USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

May 28, 1998

MEMORANDUM FOR DAA/ENI, George Ingram

FROM: IG/A/ITSA, Theodore P. Alves *Ted Alves*

SUBJECT: Audit Report on Allegations of Inappropriate Policies, Procedures, and Practices in Providing Assistance to Kazakstan (Audit Report No. A-000-98-005-P)

Congressman Benjamin A. Gilman as the Chairman of the House International Relations Committee (HIRC) requested that we review the merits of certain allegations made in the August 1997 Harper's Magazine article entitled, "Aboard the Gravy Train," regarding Burson-Marsteller activities in Kazakstan. This report responds to that request. A copy of the report will be provided to the Chairman.

We reviewed your comments to the draft report and have included them in their entirety as APPENDIX II.

We appreciate the cooperation and courtesies extended to our staff during the audit.

BACKGROUND AND THE ALLEGATIONS

In response to the dramatic collapse of the Soviet Union in 1991, the United States and other countries quickly provided the New Independent States (NIS) of the former Soviet Union with a wide variety of humanitarian and economic assistance. The United States, through the United States Agency for International Development (USAID), focused on assisting Russia and the NIS to transform their Soviet-style command economies into open-market, competitive economic systems. To this end, the rapid privatization of state-owned properties was considered by the Administration and Congress[1] to be one of the most important efforts supporting economic reform. USAID was tasked with primary responsibility for developing and implementing a rapid-response privatization program for Russia and the NIS.

[1]Congress granted USAID special authority to provide a quick response. Section 201 of the Freedom Support Act of 1992 amended the Foreign Assistance Act by adding chapter 11, section 498B, that allowed USAID to waive provisions of law in providing assistance to the former Soviet Union.

In August 1997, Harper's Magazine published an article entitled, "Aboard the Gravy Train." The article was written by a former employee of Burson-Marsteller, a U.S. public relations firm participating in USAID funded privatization activities in Kazakstan during 1994. In this case the prime contractor, KPMG Peat Marwick, had been awarded a USAID contract to supply technical assistance to support USAID's privatization efforts in the NIS, including Kazakstan. This was one of the so called "Omnibus" contracts used by USAID's Bureau for Europe and New Independent States (ENI) to deliver assistance in Russia and the NIS. Burson-Marsteller, received a subcontract from Peat Marwick to provide technical assistance to implement USAID's privatization of civilian and defense industries by providing support for USAID's public education program in Kazakstan.

The article made eight specific allegations questioning the appropriateness of USAID's practices and procedures in Kazakstan. The Chairman, House International Relations Committee, expressed concern that the allegations raised questions about whether (1) wise and appropriate contracting procedures were used, (2) government funds were mis-spent, and (3) USAID's NIS program was achieving its objectives.

SUMMARY OF RESULTS

Although we found that most of the specific allegations were not supported, prior audit reports identified problems in each of the three general areas identified by the Chairman concerning contracting procedures, misuse of government funds, and achievement of program objectives. (Our analysis of each allegation is summarized at the end of each section of the report and in Appendix Ill.)

First, to provide assistance as quickly as possible, USAID employed streamlined multiple award task and delivery order contracting procedures that were consistent with Office of Management and Budget policy and Federal Acquisition Regulations. Although these contracting procedures delivered assistance quickly, the USAID Office of Inspector General (OIG) audits identified contracting problems that occurred, in part, because of the type of contract used. The OIG found that the contracts had very general scopes of work and did not require detailed cost reporting. The OIG also questioned the legitimacy of establishing USAID obligations under the contracts before defining their scopes of work. Because of these and other concerns, USAID redesigned the contracts to strengthen scopes of work, and revise the obligation process.

Second, both General Accounting Office (GAO) and OIG audits identified weaknesses in the ENI Bureau's monitoring and oversight of its Russian and NIS programs that led to potential misuse of government funds. Limited oversight was due to staff limitations and inadequate billing information provided by contractors. Specifically, when ENI's assistance program in Russia and the NIS began, it was managed from Washington with few, if any, staff in the field and contractors were not required to submit detailed invoices for reimbursement under the contracts. In response, USAID (1) redesigned the contracts to strengthen controls over the content of contractor invoice submissions, and (2) increased the size of its field staff.

Third, USAID management believes that USAID programs have contributed to sweeping economic changes, including mass privatization, and other reforms in Russia and the NIS. In this regard the GAO reported in August 1995 that seven of the ten projects they examined in Russia met all or most of their primary objectives. Further, the GAO noted that while the privatization project in Russia had shortcomings, they considered it a success. Moreover, the GAO recognized USAID's positive contribution to the overall privatization effort. However, OIG and GAO audits also identified a variety of weaknesses which impaired the ENI Bureau's ability to monitor and report on contractor performance. However, a 1997 OIG audit showed that the ENI Mission in the Central Asian Republics' ability to monitor and report on its activities in Kazakstan has improved with implementation of Government Performance and Results Act requirements.

AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

In responding to the questions raised by the Chairman, the objective of our audit was to answer the following question:

- **Were the allegations cited in the August 1997 Harpers Magazine article entitled "Aboard the Gravy Train" accurate?**

The scope of our work was limited to a review of the specific allegations, Omnibus contracting procedures employed by the ENI Bureau, and prior audit reports that addressed the effectiveness of USAID's program in Russia and the NIS. Our work was conducted between October 30, 1997 and February 5, 1998 in accordance with generally accepted government auditing standards.

In answering the audit objective, we related each of the eight allegations to one of the three general areas that Congressman Gilman requested that we comment upon:

- whether wise and appropriate contracting procedures were used;
- whether government funds were misspent; and
- whether USAID's NIS program was achieving its objectives.

In addition to reviewing the specific allegations, we determined whether similar problems had been reported in each of the three areas, and, if so, what actions USAID had taken to correct the problems. To do this, we reviewed the contracting procedures employed by the ENI Bureau and reviewed prior audit reports that addressed USAID's program in Russia and the NIS. We did not, however, confirm that USAID actions had been effective. (A more detailed Scope and Methodology description can be found in Append ix I.)

REPORT OF AUDIT FINDINGS

Whether Wise and Appropriate Contracting Procedures Were Employed by USAID in Kazakstan?

The ENI Bureau used streamlined multiple award task and delivery order contracts-known as "Omnibus Contracts"-which allowed awards to several contractors under a single procurement action, because contracting lead times that normal procurements required were considered excessive. Although these contracts delivered assistance quickly, OIG audits identified contracting problems that occurred, in part, because of the type of contract used. The OIG found that the original contracts, called Omnibus I, had very general scopes of work and did not require detailed cost reporting. The OIG also questioned the legitimacy of establishing USAID obligations under those contracts before defining their scopes of work. Because of these and other concerns, USAID redesigned the contracts to strengthen scopes of work, and revised the obligation process-called Omnibus II contracts.

Omnibus I Contracts

Omnibus I contracts were cost-plus-fixed fee, level of effort type contract instruments[2], that used a task and delivery order mechanism. Omnibus I contracts established an overall level of effort, up front, as soon as the contract was awarded. Reimbursement was based on actual costs plus a fixed fee (cost-post-fixed fee). This type of contract provides for payment of actual costs plus a negotiated fee that is fixed at the inception of the contract. The Omnibus contracts, unlike fully defined single-purpose contracts, provided for the performance of activities, many of which needed to be further defined during execution of the contract.

Federal Acquisition Regulations (FAR) state that Cost-post-fixed Fee contracts should only be used when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to permit use of any fixed-price contract. Also, this type of contract is suitable for use when significant uncertainties are present. For example, the contract could be for the performance of research or preliminary exploration or study, and the level of effort required is unknown. This contract type permits contracting for efforts that might otherwise present too great a risk to contractors, but it provides the contractor only a minimum incentive to control costs. Omnibus I

***Cost-post-fixed fee, "Level of Effort" type contracts, describe the** scope of work in general terms and require the contractor to devote a specified level of effort for a stated time period. **(FAR 16.306(d)(2))**

contracts had very general scopes of work and only required contractors to supply a specified amount of labor and materials.

Under the Omnibus I contracts, task orders were used to identify the country in which a contractor would be required to work and the type of activities the contractor would be responsible for implementing during the period of the task order-about six months. For example, a task order negotiated under one of the Omnibus I contracts called for the subcontractor, Burson-Marsteller (the subject of the allegations), to perform tasks for a public education program supporting privatization work in Kazakstan. The prime contractor, KPMG Peat Marwick, was responsible for preparing a work plan, sometimes referred to as an action plan, which further defined the specific activities to be implemented. These work plans documented the agreements reached by the involved parties-host government, USAID, and the contractor-as to what needed to be done, and how it was going to be achieved. Once the three parties agreed to the work plan, the contractor began work on the activities.

In this manner, the Omnibus I contract process achieved significant time savings. For example, if USAID had contracted separately for each individual task, it may have required six months or longer before implementation of any project activity could begin. Under the Omnibus I contract approach, no additional time was spent initiating and awarding separate procurements to address these activities. The Omnibus I contractor was responsible for implementing tasks as soon as the work plan was completed.

In fiscal years 1993 and 1994, USAID funded most of their NIS privatization activities through Omnibus I contracts. When the contracts were awarded, general estimates were made of the total cost for all activities anticipated for every country and region. The full amount was obligated when the contracts were awarded. For the most part, these contracts lasted for three years.

However, the streamlined approach used by USAID resulted in various management problems that occurred, in part, because of the contracting provisions. For example, in a May 1994 memorandum, the OIG questioned the legitimacy of establishing USAID obligations under Omnibus I contracts before adequately defining their scopes of work. The OIG pointed out that the procurements presented serious problems. The most serious problem, one that could undermine the validity and enforceability of the contracts themselves, was the indefiniteness of the contract terms. The indefinite Statements of Work (SOW) posed two problems: (1) where the SOW were not precisely defined, the contractors might not have understood clearly the objectives that they were to undertake; hence there might not have been a “meeting of the minds”, and no contract; and (2) broadly defined SOWs that merely provided the general policy goals USAID sought to achieve, left the “how” of the matter in the hands of the contractors to work out. In effect, USAID was attempting to obligate funds for uses to be determined in the future. The OIG concluded that to obligate funds without defining what they would be used for was not a valid obligation purpose.

As a result of these and other concerns, USAID strengthened the Omnibus I contracting procedures used to provide assistance in the NIS. When the replacement Omnibus II contracts were designed, the Office of Procurement, in consultation with the **OIG** and others, determined that future contracts would need to be issued for very specific tasks. In early 1995, USAID shifted from the Omnibus I contracts and began awarding new Omnibus II contracts.

Omnibus II Contracts

Omnibus II used indefinite quantity contract (IQC) instruments[3] in which the amount and type of labor was negotiated for each task order and priced against fixed daily rates. These contracts provided for longer durations, had more complex work requirements, and changed the way that USAID obligated funds. Omnibus II contracts had very specific scopes of work and required contractors to accomplish specific assignments or objectives. For Omnibus II contracts, a small obligation (of $10,000) was made at contract award. This guaranteed that the contractor would receive $10,000 even if no task orders were issued. When a task order was issued, funds would be obligated for that task. As soon as a task order was issued, the $10,000 could be deobligated. Under the Omnibus II contracts, the level of effort was negotiated for each task order and priced against fixed daily rates and the contractor was expected to produce a specific result. Thus, the Omnibus II contracts better facilitated the use of performance-based scopes of work.

Omnibus II contracts, which were also consistent with OMB policy, continued to ensure competition and kept the ordering process from being overly burdensome, while strengthening controls over contractor activities and accountability.

The following is a discussion of the specific allegations which concern, "wise and appropriate contracting procedures."

Why a "cost-plus percentage of cost" contract between USAID and Burson-Marsteller was chosen as the means of reimbursing that contract?

The Harper's Magazine article alleged that Burson-Marsteller had a cost plus percentage of cost contract with USAID: USAID would reimburse all of the costs Burson-Marsteller incurred, "plus" pay about seven on top of that-Burson-Marsteller's profit margin. The article asserted that this created little incentive for the contractor to control costs, because the more the contractor spent the more profit the contractor collected. However, USAID did not use a "Cost Plus Percentage of Cost" type contract in either

[3] An indefinite quantity contract provides for an indefinite quantity, within stated limits, of specific supplies or services to be furnished during a fixed period, with deliveries to be scheduled by placing orders with the contractor. (FAR 16.504(a))

Omnibus I or II. In fact, this type of contract has not been used by the federal government for many years. As discussed above, the Omnibus contracts were cost-post-fixed fee type contracts designed to provide USAID with (1) the ability to respond quickly, and **(2)** maximum flexibility to the very fluid situation it faced in Russia and the NIS.

Burson-Marsteller received four task orders, or subcontracts, under the Omnibus I contract awarded to KPMG Peat Marwick. The person making the allegation apparently confused cost plus percentage of cost contracts, which are illegal in the federal government, with the cost-post-fixed fee contract awarded to Burson-Marsteller. The fixed fee is paid to the contractor as a percentage of costs reimbursed up to a fixed amount.

Why per diem payments of up to $94 for con tractor employees were provided on top of generous salaries and benefits?

The Harper's Magazine article alleged that anyone working for USAID in Kazakstan, directly or indirectly, was entitled to a $94 per diem on top of his or her salary and housing. Normally the Government pays per diem for temporary travel, but at a reduced rate under certain circumstances, such as when lodging is furnished to the employee by the Government. The article also stated that those individuals working at Burson-Marsteller were not getting the full USAID-mandated $94, but rather a per diem amount established at $25.

Initially, the Omnibus I contracts, which were managed by USAID personnel in Washington, were negotiated using standardized lodgings plus per diem rates. Under this system, the daily allowance for each travel day is established on the basis of the actual amount the traveler pays for lodgings plus a fixed allowance for meals and incidental expenses (M&IE) with the total not to exceed the applicable maximum daily rate for the location. However, in accordance with Federal Travel Regulations, USAID authorized a reduced daily rate because housing for the traveler was furnished by the Government. USAID officials told us that partial per diem, only the M&IE portion, was authorized for personnel who were temporarily assigned to Kazakstan even though housing was also provided because the individuals were sent to Kazakstan with only one or two suitcases and no household effects. In this case, even though the contractor employees were provided housing, they were not expected to be able to set up full housekeeping, hence partial per diem (only M&IE) was authorized in the contract and Federal travel regulations.

As USAID gained experience and was able to place more people in the field, more responsibility for managing the Kazakstan assistance program was moved to the field. The USAID Mission in Kazakstan began, in early 1995, to take a more direct role in managing the public education activity, and attempted to focus the program in a manner which improved both its cost-efficiency and programmatic effectiveness. One of the first major steps taken by the Mission was to revise the per diem policy which had allowed for 100 percent of the full M&IE per diem amount throughout the tenure of each six month task order contract. USAID/Central Asian Republics established, via Mission Order, a policy whereby the M&IE per diem amount was reduced to 50 percent after 60 days in country.

In response to complaints from contractors that they were being pressured to pay daily rates that are less than authorized by Federal travel regulations and their contracts, the Office of Procurement issued, on January 15, 1998, guidance to missions clarifying the procedure to be followed when implementing a mission policy of reducing per diem rates that had previously been negotiated and included in Omnibus contracts. This Supplement to Contract Information Bulletin 97-20 was issued to clarify that it may be appropriate to provide for a reduced amount of per diem under institutional contracts in some circumstances. This Supplement stated that while it would not be appropriate for Missions to issue instructions requiring contractors to reduce per diem paid to their employees outside the terms of a contract, contracts themselves may require that per diem eligible for payment by USAID be reduced over time if employees remain in-country for several months and continue to be paid per diem rather than temporary quarters subsistence allowance, living quarters allowance, or other housing. The critical element is that any such arrangement be dealt with under the contract and not through issuing instructions outside of the contract provisions.

What Type of Procedures are in Place to Ensure
That Government Funds are Not Misappropriated?

The GAO and the OIG identified monitoring and oversight weaknesses that impaired ENI's ability to ensure contractor performance and accountability for funds provided. These weaknesses were due to (1) inadequate billing information, and (2) lack of staff to cover a large geographic region. In September 1995, the OIG found that inadequate billing information was being provided by contractors and potential questioned costs amounted to about $1.1 million[4]. The OIG attributed $587,000 of these questioned costs to the Burson-Marsteller's subcontract. As a result of these and other concerns, the ENI Bureau (1) redesigned the Omnibus contracts by strengthening controls over the content of contractor invoice submissions, and (2) increased the size of its field staff. USAID also requested that the Defense Contract Audit Agency (DCAA) pay special attention to the questioned costs identified by the OIG during the next incurred cost audit of Burson-Marsteller.

---

[4]Audit of the ENI Bureau's Privatization Activities in the Central Asian Republics (Project 110-0005) (Audit Report No. 8-115-95-016, September 1, 1995).

In August 1995, the GAO reported[5] that the large size of USAID's program in the former Soviet Union, the vast geographic area in Russia and the NIS receiving assistance, and staff limitations had prevented adequate monitoring in some cases. The GAO found that USAID officials were unaware of positive and negative aspects of some projects. USAID officials had not visited some projects, and USAID did not have representatives located outside Moscow. USAID expected its Russian staff to conduct field monitoring, but the Russian nationals lacked the necessary training.

In September 1995, the OIG reported control weaknesses related to USAID's Privatization activities in the Central Asian Republics! The OIG reported that USAID Contracting Officer's Technical Representatives' (COTR) administrative approval is an important step in USAID's payment process as it signifies that claimed costs are appropriate and form the basis for USAID certifying officer's approval and payment. The audit noted that ENI Bureau COTRs in Washington were not in the best position to ensure that contractors were following contract terms and conditions and FAR requirements because: (1) their approvals were based on inadequate invoice summary information; and (2) they were located long distances from the locations where the costs were incurred. As a result, questionable costs were not being identified in a timely manner.

The audit also identified a total of $1 .1 million in unsupported and other questionable costs, of which $587,158 were attributed to Burson-Marsteller activities in Kazakstan. USAID officials agreed with the audit findings and concurred with the report's recommendations to strengthen management controls over contractor billings and to classify the administrative review process for contractor billings as a material internal control weakness. USAID officials have also asked DCAA to go beyond its normal scope when auditing KPMG by including the Burson-Marsteller subcontract, including the questioned costs identified in the OIG audit report.

ENI Bureau and Office of Procurement officials redesigned the Omnibus II contracts to strengthen controls over the content of contractor invoice submissions. The redesigned Omnibus II contracts required contractors to submit invoices for reimbursement which contained detailed information supporting costs claimed. The contractors were required to provide a separate breakdown, both cumulative and by billing period, of labor by category and other direct costs. Thus, the Omnibus II contracts improved control over contractor invoice submissions by providing much more detailed information than was required under the Omnibus I contracts. Under Omnibus I contracts, contractors were only required to submit an invoice for payment for services accepted by the

---

'Foreign Assistance: Assessment of Selected USAID Projects in Russia (Letter Report, 08/03/95, GAO/NSIAD-95-156).

[6]Audit of the ENI Bureau's Privatization Activities in the Central Asian Republics (Project 110-0005) (Audit Report No. 8-l 15-95-016, September 1, 1995).

Government. The contract did not specify any specific form or level of detail that should be included on the invoice.

The ENI Bureau believes that systems exist to ensure proper checks and balances are in place to oversee expenditures of public funds. In the case of Omnibus I and II, Washington and field-based COTRs were responsible for ensuring that the technical requirements of the contractors' performance were met. Both Omnibus I and II contracts contained FAR Clause 52.216-7, "Allowable Cost and Payment", (4)(g), which provides the right for the Government to audit contractor invoices or vouchers, reduce amounts found by the Contracting Officer that do not constitute allowable costs, or adjust payments for prior over payment or under payment. This clause provided the Government further means to safeguard against contractors misappropriating funds under both Omnibus I and II.

The ENI Bureau also improved controls over contractor billings by increasing the number of COTR's assigned to missions. The voucher review process under Omnibus I was performed by ENI Bureau COTRs based in Washington. According to the ENI Bureau, the Washington based COTR's would have some familiarity with contractor activities based on periodic trips to the field. Over time, oversight provided by field missions improved as experience in the region as well as staff numbers increased. One major difference between Omnibus I and II was the existence of field-based COTRs.

According to ENI Bureau officials, COTRs review all vouchers for technical accuracy, in order to provide administrative approval for the voucher. The COTR's recommended approval of a voucher implies that to the best of the COTR's knowledge, the nature, type, and quantity of effort or materials being expended are in general accord with the progress of work under the contract. However, when a COTR believes that a voucher includes questionable costs, the COTR is expected to note the discrepancy for possible disallowance by the contracting officer.

The voucher information is usually corroborated by meetings or field visits made by the COTR. If a questionable item is submitted, the contractor is requested to explain the charge and if it cannot be satisfactorily justified, it can be disallowed. According to ENI Bureau officials, USAID is also relying on incurred cost audits conducted by the DCAA, independent auditors (A-I 33 Audits) or other independent audits to identify questionable costs.

The following is a discussion of the specific allegations which concern, "misappropriated government funds."

The Harper's Magazine article also asserted that costs for printing, telephone service and production of television programs were inflated by Burson-Marsteller's subcontractors. These three issues are discussed below. USAID has asked DCAA, during its audit of Burson-Marsteller, to give special attention to the three questioned cost allegations made in the Harper's Magazine article, plus questioned costs amounting to over $587,000 identified by an OIG audit. DCAA will schedule an incurred cost audit of Burson-Marsteller for fiscal years 1993-96 as soon as Burson-Marsteller provides its incurred cost submission.

That a $69,000 payment to Kazakstan subcontractor (Alamura-the privatization press) had included padded costs by this entity. (Butya ad agency)

The Harper's Magazine article alleged that Burson-Marsteller paid $69,000 for five million pocket calendars or about 1.4 cents each. The calendars were used to disseminate information to the public about the benefits of participating in the privatization program. According to the allegation, in addition to the printing and paper costs, the vendor included an author's fee, office rent; storage; transportation; banking services; a "labor Fund"; medical insurance; "social" insurance; a road-building fund; five percent for an "investment fund"; ten percent for "rush printing"; and finally, ten percent for profit. The allowability of these costs will be determined through the next incurred cost audit of Burson-Marsteller. This audit will be conducted by the DCAA.

That the USAID contractor's telephone charges included fictitious charges inserted by a Kazakstan official.

The Harper's Magazine article alleged that Burson-Marsteller paid its telephone bill through an intermediary who padded the bill with fictitious charges. The allowability of these costs will be determined through the next incurred cost audit of Burson-Marsteller.

That a subcontractor (Ulkia) over charged the contractor for production of television programs.

The Harper's Magazine article alleged that Burson-Marsteller paid $110,000 for the production of six "soap opera" episodes or $18,333 per episode. The television shows were designed to promote the privatization program by following two fictional families who achieve economic security. The author of the article speculated that the producer of the "soap opera" padded the bill for this work. The allowability of these costs will be determined through the next incurred cost audit of Burson-Marsteller.

That USAID audits of Burson-Marstellar's work in Kazakstan were conducted without examination of documents.

The Harper's Magazine article alleged that an OIG auditor conducted an audit of Burson-Marsteller without an examination of documents. The article stated that, "There was no painstaking examination of documents, no double-checking the math or the bids." As discussed above, the OIG audit of ENI Bureau's Privatization Activities in the Central Asian Republics identified a total of $1.1 million in unsupported and other questionable costs, of which $587,158 were attributed to Burson-Marsteller activities in Kazakstan.

The individual making this allegation apparently did not understand that OIG auditors, when they conduct financial or financial-related audits, review the "official records" of an organization. Since, Burson-Marsteller's "official financial records" were maintained at their home office in the U.S. and not in Kazakstan, the individual making the allegation did not see the OIG auditors when they examined Burson-Marsteller's records at the home office and may have incorrectly concluded that the auditors performed the audit without examining any records. USAID is follolwin,g-up on the findings in the OIG report by asking DCAA to go beyond its normal scope when auditing KPMG by including the Burson-Marsteller subcontract, including those issues identified in the OIG audit report.

Why there have not been full financial audits of Omnibus USAID contracts in the New Independent States?

The Harper's Magazine article alleged that no Omnibus USAID contract has ever had a full financial audit. However, we found that incurred cost audits of Omnibus contracts were done according to USAID's normal audit policy and procedures. USAID is required by Federal Acquisition Regulations, the Single Audit Act (Public Law 98-502), OMB Circulars, and its own internal policies and procedures to obtain appropriate and timely audits of its contractors and grantees. To fulfill these requirements, USAID contracts with the DCAA, or other federal agencies, to audit its U.S.-based contractors and relies on non-Federal auditors (independent public accounting firms) to audit its U.S-based grantees. USAID's foreign grantees and contractors are also audited by non-Federal auditors. Accordingly, the ENI Bureau relies on these audits to identify any questionable costs.

<u>Are USAID Programs Achieving Their Objectives?</u>

The GAO reported in August 1995 that seven of the ten projects they examined in Russia met all or most of their objectives. Further, regarding the privatization project-the subject of the allegations-the GAO commented that although the project had shortcomings, it also contributed toward the privatization process and GAO considered the project a success. Moreover, the GAO recognized USAID's positive contribution to the overall privatization effort. USAID management asserted in its Fiscal Year 1998 Congressional Presentation, that USAID programs have contributed to sweeping economic changes, including mass privatization, and other reforms in Russia and the NIS.

Both the GAO and the OIG identified monitoring and oversight weaknesses that USAID needed to address in order to better monitor program impact. A 1997 OIG report found that USAID had improved its ability to monitor and report on its assistance in Kazakstan. Finally, USAID, in general, and specifically the ENI Bureau, asserted in the Fiscal Year 1998 Congressional Presentation that they have made progress in designing and implementing tools to monitor program impact.

Achieving Results

In August 1995, the GAO reported[7] that, USAID's projects in Russia have had mixed results in meeting their objectives. Although individual projects had mixed results, overall USAID's effort has been a success. The GAO also pointed out that USAID's rapid response from the Omnibus contracts used for the privatization project contributed to the project's success. Most of the USAID projects reviewed met their primary objectives, were contributing to systemic reform, and were sustainable. Others did not have all or some of these attributes of success.

For example, the GAO reported that of ten USAID projects reviewed in Russia; two met or exceeded their objectives; five met some but not all of their objectives; and three met few or none of their objectives (one of these projects was new and was just beginning to be implemented). Nevertheless, the GAO also concluded that USAID's privatization project in Russia was a success. In discussing the Russian privatization project's results, the GAO described how a USAID contractor established a national system of centers to process millions of vouchers that Russians received and used in the privatization process. Privatization vouchers were used to transfer ownership from the state to private individuals-each Russian citizen was eligible to receive one voucher.

One factor contributing to this success, according to GAO, was USAID's Omnibus contracting mechanism. The Omnibus contracts allowed the contractor to quickly implement activities as well as to adjust the scope of work when warranted. For example, the GAO report pointed out that Omnibus contracting enabled USAID's contractor to create and implement a functioning national voucher system in a short time. This system handled over 70 million vouchers, nearly half the vouchers processed in the program. People used these vouchers to buy shares in enterprises located in remote areas. Furthermore, over half of the centers had evolved into institutions that

---

'Foreign Assistance: Assessment of Selected USAID Projects in Russia (Letter Report, 08/03/95, GAO/NSIAD-95-156).

were active in capital market activities, such as share registrars and depositories. These centers intend to become self-financing, on a fee-for-service basis, when USAID assistance ends.

The GAO report also stated that the scope of voucher privatization in Russia was unprecedented in scale and speed. The Russian Privatization Center estimated that 14,000 large- and medium-sized enterprises were privatized by July 1994. These enterprises employed over 60 percent of the industrial workforce. Nevertheless, the report noted that the overall effect of the privatization program on Russia had yet to be determined. Enterprise restructuring had only begun, monopolies still existed, and inadequate tax legislation made foreigners reluctant to provide badly needed capital investment.

Finally, the USAID Fiscal Year 1998 Congressional Presentation, reported that from mass privatization in Russia to small-scale privatization in Kazakstan, USAID has been at the forefront of privatization efforts in Russia and the NIS. For example, the private sector contribution to the NIS gross domestic product (GDP) has grown dramatically, from a regional average of about seven percent in 1989, to over 30 percent in 1995.

The Congressional Presentation also cited the following examples of how USAID assistance fostered privatization in the NIS:

- in Moldova, people are owning their homes for the first time;
- outside of the cities, USAID's collective farm restructuring project has proven so successful the Moldovan Government has requested its replication in all 40 districts;
- in Kyrgyzstan, privatization work resulted in new businesses being created in transport and wholesale marketing; and
- finally, polls show that 70 percent of the population in the **NIS** now supports privatization, representing a dramatic, positive shift in opinion.

Monitoring System

Previous GAO and OIG audit reports identified monitoring and oversight weaknesses that USAID needed to address in order to better monitor program impact. The GAO[8] and the OIG reported that one of the factors contributing to the ENI Bureau's oversight weaknesses was USAID's lack of adequate information systems for monitoring its Russian

---

[8] **Foreign Assistance: Assessment of Selected** USAID **Projects in Russia** (GAO/NSIAD-95-156, **August 3, 1995).**

and NIS programs. In November 1994, the OIG reported[9] that USAID lacked an information system with baseline data, targets, time frames, and quantifiable indicators by which to measure program progress and results. USAID officials said the pressure to provide assistance quickly meant forgoing the traditional project design process, which included developing progress indicators.

Subsequently, in March 1995, the OIG reported” that, while the ENI Bureau's streamlined procurement process enabled it to accelerate deliveries, it also required that greater attention be given to internal controls over contractor work plans and contractor reporting. These internal control techniques are necessary to better ensure that resources were efficiently used to accomplish objectives and to facilitate monitoring by USAID. The ENI Bureau stated that it shared the report's concerns that there be adequate work plans and contractor reporting, and they tailored procurement procedures to address these concerns.

While the above audit reports identified a variety of weaknesses which impaired USAID's ability to monitor and report on an activity's performance, a 1997 OIG audit showed that USAID/Central Asian Republics's ability to monitor and report on its achievements has improved. In February 1997, the OIG reported” that for Kazakstan Civil Society Activities, USAID's Mission in the Central Asian Republics had generally implemented the Agency reengineering and Government Performance and Results Act (GPRA) requirements in accordance with Agency directives and ENI Bureau guidance. The audit also found that the Mission needed to complete its performance monitoring plan and to stress accuracy in reporting results. The Mission subsequently completed the plan in accordance with USAID policy.

Finally, USAID reported in its Fiscal Year 1998 Congressional Presentation that the ENI Bureau has made progress during the last two years in designing and implementing tools to monitor program impact. In that time, the ENI Bureau developed a strategic framework for assistance to the ENI region and established strategic objectives for all country programs. Through a collaborative process with USAID development partners, field missions defined sets of results, performance indicators and targets for measuring progress against the achievement of strategic objectives. With these tools in place, the ENI Bureau is incorporating performance information into program reviews, planning, and decision-making.

‘Audit of the ENI Bureau's Monitoring, Reporting and Evaluation System (Audit Report No. 8-000-95-002, November 28, 1994).

“Audit of Selected Privatization and Restructuring Activities in Russia (Project 1 W-0005) (Audit Report No. 8-l 15-95-007, March 10, 1995).

“Audit of USAID/CAR's **Implementation of the Government Performance and Results Act for Democracy-Civil Society-Activities in Kazakstan (Audit Report No. 8-l 15-97-005-P, February 26, 1997).**

The following is a discussion of the specific allegation which concerns, "achievement of programs objectives."

Whether seminars were held simply to produce "deliverables" as a simplistic means of evaluating the contractor's work and progress?

The Harper's Magazine article alleged that seminars are the bread and butter of the foreign-aid community. More importantly, seminars produce "deliverables"-a deliverable being any physical proof of Burson-Marsteller's work. Furthermore, the article claimed that deliverables are the sole benchmark by which USAID evaluates success or failure.

Omnibus I contracts were level of effort (LOE) type contracts which required vendors to supply a specified amount of effort to perform various tasks assigned to them. Within these level of effort contracts, desired results were established in the statement of work. The contractor's services were directed to achieving those results. However, the contractor in LOE contracts like Omnibus I, were not paid for deliverables. They were paid for effort.

We found that seminars were but 1 of 21 tasks performed by Burson-Marsteller in support of USAID's effort to explain to the public the concept and practice of privatization in Kazakstan. Examples of other tasks performed by Burson-Marsteller included: (1) reviewing media infrastructure and identifying pilot areas, (2) initiating national opinion research to identify attitudes towards privatization, and (3) developing educational materials and identifying the most effective channels of communication. The real results of these activities were the major shift in public opinion in support of privatization and market reforms.

USAID officials told us that, in regards to the Burson-Marsteller subcontract, seminars were not a good way to judge the activity. While seminars were useful in the process of improving the public perception of the privatization effort, they were certainly not the only, or even a good indicator of performance. USAID officials managing the public education activity in Kazakstan believed that a much better measure of success would be illustrated by a change in the attitude of the public toward the privatization effort.

USAID officials managing the Burson-Marsteller public education activity provided us with the results of baseline and subsequent public attitude surveys showing how public attitude or opinion changed as a result of Burson-Marsteller's public education activities. These surveys showed that the number of citizens (1) supporting privatization increased from 36 to 57 percent between April 1994 and June 1995, and (2) in favor of a free market economy rose from 24 to 40 percent from April 1994 to April 1995.

MANAGEMENT COMMENTS AND OUR EVALUATION

In general, USAID management concurred with our conclusions on the allegations and Congressman Gilman's questions concerning contracting procedures, misuse of government funds, and program objectives. However, they expressed concern that the report does not make these points as clearly and succinctly as possible. Accordingly, USAID management proposed language to replace certain sections of the report. However, we have retained the existing language that was included in our draft report. The full text of USAID's comments, including their proposed revisions, are included in their entirety as Appendix II to the report.

SCOPE AND METHODOLOGY

Scope

We conducted this audit, in response to a request by the Chairman of the House International Relations Committee (HIRC), to review the merits of certain allegations made in the August 1997 Harper's Magazine article entitled, "Aboard the Gravy Train," regarding Burson-Marsteller activities in Kazakstan. We categorized the eight specific allegations into the three areas identified by the Chairman concerning contracting practices, misuse of government funds, and program progress. The audit was conducted between October 30, 1997 and February 5, 1998 in accordance with generally accepted government auditing standards.

We assessed whether the allegations were accurate and, if so, whether the problems were due to deficiencies in USAID Bureau for Europe and New Independent States' (ENI) oversight practices or policies. In addition to reviewing the specific allegations, we also determined whether similar problems had been reported in each of the three areas, and, if so, what action ENI had taken to correct the problems.

This audit was limited to reviewing the ENI Bureau's practices in Kazakstan under the Omnibus I Contract (which was in place during the time frame that the allegations took place) and the Omnibus II contract which replaced the Omnibus I contract in 1994. The audit also covered the USAID policies and procedures which were in effect at the time that the allegations took place and the current policies and procedures. Because the scope is limited to Kazakstan, we were not able to estimate the extent to which identified problems existed in other parts of the region covered by USAID's ENI Bureau. In addition, our review of the effectiveness of USAID's program was limited to progress and/or problems reported by USAID, the USAID Office of Inspector General (OIG) and the General Accounting Office (GAO). Thus, we did not verify the reliability of the underlying data.

Methodology

We answered the audit objective by gaining an understanding and reviewing ENI's (1) contracting practices under the Omnibus I and Omnibus II contracts, (2) administrative approval over contractors' billings, and (3) policies and practices in monitoring the effectiveness of USAID operations in Kazakstan. We (1) interviewed USAID officials in the ENI Bureau and the Office of Procurement, (2) corresponded with officials from USAID's mission in the Central Asian Republics, (3) reviewed documentation related to the specific allegations in the Harper's Magazine article, and **(4)** reviewed OIG and GAO audit reports dealing with the subject matter.

After determining the validity of the specific allegations, we determined if the identified problems occurred because of weaknesses in USAID and ENI Bureau policies, procedures, practices, and systems. If such weaknesses existed during the time frame of the specific allegations, we reviewed current policies, procedures, practices, and systems to determine what corrective action the ENI Bureau had taken.

For this audit, we have determined that the significant internal controls for the purpose of answering the audit objectives related to the ENI Bureau's policies and procedures concerning (1) contract procurement, (2) prevention of the misappropriation of Government funds, and (3) the achievement of USAID and ENI Bureau objectives. Although we identified what changes ENI made to policies and procedures to correct identified deficiencies, we did not determine the extent to which the changes were effective. Regarding compliance with laws and regulations we focused on whether the allegations represented violations of the Federal Acquisition Regulations.

In addition, we asked that the DCAA, look for indicators of and test for fraud, waste, and abuse in addressing the allegations concerning (1) the privatization press, (2) telephone charges, and (3) television programs during the next incurred cost audit of Burson-Marsteller. We also asked that DCAA give special attention to the questioned costs identified by an OIG 1995 program audit of Burson-Marsteller's activities in Kazakstan.

USAID
U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MAY 8 1998

MEMORANDUM

FOR: IG/A/ITSA, Ted Alves

FROM: A-DAA/ ENI, Brian E. Kline

SUBJECT: ENI Bureau Comments on the Draft Audit Report on Allegations of Inappropriate Policies, Procedures, and Practices in Providing Assistance to Kazakstan

We appreciate the opportunity of interacting with your staff in your investigation of the merits of the allegations made in the August 1997 Harper's magazine article entitled "Aboard the Gravy Train."

We fully concur with the conclusions reached by your Office that: (a) four of the allegations made in the Harper's magazine article are unfounded; (b) one of the allegations was accurate, but explainable due to extenuating circumstances; and (c) a DCAA audit requested by USAID will assess the validity of the three allegations which questioned the propriety of the cost charges made by Burson-Karsteller.

In response to Congressman Gilman's questions regarding the appropriateness of contracting procedures used by USAID, potential misappropriation of government funds, and achievement of program impact, you cited rather dated (1994 and 1995) audit reports which noted problems in these three areas. However, you did conclude that USAID has since adopted measures to address potential sources of vulnerability and noted that USAID's privatization initiatives in the NIS have generated positive results. Again, we have no problems with your proposed response to Congressman Gilman's more general questions.

'We are concerned, however, that the draft audit report does not make the points noted above as clearly and succinctly as you made them in your January 1998 discussion report. Our concern is exacerbated by the introductory section of the audit report, which does not effectively get the message across that: (a) this audit did not find USAID to have committed any wrongdoing; (b) USAID has adopted appropriate measures to address problems identified by audit reports issued in 1994/1995 which have

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

relevance to the three general questions raised by Congressman Gilman; and (c) USAID has positively contributed to privatization effort8 in the NIS. Specifically, the statement "Although...most of the allegations were not supported," is an Incomplete representation of the situation (oee second paragraph above). Moreover, to end the introductory paragraph with the statement "prior audit reports identified problems in each of the three general areas identified by the Chairman..." is misleading. In fact, am you indicated in subsequent sections of the audit report, the problems have *been addressed and impact on* privatization has been observed and recorded.

Attached is our *proposed* language to replace the first paragraph of the draft audit report.

cc: USAID/Almaty, Patricia Buckles
M/OP/ENI, Anne Quinlan
IG/A/HLC, Tim Elkins
IG/A/HLC, Andy Malineer
IG/A/ITSA, Thomas Anklewich
IG/A/ITSA, Pete Koechley
IG/A/ITSA, Louise Pierce

GDSteele

Drafted:GDSteele:ENI/OIM:5-7-98

Summary of Resulte

Four of the allegations cited in Auguet 1977 Harper's magazine article were unfounded and one of the allegationr wae accurate but explainable due to extenuating circumstances. The validity of the remaining three allegations which questioned costs charged to USAID will be determined by the Defense Contract Audit Agency, (DCAA) which is conducting an incurred cost audit of the Burson-Marstellar subcontract on USAID's request. (Our analysis of each allegation is summarized at the end of each section of the report and in Appendix III.)

Prior audit reports identified problems in each of the three general areas identified by the Chairman concerning contracting procedures, misuse of government funds, and whether the program was achieving its objectives. We found, however, that USAID has adopted specific measures to address potential sources of vulnerabilitiee in these areas. Moreover, previous GAO examination of program impact and other documents have confirmed USAID's positive contribution to the Overall privatization effort in the NIS region.

(Continue with the second paragraph of the current draft)

Harper's Magazine Allegations

1. Why a "cost-plus percentage of cost" contract between USAID and Burson-Marsteller was chosen as the means of reimbursing that contract?

The Harper's Magazine article alleged that Burson-Marsteller had a cost plus percentage of cost contract with USAID: USAID would reimburse all of the costs Burson-Marsteller incurred, "plus" pay about seven percent on top of that-Burson-Marsteller's profit margin. The contracting methods used by USAID did not involve Cost-Plus Percentage of Cost type contracts.

2. Whether seminars were held simply to produce "deliverables" as a simplistic means of evaluating the contractor's work and progress?

The Harper's Magazine article alleged that seminars are the bread and butter of the foreign-aid community. More importantly, seminars produce "deliverables"-a deliverable being any physical proof of Burson-Marstel ler's work. Furthermore, the article claimed that deliverables are the sole benchmark by which USAID evaluates success or failure.

Omnibus I contracts were level of effort (LOE) type contracts which required vendors to supply a specified amount of effort to perform various tasks assigned to them. Within these level of effort contracts, desired results were established in the statement of work. The contractor's services were directed to achieving those results. However, the contractor in LOE contracts like Omnibus I, were not paid for deliverables. They were paid for effort.

3. ***Why per diem payments of up to $94 for con tractor employees were provided on top of generous salaries and benefits?***

The Harper's Magazine article alleged that anyone working for USAID in Kazakstan, directly or indirectly, was entitled to a $94 per diem on top of his or her salary. The article also stated that those individuals working at Burson-Marsteller were not getting the full USAID-mandated $94, but rather a per diem amount established at $25.

Initially, the Omnibus I contracts, which were managed by USAID personnel in Washington, were negotiated using standardized lodgings plus per diem rates. Under this system, the daily allowance for each travel day is established on the basis of the actual amount the traveler pays for lodgings plus a fixed allowance for meals and incidental expenses (M&IE) with the total not to exceed the applicable maximum daily rate for the location. However, in accordance with Federal Travel Regulations, USAID authorized a reduced daily rate because housing for the traveler was furnished by the Government. USAID officials told us that partial per diem, only the M&IE portion, was authorized for personnel who were temporarily assigned to Kazakstan even though housing was also provided because the individuals were sent to Kazakstan with only one or two suitcases and no household effects. In this case, even though the contractor employees were provided housing, they were not expected to be able to set up full housekeeping, hence partial per diem (only M&IE) was authorized in the contract and Federal travel regulations.

4. ***Why there have not been full financial audits of Omnibus USAID contracts in the New Independent States?***

The Harper's Magazine article alleged that no Omnibus USAID contract has ever had a full financial audit. However, we found that incurred cost audits of Omnibus contracts were done according to USAID's normal audit policy and procedures. The ENI Bureau relies on incurred cost audits conducted by the DCAA, or other independent audits to identify any questioned costs.

5. ***That a $69,000 payment to Kazakstan subcon tractor (Alamura-the privatization press) had included padded costs by this entity. (Butya ad agency)***

The Harper's Magazine article alleged that Burson-Marsteller paid $69,000 for five million pocket calendars or less than 1.4 cents each. The calendars were used to disseminate information to the public about the benefits of participating in the privatization program. In addition to the printing and paper costs, the vendor also included an author's fee, for the five sentence text on the calendar; office rent; storage; transportation; banking services; a "labor Fund"; medical insurance; "social" insurance; a road-building fund; five percent for an "investment fund"; ten percent for "rush printing"; and finally, ten percent for profit. The allowability of these costs will be determined through the next incurred cost audit of Burson-Marsteller. This audit will be conducted by the DCAA.

6. ***That the USAID contractor's telephone charges included fictitious charges inserted by Kazaks tan official.***

The Harper's Magazine article alleged that Burson-Marsteller paid its telephone bill through an intermediary who padded the bill with fictitious charges. The allowability of these costs will be determined through the next incurred cost audit of Burson-Marstel ler.

7. ***That a subcon tractor (Ulkia)*** over ***charged the contractor for production of television programs.***

The Harper's Magazine article alleged that Burson-Marsteller paid $110,000 for the production of six "soap opera" episodes or $18,333 per episode. The television shows were designed to promote the privatization program by following two fictional families who achieve economic security. The author of the article speculated that the producer of the "soap opera" padded the bill for this work. The allowability of these costs will be determined through the next incurred cost audit of Burson-Marsteller.

8. ***That USAID audits of Burson-Marstellar's work in Kazakstan were conducted without examination of documents.***

The Harper's Magazine article alleged that an OIG auditor conducted an audit of Burson-Marsteller without an examination of documents. The article stated that, "There was no painstaking examination of documents, no double-checking the math or the bids."

The OIG audit of ENI Bureau's Privatization Activities in the Central Asian Republics identified a total of $1 .1 million in unsupported and other questionable costs, of which $587,158 were attributed to Burson-Marsteller activities in Kazakstan. The individual making this allegation did not understand that OIG auditors, when they conduct financial or financial-related audits, review the "official records" of an organization. Since, Burson-Marsteller's "official financial records" were maintained at their home office in the U.S. and not in Kazakstan, the individual making the allegation did not see the OIG auditors when they examined Burson-Marsteller's records at the home office and may have incorrectly concluded that the auditors performed the audit without examining any records. USAID is following up on the findings in the OIG report by asking DCAA to go beyond its normal scope when auditing KPMG by including the Burson-Marsteller subcontract, including those issues identified in the OIG audit report.