

**Audit of USAID/Bosnia-Herzegovina's
Monitoring of Parsons' Subcontractor Selection
Process and Construction Change Orders**

**Audit Report No. B-168-00-001-P
November 19, 1999**

**Regional Inspector General
Budapest, Hungary**



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November 19, 1999

MEMORANDUM

TO: USAID/Bosnia-Herzegovina, Craig G. Buck
FROM: RIG/Budapest, *James R. Bonnell*
James R. Bonnell

SUBJECT: Audit of USAID/Bosnia-Herzegovina's Monitoring of Parsons' Subcontractor Selection Process and Construction Change Orders

This is our final report on the subject audit. In preparing the report, we considered your comments on the draft and included them in Appendix II. Based on the results of our audit, we found that, although the Cognizant Technical Officer did not fully monitor Parsons' subcontractor selection process, Parsons' overall procurement process resulted in free and open competition. As the work to be performed under the subcontracts consisted of construction projects, we included a limited review of construction change orders because such orders can modify specifications and increase prices. The audit found that improvements are needed in how the Mission tracks and monitors change orders.

This report contains two recommendations for your action. Recommendation No. 1 concerns monitoring and reporting on the implementing contractor's procurement activities. We reviewed the Mission's proposed procedures, verified that the RCO received a copy to review, and consider that final action has been taken. Recommendation No. 1 is closed upon report issuance.

Recommendation No. 2 concerns the establishment of a tracking system for change orders. We have reviewed the Mission's response and Recommendation No. 2 is classified as having reached a management decision. When the described budget and commitments modules are implemented, please contact the Bureau for Management (M/MPI/MIC) to request that a determination be made that final action has been taken on the recommendation.

Thank you for your assistance and the courtesies extended to my staff during the audit.

Background

In June 1996, Parsons Delaware, Inc., (Parsons) was competitively selected to implement the Municipal Infrastructure and Services (MIS) Program in Bosnia-Herzegovina. The Regional Inspector General Office in Budapest (RIG/Budapest) provided on-going audit coverage of this program from the beginning, issuing six audit reports.¹ RIG/Budapest ended its audit coverage of the MIS program, but, in response to Mission concerns and allegations, conducted a three-week survey of local procurement activities. Specifically, we looked at how USAID/Bosnia-Herzegovina monitors and Parsons manages the process of awarding subcontracts to local Bosnian contractors. As a result of the survey, both RIG/Budapest and the Mission agreed that the procurement process should be audited.

Parsons awards subcontracts for construction projects related to the energy, transportation, water, health, and education sectors. Originally, projects included small Community Infrastructure Rehabilitation Projects (CIRPs), which focused on one sector and were expected to cost approximately \$50,000 each, and large municipal infrastructure projects that cost approximately \$1.5 million each. Later, the Mission began approving larger CIRP projects (dubbed Super CIRPs) which encompassed several sectors and had a budget of approximately \$350,000 each.

As of December 31, 1998, Parsons awarded 547 subcontracts, valued at about \$73.4 million. In awarding subcontracts, Parsons used a streamlined competitive procurement process for small CIRP projects and full and open competition procedures for Super CIRP and MIS projects.

Audit Objective

The overall objective of this audit was to determine if the implementing contractor followed competitive procurement practices in the selection and award of subcontracts as required by their contract.

We also included three additional areas of interest—two to the Mission and one to the USAID contracting officer. First, we reviewed whether requests for change orders from Parsons were approved by USAID. Secondly, we determined whether Parsons ensured that subcontracts were not being awarded to firms whose principal officers were on the International War Crimes Tribunal list of indicted war criminals. Finally, at the request of the USAID contracting officer, we determined whether USAID/Bosnia-Herzegovina was improperly participating in Parsons' contractor selection and award process.

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

¹ Audit Report Nos: B-168-97-003-P, dated March 26, 1997; B-168-97-005-P, dated June 27, 1997; B-168-98-002-P, dated January 9, 1998; B-168-98-003-P, dated March 26, 1998; B-168-98-007-P, dated September 30, 1998 and B-168-99-003-P, dated August 13, 1999.

Audit Findings

Did USAID/Bosnia-Herzegovina ensure that the implementing contractor followed competitive procurement procedures in the selection and award of subcontracts according to the terms of their contract?

USAID/Bosnia-Herzegovina was not fully carrying out its monitoring responsibilities to ensure that the implementing contractor followed competitive procurement practices. USAID/Bosnia-Herzegovina did not have a plan for regular, on-going monitoring and reporting on Parsons' procurement activities. Nor did the Mission have an effective system of tracking and monitoring change orders to subcontracts awarded by Parsons, ensuring that change orders were reasonable and necessary. While we found that the subcontract award process followed by Parsons resulted in free and open competition, improvements in the Mission's monitoring will provide greater assurance that Parsons' subcontracts are awarded fairly, particularly in such a high risk environment as Bosnia.

Our audit also found that (1) Parsons was ensuring that subcontracts were not awarded to indicted war criminals and (2) USAID was not improperly participating in Parsons' subcontractor selection and award process.

Parsons Was Competitively Awarding Subcontracts

Parsons, acting as USAID's implementing contractor, was responsible for contracting with local Bosnian firms to carry out the work on CIRP, Super CIRP and MIS projects throughout Bosnia. Parsons' prime contract specified that these subcontracts were, to the maximum extent possible, to be competitive procurements, using procedures acceptable to USAID. Given a possible shortage of qualified contractors and the fact that other aid donors may also place demands on available resources, competition may not always be possible. However, every effort was to be made to survey and encourage participation from a broad base of qualified firms.

We selected a statistical sample of 132 of the 547 subcontracts to assess Parsons' subcontractor selection process. In determining whether Parsons followed procedures that resulted in full and open competition in the selection and award of subcontracts, we considered the following factors:

- Did Parsons' subcontract file contain documents showing that competitive procedures had been followed?
- Did Parsons follow its established selection criteria?
- Was the "best value determination" documented and justified by Parsons?

- In general, were at least three competitive proposals received?

As summarized below, our review of 132 subcontract files showed that:

Competitive procedures were followed. We found that only 17 (12.9 percent) of the 132 files sampled lacked at least some of the required documentation that showed evidence of competition. However, all but three (2.3 percent) of the files had enough documentation for us to conclude that competitive procedures were followed.

While Parsons' officials asserted that they considered established selection criteria when determining subcontractor qualifications, they generally did not document the results. Parsons' selection criteria are used to determine whether prospective subcontractors are qualified—that is possess the financial and technical capability to perform. The selection criteria consists of: (1) verifying a subcontractor's experience; (2) analyzing a subcontractor's financial strength; (3) making reference checks; (4) considering a subcontractor's past performance; and (5) verifying a subcontractor's equipment and staffing resources. Initially, we found that 60 (45.5 percent) of the files sampled lacked evidence that these criteria were followed. However, through subsequent discussions with Parsons' officials, we learned that Parsons did informally consider the criteria when selecting a subcontractor, but did not document it in the contract file.

Parsons made and documented the best value determination. All but two (1.5 percent) of the files reviewed had enough documentation for us to conclude that Parsons had awarded the subcontract to the firm offering the "Best Value," usually the most responsive bidder with the lowest price.

Whenever possible Parsons solicited proposals from more than one firm. Twelve (9.1 percent) of the subcontracts in our sample had been awarded despite the fact that Parsons received less than the three required competitive proposals from interested firms. The reasons for the lack of competitive proposals were that either the subcontract was a sole source procurement (six subcontracts) or, in the case of the other six subcontracts, that firms invited to submit a proposal did not do so. These 12 subcontracts did not constitute a material weakness because Parsons justified the six sole source subcontracts and all but one were awarded with USAID approval. The remaining subcontracts were awarded through the normal competitive process.

Appendix III projects the audit sample results to the universe of 547 subcontracts.

Parsons Not Conducting Procurement Compliance Reviews

We also found that, while Parsons' procurement policy requires procurement compliance reviews to be conducted, reviews were not being done. The purpose of review is to ensure compliance with Parsons' procurement policy (including Federal Acquisition Regulations and USAID

Acquisition Regulations), and that Parsons consistently adhere to high standards of ethical and business practices. Parsons' procurement policy states that all subcontracts exceeding \$25,000 require policy compliance review and approval by the Parsons' Sarajevo procurement manager. If the procurement exceeds \$250,000 the policy review is to be conducted by Parsons' Director of Contracts and Procurements. Parsons' policy also requires that, where applicable, written evidence of the review be included in all procurement files. This is an important internal control, especially when conducting business in an inherently risky business environment such as Bosnia.

Parsons' procurement manager confirmed that the reviews were not being conducted despite this deficiency being reported in two prior reviews conducted by Parsons' corporate office. However, the Parsons' Sarajevo procurement manager plans to do so in the future, and new procedures emphasizing the requirement, including a new form for documenting the reviews in contract files, have recently been drafted. Had compliance reviews been conducted the deficiencies cited in this report may have been mitigated.

USAID Not Monitoring Parsons' Subcontractor Selection Process

Controls over Parsons' subcontractor selection and award process are essential for ensuring that competitive procurement procedures are followed in the selection and award of subcontracts to local Bosnian firms. As the eyes and ears of USAID's contracting officer, the Cognizant Technical Officer (CTO), is responsible for monitoring the implementing contractor's performance and compliance with the terms of the contract and reporting any potential or actual problems to the contracting officer. However, the audit found that USAID's CTO was not monitoring this aspect of Parsons' activities and had no plan in place to do so. For example, had the CTO been monitoring Parsons' procurement activities the Mission and the contracting officer would have known that Parsons was not conducting required procurement compliance reviews and that procurement actions were not always fully documented. The CTO needs to monitor Parsons' procurement activities more aggressively to ensure compliance with the contract. To do this the CTO should, with assistance from the contracting officer, develop a plan for monitoring and reporting the contractor's efforts, including their procurement activities.

Recommendation No. 1: We recommend that USAID/Bosnia-Herzegovina, in coordination with the Regional Contracting Office/Budapest, develop a plan for regular, on-going monitoring and reporting of the implementing contractor's procurement activities.

Controls Over Construction Change Orders Can Be Strengthened

The Mission needs to improve its system for managing change orders. Our audit found that 48 of the 132 subcontract files reviewed had one or more change orders associated with it, and although all change orders must be approved by USAID/Bosnia-Herzegovina, 12 files (25 percent), lacked evidence of USAID approval. Furthermore, neither USAID nor Parsons could

provide copies of the approved change order documents.

A change order authorizes time extensions, and additions, deletions, or revisions in the subcontract's original scope of work. Such modifications may affect the completion date or the price of the subcontract. Change orders come about due to a number of reasons including schedule delays caused by bad weather; the site not being available for work at the agreed upon date due to lack of permits; or site conditions not anticipated in the original bid.

We limited our review of change orders to the 132 sampled subcontract files and found that 48 subcontracts (36.4 percent) contained at least one change order. A closer examination of individual change orders revealed that original subcontracts are being significantly modified by change orders.

- 27 of the 48 subcontracts containing change orders (56.3 percent) had the original scope of work enlarged
- 35 of the 48 subcontracts (72.9 percent) had the original completion date extended
- 24 of the 48 subcontracts (50 percent) had change orders that increased the subcontract price

In June 1998, the Mission issued revised change order procedures to ensure that change orders would only be approved for problems that could not be foreseen or identified during the preparation of scopes of work, plans, designs or procurement packages. In addition, the Mission advised Parsons that change orders were not to be used to enlarge scopes of work or to change projects beyond their original intent. However, as evidenced by the absence of Mission approval on 25 percent of the change orders we reviewed, the Mission lacks an effective system for tracking and monitoring change orders. Until such a system is put in place the Mission cannot ensure that change orders are only being used as intended. Accordingly we are making the following recommendation.

Recommendation No. 2: We recommend that USAID/Bosnia-Herzegovina establish a system to track change orders to ensure that they are approved by the Mission and comply with applicable policy, procedures, and regulations.

Parsons Ensured that Subcontracts Were Not Awarded to Indicted War Criminals

The Foreign Operations, Export Financing and Related Programs Appropriations Act of 1998 (PL 105-118)—commonly known as the Lautenberg Amendment—enacted restrictions on funding to countries providing sanctuary to indicted war criminals. Accordingly, USAID/Bosnia-Herzegovina directed Parsons to check the names of principal officers of construction companies that qualify to bid on MIS Projects or CIRP activities against the list of indicted war criminals issued by the International War Crimes Tribunal. USAID took this action

to help guarantee that project funds were not used by people indicted by the International War Crimes Tribunal or used for purposes which did not meet the spirit of the MIS Project and the Dayton Peace Accords. Our sample revealed no instances where subcontracts were awarded to firms whose principal officer was named on the published list of indicted war criminals.

USAID Correctly Did Not Participate in Parsons' Contractor Selection and Award Process

USAID's role with regard to subcontracts should be circumspect. By becoming involved in subcontract negotiations, USAID assumes responsibility that should rest solely on the contractor for the success of the activity. The whole point of Parsons' prime contract was to give them full responsibility for subcontractor selection. Therefore, other than monitoring the subcontractor selection and award process, the CTO should not be involved. Our sample confirmed that the CTO correctly did not participate in the process.

Conclusion

When considering the above factors and the intent of USAID/Bosnia-Herzegovina's contract with Parsons, we concluded that competition was taking place. We found no material indications that anything other than free and open competition in the selection and award of subcontracts had taken place. Although we found some areas where improvements could be made, the overall procurement process used by the Parsons resulted in free and open competition.

Management Comments and Our Evaluation

USAID/Bosnia-Herzegovina officials agreed with the audit findings and recommendations and their comments are included as Appendix II to this report. In response to Recommendation No. 1, USAID/Bosnia-Herzegovina provided information on actions it took in January 1999 to meet its oversight obligations for procurement and change order actions. In addition, the Mission advised that it plans to institute a procurement review, modeled after our audit, of the contractor's subcontractor selection process—covering 36 procurement actions per year and implemented in conjunction with other contractor monitoring actions.

Regarding Recommendation No. 2, USAID/Bosnia-Herzegovina stated that, in order to facilitate analysis and tracking of change orders, it is adding a budget and commitments module to its current computerized management information system. Once added the module will simplify budget review, facilitate change order analysis, and make change order documentation more readily accessible to those who need it.

Based on USAID/Bosnia-Herzegovina's response, our review of supporting documentation provided by the Mission and consultation with the Regional Contracting Officer we consider that final action has been taken with respect to Recommendation No. 1 and consider the recommendation closed upon report issuance. Recommendation No. 2 is classified as having reached a management decision.

Scope and Methodology

Scope

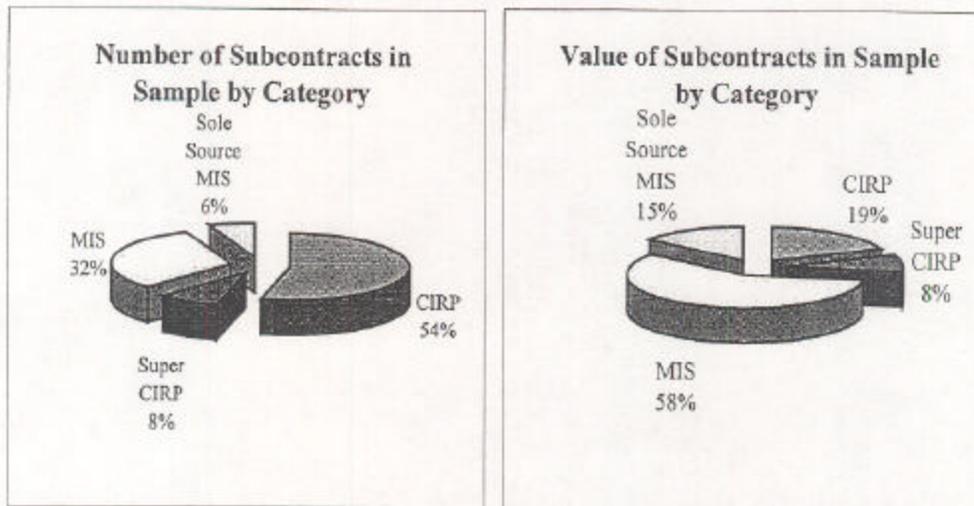
We audited USAID/Bosnia-Herzegovina's internal management controls for ensuring that the USAID Municipal Infrastructure and Services (MIS) program's implementing contractor, Parsons Delaware, Inc., (Parsons) followed competitive procurement procedures in accordance with contract terms, Federal Acquisition Regulations, and USAID policies and procedures in the selection and award of subcontracts. The audit universe covered 547 subcontracts valued at \$73.4 million, which Parsons awarded from June 1996 through December 1998. We did not conduct a financial audit of these costs. The audit was limited to a review of controls over the selection and award of subcontracts by Parsons. We obtained an understanding of these controls, and determined whether they were operating.

The audit was performed in accordance with generally accepted government auditing standards and conducted between February 10 and May 19, 1999, at the USAID and Parsons offices in Sarajevo.

Methodology

To answer the audit objective, we reviewed controls over the contractor selection process used by Parsons for awarding subcontracts to local Bosnian firms from 1996 through 1998. We also reviewed Public Law 104-122, Public Law 105-118, Parsons' contract, and other applicable policy, procedures and regulations.

To assess the Parsons' subcontractor selection process, we selected a statistical sample of 132, or 24 percent, of the 547 subcontracts for review. The sample results are projected to the audit universe at the 95 percent confidence level in Appendix III—we are 95 percent certain that the actual number of each attribute projected will be between the lower and upper confidence limits calculated for this sample. The sample showed that, while there are fewer Municipal Infrastructure and Services (MIS) subcontracts than Community Infrastructure Rehabilitation Project (CIRP) and Super CIRP subcontracts—38 verses 62 percent—the MIS subcontracts represented 73 percent of the value of all subcontracts awarded by Parsons. The distribution of the sample subcontracts by contract type and dollar value is illustrated in the following charts:



We reviewed 132 subcontracts to determine whether: (1) procurement documentation was adequate; (2) competitive proposals were solicited; (3) at least three competitive proposals were received from qualified firms; (4) subcontract instrument was firm fixed price; (5) established selection criteria was followed; (6) "best value" determination was justified and documented; (7) USAID participated in subcontractor selection process; (8) sole source subcontracts were justified and approved by USAID; and (9) any subcontracts were awarded to firms whose principal officer was named as an indicted war criminal by the International War Crimes Tribunal.

Where problems were found, we reviewed to the extent practical the causes of the problems. This included additional interviews with Mission and contractor personnel and the review of additional documentation.

In evaluating the results of the fieldwork, we considered an error rate of five percent or more of the audit sample to represent significant problems. This threshold reflects our judgment about the extent of compliance that is practical and cost effective.

We also conducted a review of change order documentation. Our review was limited to collecting information related to change orders for the subcontracts we sampled. The change orders found in the subcontract files were reviewed to determine if they were approved by USAID/Bosnia-Herzegovina and whether they enlarged the subcontract's statement of work, extended the subcontract's completion date, or increased the subcontract price.

Appendix II

Comments on the draft audit report provided by USAID/Bosnia-Herzegovina



United States Agency for International Development
Sarajevo, Bosnia and Herzegovina

November 10, 1999

MEMORANDUM

TO: James R. Bonnell, RIG/Budapest

FROM: Craig G. Buck, Mission Director

SUBJECT: Audit of USAID/Bosnia-Herzegovina's Monitoring of Parsons' Subcontractor Selection Process and Construction Change Orders

Thank you for bringing to our attention your findings on the subject audit. We agree that at the time of auditors' visit there were certain weaknesses in the system set up to monitor the implementing contractor's practices. We strongly agree with the need for close oversight of MIO activities as described in RIG/Budapest's two recommendations. Since the auditors' visit, we have instituted new procedures to spot check procurement activities on a regular basis. Copies of the new procedures are being cleared by RCO/Budapest to ensure they are consistent with USAID contracting procedures. As soon as the added procedures are approved by RCO/Budapest, we will forward copies of them to RIG/Budapest. The Mission has also notified the contractor that any change orders which do not strictly follow established change order procedures will not be approved.

Recommendation No. 1: We recommend that USAID/ Bosnia-Herzegovina, in coordination with the Regional Contracting Office/Budapest, develop a plan for regular, on-going monitoring and reporting on the implementing contractor's procurement activities.

In January 1999, USAID's MIO engineering staff instituted a procedure for review of unit costs and conducted a unit cost survey to meet the oversight objectives for procurement and change order actions. The survey resulted in 10 "issues," which were presented to the implementing contractor (Parsons) for review. That review resulted in a series of actions and procedural reforms that contributed substantially to improving the quality and cost-effectiveness of procurement actions. The review also created a database of regularly updated unit costs that are currently being used in the ongoing review of procurement actions and change orders. The next unit cost survey will be conducted in December 1999. The unit cost survey provides the MIO engineering staff with a source of reliable, market-based data for use in technical and cost review of procurement actions and change orders, and represents a substantial contribution to ensuring competitive procurement.

In addition to the above procurement monitoring, MIO is instituting a procurement activity review modeled on the RIG's recent audit of the implementing contractor's subcontractor selection process. This review will provide further monitoring of procurement activity focused on procedural issues, and will complement the above-described monitoring procedures focused on technical and cost considerations. The review will be conducted by the MIO engineering staff, will cover 36 procurement actions per year, will be implemented in conjunction with the unit cost survey, and will be based on current Parsons Procurement Procedures. The procedure has been drafted and is being reviewed by the RCO. Implementation of the first review of 18 procurement actions will be conducted in December 1999 with the Unit Cost Survey.

Recommendation No. 2: We recommend that USAID/Bosnia-Herzegovina establish a system to track change orders to ensure all such change orders are approved by the Mission and comply with applicable policy, procedures, and regulations.

MIO change order procedures currently require engineering, program, and budget review before being submitted for approval. Approval is made by the Mission Director for budget increases, and by the COTR for all other change orders. The work that has been, and continues to be, done in establishing current market rates for construction unit costs contributes significantly to ensuring that current competitive rates are being used for change order costs. Moreover, in response to the recommendations of the previous unit cost survey, Parsons agreed it needed "to separate the unit costs into more functional categories," thereby facilitating analysis of change orders and further improving the review process.

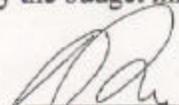
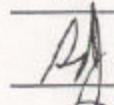
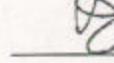
To further facilitate analysis and tracking of change orders, MIO is adding a budget and commitments module to the current computerized management information system. The implementation of these modules will simplify budget review, facilitate change order analysis, and make change order documentation more readily accessible to those who need it. Modification of the MIS program is currently awaiting approval of the MAARD for programming services tied up by the budget impasse.

Drafted by: MIO:MBroadly

Cleared by: DDIR:EKerst

CONT:RPJacobs

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**Projection of Sample Attributes
To the Universe of Subcontracts Awarded by the
Implementing Contractor
1996 through 1998**

The following table summarizes the results of attributes tested in our random sample of 132 out of a universe of 547 subcontracts awarded by the implementing contractor, Parsons Delaware, Inc., since the inception of the MIS project.

Attribute	Number of Occurrences in Sample	Projected Number of Errors in Universe (with 95 % Confidence)			% of Errors in Population: Best Estimate
		Lower Limit	Best Estimate	Upper Limit	
File Lacked Evidence of Competition	3	4	12	33	2.3
File Lacked all Required Documents	17	46	70	104	12.9
File Lacked Evidence that Parsons Followed Selection Criteria	60	207	249	291	45.5
File Lacked Evidence of Best Value Determination	2	2	8	27	1.5
Less than Three Competitive Proposals Received ²	12	29	50	80	9.1
USAID Participation in Contractor Selection & Award Process	0	0	0	13	0.0
Principal Officer of Subcontractor Firm Named as War Criminals	0	0	0	13	0.0
File Contained Evidence of Procurement Compliance Review	0	0	0	13	0.0
Subcontracts with Change Orders ³	48	160	199	241	36.4
Evidence of USAID Approval of Change Order Missing	12	29	50	80	9.1

The use of random sampling techniques allowed us to evaluate the sample results in terms of how far the sample projection might deviate from a 100 percent check. For example, our sample disclosed that three of the subcontract files lacked evidence of competition. Therefore, we can say with 95 percent certainty that the actual number of subcontract files lacking evidence of competition would fall between four and 33, with the most likely number being 12 (2.3 percent) of the total. We consider error rates in excess of five percent to be significant, and have put in bold print those percentages exceeding that rate.

² Not considered a material weakness. See report, page 4.

³ The attribute is descriptive and not an error.