with one Government of Philippines agency for approximately \$58.2 million, which is the universe for objective two. As of December 31, 1992, there were 18 active host country contracts amounting to approximately \$48.2 million.

Methodology

The methodology for each audit objective is discussed below:

Audit Objective One

To accomplish this objective, we reviewed the files to determine whether the Mission had assessed and certified the capabilities of all host country agencies receiving contracts over \$250,000. These files included contracts with public accounting firms, assessment reports, and the Director's certification. We examined an assessment report of the host country agency that awarded all the host country contracts in our universe in order to determine whether the assessment report contained adequate information for the Mission Director's certification, as required by the guidance. We also examined the Mission Director's certification to determine whether it contained the recommendations from the appropriate officials and the appropriate language, as required by the guidance. We interviewed Mission officials to learn of any Mission Order or directive to implement the guidance and to verify the collected data.

Audit Objective Two

For this objective, we reviewed the Mission files and interviewed officials to determine whether new responsibilities were formally assigned to the Contracting Officer. From the 18 active host country contracts, we randomly selected seven host country contracts valued at \$22.2 million for our review. We determined whether interim procurement steps were approved by the Mission and clearances were obtained from the Contracting Officer for the seven selected contracts. We also reviewed the appropriate project paper to assess whether audits were planned and funded during the design stage. Finally, we visited the seven contract sites to assess the performance of the contractors.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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AUG 6 1993

MEMORANDUM

TO : Mr. Richard A. Thabet
RIG/A Singapore

FROM : Thomas W. Stukel *TWS*
Mission Director
USAID/Philippines

SUBJECT : Mission Comments on Draft Report on Audit
of A.I.D.'s Implementation of Agency Guidance
on Host Country Contracting

Attached are the Mission comments on the subject draft report, and a Representation Letter signed by me covering the subject audit.

We ask that these comments, and the Representation Letter be considered in finalizing the report, and be included in the final report as Annexes.

Attachments: a/s

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**MISSION COMMENTS
ON
AUDIT OF A.I.D.'s IMPLEMENTATION OF AGENCY GUIDANCE
ON HOST COUNTRY CONTRACTING - PHILIPPINES**

We note on page 12 reference to criticism made by a consultant for a Philippine Senate Committee. Our experience with such assertions reported in the media is that they are usually untrue, and it seems inappropriate to quote an unsubstantiated charge. In fact, change orders do receive intense scrutiny within the Mission. Our Engineering office has assured that all change orders approved by USAID are due to changes in field conditions between completion of design and start of construction or faulty field survey work during the design. While the report is correct in stating that certain clearances required by the 1990 guidance were not obtained, the Mission has given change orders intense review. Also on page 12, the reference to a USAID Project Officer originally refusing to approve a change order and later approving it is correct, but this was due to inadequate documentation in the original submission and not to the fact that the change order was not required.

RECOMMENDATION NO. 1

We recommend that USAID/Philippines establish a review procedure that will ensure that the required assessments meet the standards set forth in the guidance.

Comments:

To ensure that the required assessments meet the standards set forth in the November 1990 Guidance on host country contracting, the Mission has revised the questionnaire which will be used as a guide in determining the contracting capabilities of host country agencies. The questionnaire (Exhibit A) now includes procedures which will ensure that the assessment will: (a) address the host country contracting agency's organizational diagrams and flowcharts to illustrate the decision making process, flow of documents and sequence of procedures to be followed in the solicitation, negotiation, award, monitoring and payment of contracts; and, (b) test the practical application of these policies and procedures by examining actual performance through a sample selection of completed procurement actions. The Mission will also ensure that the following language is included in the Director's certification: "The determination should be reviewed at any appropriate time that staff, organization, legal or other changes suggest that a current assessment would be appropriate and will in any event be repeated or updated by limited review, within three years from the date indicated below."

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We believe that the above actions are responsive to Recommendation No. 1, and ask that this recommendation be considered resolved and closed.

RECOMMENDATION NO. 2

We recommend that USAID/Philippines:

- 2.1 take the necessary steps to ensure that required host country assessments are repeated or updated every three years; and
- 2.2 repeat or update the capability assessment of the Department of Public Works and Highways.

Comments:

A requirement has been established for the Financial Management Services Division (FMSD) to submit a memorandum report to the Controller on June 30 annually. This report will list the organizations which have been assessed for contracting capability and the date of the last assessment. It will state that no significant changes have taken place which would necessitate an update to the assessment, and state the date at which the current assessment validity will expire. A copy of this memorandum will be sent to the Director. In this manner, the Mission will ensure that assessments are updated or repeated as required. The Mission feels that this action is responsive to Recommendation No. 2.1 and asks that it be resolved and closed.

The Mission is currently reviewing which of the host country contracting agencies, certified in June 1991 by the Mission Director as having contracting capabilities to undertake procurement actions over \$250,000, need to be reassessed. The host country contracting capability assessment of the Department of Public Works and Highways (DPWH) which was performed in October 1989 is now being updated as required by the 1990 Guidance. We will advise you of the outcome of this assessment and the actions we plan to take on the other host country contracting agencies within 30 days of the issuance of the final report. We ask that Recommendation 2.2 be considered resolved and will request closure once the review is complete.

RECOMMENDATION NO. 3

We recommend that USAID/Philippines circulate all directives which formally assign these new responsibilities to the

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Contracting Officer as required by the guidance, and take steps to ensure that the Contracting Officer is included in all recommended phases of the clearance process of host country contracting.

Comments:

On June 22, 1993, the Mission issued USAID Order No. 1.1 (Exhibit B) delegating to the Contracting Officer the authority to provide A.I.D. approval for the following host country contracting actions:

1. Notices to prospective bidders
2. Lists of prequalified bidders
3. The contractor selection method
4. The contract, prior to execution
5. Signed contract documents, before financing
6. Contract administrative actions, such as subcontracts, amendments and change orders

This Mission Order also provides that the authority to approve the following actions remains with the Mission Director:

1. Complete solicitation document, prior to issuance
2. The selected contractor
3. Decision to reject all bids.

This Mission Order is now being implemented and we believe that its issuance is responsive to Recommendation No. 3 and therefore, request that it be considered resolved and closed.

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U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID / Philippines
APO AP 96440



Fax No.: 632-521-52
Tel. No.: 632-521-71

AUG 5 1993

REPRESENTATION LETTER

AUDIT OF IMPLEMENTATION OF HOST COUNTRY CONTRACTING GUIDANCE

Mr. Richard A. Thabet
Regional Inspector General for Audit/Singapore
U. S. Agency for International Development
APO AP 96534

Dear Mr. Thabet:

You have asked that USAID/Philippines provide a Representation Letter in connection with your audit of the implementation of Agency guidance on host country contracting by USAID/Philippines. Your staff has informed us that the audit covered the Mission's implementation of this guidance from November, 1990 to date. The audit was intended to answer the following audit objectives:

Did USAID/Philippines assess and certify host country contracting agencies' capabilities in accordance with A.I.D.'s November 1990 host country contracting guidance?

Did USAID/Philippines comply with A.I.D.'s November 1990 host country contracting guidance in approving interim procurement steps and contract administration actions, in using observers on proposal panels, in assigning new responsibilities to Mission contracting and commodity management officers, and in planning and funding contract audits?

I have been assigned as Mission Director to the Philippines since September 22, 1992, and accordingly was not personally involved prior to that time with the implementation of the activities audited. Since my arrival in Philippines, my staff has briefed me on the implementation of the Agency Host Country Contracting Guidance covered by the audit prior to my arrival.

I have asked the offices concerned with the audit, particularly the Office of Capital Projects, the Contract Services Office and the Office of Financial Management to make available to your staff all records in our possession for the purpose of the audit. They have assured me that all records in our possession have been made available. I have also asked them to make representations to me about the activities audited and the audit itself. They have made these representations and indicated they are aware that USAID/Philippines management is relying on their representations and knowledge and the representations and knowledge of their staffs as the basis for the representations in this letter.

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Based on advice from the General Counsel's office in AID/Washington, I advised the officials of the offices concerned with the audit, mentioned above, that their written concurrence with this letter is entirely voluntary. This advice is based on the fact that there has been no progress in negotiations with AFSA on the issue. These officials gave me their verbal concurrence with the representations made in this letter and cleared a copy of this letter. A clearance copy of this letter is available in the Mission.

Among other techniques we rely extensively on the audit reports of contracted private independent audit firms and A.I.D.'s Office of the Inspector General as a primary element of internal control, to determine compliance with applicable laws and regulations, and to ensure the accuracy of accounting and management information.

Based upon this reliance on audit, the representations made to me by my staff and their concurrence with the representations made herein, and in reliance on your office which has not informed me of any difficulty in obtaining records or information, or of any difficulty in obtaining the full cooperation of the various offices and staff involved, I confirm, as a layman and not as a lawyer, the following representations with respect to the Mission's implementation of A.I.D.'s November 1990 guidance on host country contracting:

1. USAID/Philippines is responsible for 1) the Mission's internal control system relating thereto, 2) the Mission's compliance with applicable U.S. laws, regulations, project agreement and contract terms relating thereto, and 3) the fairness and accuracy of the Mission's accounting and management information relating thereto.
2. To the best of my knowledge and belief, USAID/Philippines has made available to RIG/Singapore auditors all Mission records related to the activities audited.
3. To the best of my knowledge and belief, to the extent available within the Mission, Mission records relating to the activities audited are accurate and complete and give a fair representation as to the status of the activities audited.
4. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines is not aware of any known material instances where financial or management information directly relating to this audit has not been properly and

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accurately recorded, other than the findings in the draft report.

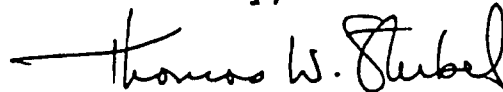
5. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines has disclosed any known material irregularities related to the implementation of A.I.D.'s host country contracting guidance dated November 1990 which we consider substantive, involving Mission employees with internal control responsibilities for the matter under audit or other organizations responsible for management of the implementation of this guidance. For the purposes of this representation, "irregularities" means the intentional noncompliance with applicable laws or regulations and/or intentional misstatements, omissions or failure to disclose.
6. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines is not aware of any known instance (other than what has been included in the draft audit report or reported by the Mission during the course of the audit) in which, in the Mission's judgment, there has been a material noncompliance by the Mission with A.I.D. policies and procedures or violation of U.S. law or regulation, which would substantially impact upon the matter under audit.
7. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines is not aware of any known instance (other than what has been included in the draft audit report or reported by the Mission during the course of the audit) in which, in the Mission's judgment, there has been a material noncompliance by the Mission with the terms of the November 1990 host country contracting guidance which would substantially impact upon the matter under audit.
8. Following our review of your draft audit report and further consultation with my staff, I know of no other facts as of the date of this letter (other than those expressed in our enclosed management comments to the draft report) which, to the best of my knowledge and belief, would materially alter the conclusions reached in the draft report.

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I request that this Representation Letter be included as a part of the official management comments on the draft report and that it be published herewith as an Annex to the report.

Sincerely,

A handwritten signature in cursive script that reads "Thomas W. Stukel". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Thomas W. Stukel
Director

APPENDIX III

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