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Report of the Secretary-General on the activities of the Office of Internal Oversight Services

Administrative and budgetary aspects of the financing of the United Nations peacekeeping operations

Report of the Office of Internal Oversight Services on the audit of the management of service and ration contracts in peacekeeping missions

Note by the Secretary-General

1. Pursuant to General Assembly resolution 48/218 B of 29 July 1994, the Secretary-General has the honour to transmit, for the attention of the General Assembly, the attached report, conveyed to him by the Under-Secretary-General for Internal Oversight Services, on the audit of the management of service and ration contracts in peacekeeping missions.
2. The Secretary-General takes note of its findings and concurs with its recommendations.

* A/54/150.

Summary of major findings

In 1998, the Office of Internal Oversight Services (OIOS) performed an audit of service and ration contract management (assignment No. AP98/25/1) at five peacekeeping missions comprising contracts with an annual contract value of \$37 million. The objectives were: (a) to ascertain the role of the missions, the Department of Peacekeeping Operations and the Procurement Division in the management of contracts; (b) to assess the effectiveness of service and ration contract management in missions; and (c) to determine what steps could be taken to improve the contract management process.

There has been a general trend in peacekeeping operations to move towards large-scale contracts for the provision of support services and rations. This form of outsourcing was seen as an economical and efficient way of providing support to missions. The OIOS review of six service contracts in five missions found, however, that the contract management needed to be improved. The review of those contracts found that:

- Most of the missions reviewed did not have a contract management unit, which had resulted in an uncoordinated approach to managing complex contracts;
- Standard systems had not been developed to enable missions to track ration deliveries in accordance with contractual provisions;
- No comprehensive training programmes had been established by DPKO to train personnel in contract management techniques;
- Inadequate monitoring of invoice payments could result in loss of early payment discounts and disputes with vendors leading to arbitration. In one case, an amount of \$3.25 million owed to one contractor had been unjustifiably withheld;
- Out of 30 requests for proposals sent out for the provision of support services to the United Nations Observer Mission in Angola (MONUA), only one vendor had submitted a proposal;
- In one mission, indecision on contract arrangements had led to delays in awarding a contract and resulted in additional costs of \$7.7 million;
- The basis for adjusting fees for the performance-based service contract in MONUA had not been established, resulting in disputes with the contractor;
- The MONUA service contractor had not provided a performance guarantee of \$1.6 million, as required by the contract.

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I. Introduction

1. Contractual services, including provision of logistic and general services and rations, constitute one of the major costs of peacekeeping operations. The OIOS review of six service and ration contracts in five missions found that there were a number of areas where improvements in contract management would result in maximizing the effectiveness of those contracts.

2. Although missions are primarily responsible for contract management, other players are also involved, including the Procurement Division (PD), which is responsible for the commercial aspects of contracts, the Office of Legal Affairs (OLA), which reviews contracts and offers advice when requested, and the Department of Peacekeeping Operations (DPKO), which provides support to missions and maintains liaison on contractual matters with PD. The success of the mission in managing large-scale contracts therefore depends, to a great extent, on the coordination between these parties.

3. The objectives of the audit were: (a) to assess the effectiveness of service and ration contract management in missions; (b) to ascertain the role of missions, DPKO and PD in the management of contracts; and (c) to determine what steps could be taken to improve the contract management process. The audit included a review of six service and ration contracts in the United Nations Observer Mission in Angola (MONUA), the United Nations Mission in Haiti (UNMIH), the United Nations Interim Force in Lebanon (UNIFIL), the United Nations Disengagement Observer Force (UNDOF) and the United Nations Peacekeeping Force in Cyprus (UNFICYP).

4. The audit included a review of the following contracts with current annual costs of \$37 million:

	MONUA	UNMIH	UNIFIL/UNDOF/ UNFICYP
Contractor	DynCorp Aerospace Operations, Inc.	1. Brown and Root Services Corporation 2. Serv-Air	Fra-zer Operations N.V.
Service provided	Logistics and general services	Logistics and general services	Dry, frozen and canned rations
Contract type	Cost plus fee (fee adjusted based on performance)	Cost plus fee	Fixed cost
Current amount/period	\$16,192,394/ 12 months	Brown and Root: \$6,082,604/ 12 months Serv-Air: \$6,921,370/ 12 months	UNIFIL: \$4,983,345/ 12 months UNDOF: \$1,273,014/ 12 months UNFICYP: \$1,507,750/ 12 months

5. A draft of the report was made available to DPKO and PD for their review. Their comments have been taken into account and are identified by the use of italics.

II. Pre-contract award phase

6. The pre-contract award phase is crucial to the contract management process. OIOS is of the view that the process can be improved by ensuring that:

- Procurement action is done on a timely basis based on a comprehensive statement of works;
- Contractors are fully briefed on contract requirements;
- Contractors' proposals are promptly evaluated and assessed;
- Contract terms and conditions are precise and unambiguous.

A. Excessive time is required for the procurement process

7. The audit disclosed that the time required for the procurement process was generally excessive and resulted in costly interim arrangements. In the case of UNMIH, the mission had to rely on the provision of services by extending a letter of assist with a Member State. Had a service contract been established on a timely basis, this

would have resulted in savings of approximately \$7.7 million. The following table sets out the time taken to complete the procurement process with respect to the two service contracts:

Major steps	Service contract with Brown and Root	Service contract with Serv-Air
Requirements submitted to PD	7 January 1995	7 January 1995
Request for proposal issued by PD	7 February 1995	7 February 1995
Mission visit by interested contractors	1 March 1995	1 March 1995
Contract signed by PD	9 August 1995	7 August 1995
Days from submission of requirements to contract signing	244 days	242 days

8. *The Department of Management, in their reply to the draft report, stated that they continued to have concerns on the above table; in particular there were several intervening events, including four meetings of the Headquarters Committee on Contracts. In their view, expeditious and continuous procurement action had been taken, considering that issues of principle and cost were involved in this case. In the end this had resulted in substantial cost reductions. OIOS believes that the timely identification of requirements would have enabled procurement action to commence at an earlier stage, thus eliminating or reducing the need for costly interim arrangements.*

9. An audit of ration contracts in UNIFIL and UNDOF also found that there were delays in selecting a contractor, which resulted in the uneconomical extension of the current contract. PD informed OIOS that the documentation provided by DPKO did not enable it to commence the bidding exercise on a timely basis. OIOS believes that additional effort is required to reduce the procurement time-frame.

10. Formulating the statement of requirements for ration contracts is a complex matter, which has to take into account such diverse factors as quality standards, packaging sizes, labelling language, expiry dates and the taste requirements of contingent personnel of various nationalities. Establishing clear specifications is, therefore, a key factor for successful contract management. However, in the case of the UNIFIL and UNDOF ration contracts, the specifications were unclear, resulting in numerous rejections of deliveries. The difficulty encountered by the

missions was corroborated by an analysis of the specifications by the Canadian National Defence Headquarters, which concluded: "If we had to give these specifications you asked us to review a grade, it would be D. Much further work is required to make an A."

11. *DPKO indicated that it was undertaking a complete overhaul of the ration specifications. Testing of the revised specifications commenced in the new bidding exercise for UNIFIL, UNDOF and UNFICYP conducted in late 1998, with an evaluation to be performed at a later stage.*

B. Contractors need to be fully briefed on contract requirements

12. In MONUA, the contractor had not attended the site visit, which would have provided a first-hand idea of the work to be performed and of local conditions. Furthermore, the former contractor had provided the new contractor with incorrect information on labour costs, resulting in the need to renegotiate the contract at a higher cost owing, in part, to labour disputes.

13. The audit also found that contractors had expressed little interest in bidding for the service contract with MONUA. Although 30 requests for proposals had been sent out, only 4 contractors had attended the site visit and none of the contractors had made a formal proposal. A rebidding exercise was not considered feasible owing to the exigency of the requirements. In the end, it became necessary to obtain services from a contractor who was not fully aware of the field conditions and relied on second-hand information. In the opinion of OIOS, there may be underlying reasons for the lack of interest in bidding on a major contract valued at approximately \$19 million per year. In its response to the audit report, PD indicated that it had surveyed contractors to determine the reasons for the lack of response. Only six contractors provided explanations:

- One contractor believed that the outcome was predetermined;
- The incumbent contractor was not interested because of the changed requirements;
- One contractor believed the requirements were not feasible;
- Two contractors believed the requirements did not fit their companies' capabilities;
- One contractor did not provide the required goods and services.

C. Contractors' proposals need to be promptly evaluated and assessed

14. Another key factor in determining the success of contract management is evaluating the contractors' proposals to determine if they meet specified requirements. OIOS is of the opinion that the evaluation process could be improved by:

- Verifying the quality of the rations offered by the contractor and the suitability of the contractors' major suppliers;
- Inspecting facilities that may affect the contractors' ability to implement the contract;
- Assessing the validity of offers that are substantially lower than others.

15. In the case of ration contracts, in particular when a new contractor is being considered, the products offered should be examined and tested, if necessary, by having the contractors provide samples and information on suppliers. It may also be necessary to visit the contractors' facilities or those of the contractors' suppliers to assess their adequacy. In the case of the ration contracts with UNIFIL, UNDOF and UNFICYP, the goods supplied had not been examined. The end result was widespread dissatisfaction with the rations provided to UNIFIL and UNDOF, which were stated to be of inferior quality and did not satisfy the taste requirements of mission personnel. This complicated the management of the contract and resulted in an inordinate amount of time being spent by UNIFIL, DPKO and PD in resolving the issue.

16. Financial rule 110.21 states that "contracts shall be awarded to the *lowest acceptable* [emphasis added] bidder". In two of the cases examined, the successful contractors had made cost proposals that were substantially lower than the others received. In the contract for the provision of support services to MONUA, DPKO calculated that the sole offer received was 20 per cent less than the cost of the contract it was replacing. Since the new contract was broader in scope than the previous contract, that aspect should have been specifically raised in the preliminary discussions with the contractor and clarifications obtained. In the contract for the provision of rations to UNIFIL, the contract man-day rate was 39 per cent less than the previous contract and significantly lower than other offers received. However, there was no documentation indicating that an attempt had been made to determine how the contractor was able to provide such pricing.

17. Not scrutinizing low-cost proposals may lead to future problems, as was the case with both the contracts mentioned above. Resolving such problems after the contracts had been awarded was costly, since the contract then required extensive corrective action and renegotiation. In such cases, there is also a risk that disputes will lead to arbitration and further costs to the Organization. *In their preliminary reply, the Procurement Division indicated that it would, on a case-by-case basis, assess cost proposals in comparison with the previous performance and problems of the contractors who offered low prices within contracts of similar nature.*

D. Contract terms and conditions need to be precise and unambiguous

18. Effective contract management requires that contract terms and conditions be as clear and precise as possible. The MONUA contract, which was intended to be a performance-based contract, illustrates the importance of that principle. While it was apparent that there was a performance element built into the contract, the basis and criteria for it had not been adequately established. The intention was that the fee would be adjusted based on the contractor's performance, but this concept was stated vaguely in the contract. A scale of fee adjustments was subsequently proposed by DPKO, but this was not accepted by the contractor, who maintained that the contract did not make provision for such adjustments. Since the contractor had already commenced work with a staff of over 1,100 personnel, the mission was only able to negotiate for adjustments to the provision. *DPKO agreed that in the future they would include fee adjustment formulas when requesting proposals.*

19. The contractor also had not provided a performance guarantee equal to 10 per cent of the value of the contract (\$1,619,000) as specified in the contract. This would have exposed the Organization to unnecessary financial risk had the contractor failed to fulfil its obligations under the contract. A possible solution would be for MONUA to withhold an appropriate amount from the invoices to compensate for the failure of the contractor to provide the performance guarantee. *Both PD and DPKO stated that they had not been able to obtain the performance guarantee from the contractor.*

III. Receiving and inspection procedures for ration contracts

A. A system is required to record ration deliveries

20. The OIOS review of receiving and inspection procedures for rations at UNIFIL and UNDOF indicated that there was scope for improving contract management by implementing a system to record, *inter alia*: (a) commodities ordered and received; (b) short deliveries; (c) deliveries that did not meet specifications; and (d) the reasons for rejections. The existing receiving system, while adequate for general supplies, did not provide sufficient information to manage ration contracts properly. Moreover, such a system would enable the missions to meet contractual terms and conditions by recording the dates of vendor notification and any purchases made to replace undelivered or rejected goods that could not be replaced by the vendor in accordance with the time-frames indicated in the contract.

B. Inspection procedures require improvement

21. The audit of UNDOF found that the inspection procedures for ration deliveries were inadequate to determine their quality and conformance with contract specifications. This was due mainly to:

- Inspection personnel not having access to the contract's specifications (this was later remedied);
- Inspections being made by military personnel who had not been adequately trained and who rotated every six months;
- Inadequate supervision by the Receiving and Inspection Unit, which did not have a representative at the inspection site.

Thus, the mission had no assurance that the products received complied with the contractual specifications.

22. *DPKO indicated that new ration specifications being developed would be linked to the receiving and inspection procedures. However, they pointed out that it was initially more important to implement the revised specifications fully. The receiving and inspection system would form the second phase of the project.* While OIOS agrees with this priority, it believes that DPKO should establish a plan indicating time-frames for the development and

implementation of both the ration specifications and the receiving and inspection system.

IV. Management of invoice payments

A. Invoices need to be processed efficiently and adequate internal controls established

23. A review of the processing of direct labour cost invoices for the service contract in MONUA found that this was a time-consuming process involving the review of 4,000-6,000 pages of data by the mission's Contract Management Section. A 100 per cent review of invoice-supporting documentation, therefore, significantly increases the cost of processing the invoices. OIOS believes that it would be feasible to review the invoices on a test basis using statistical sampling techniques that would provide the required degree of accuracy. Depending on the discrepancies found during the test checks, the Contract Management Section could then decide whether to increase the sample size. Such procedures could be established whenever complex invoices, with a large number of supporting documents, are processed in order to reduce costs without increasing the risk of making overpayments.

24. The audits of UNIFIL and UNDOF found a lack of segregation of duties in the payment of invoices. Invoice verification was being done by the Procurement Section and not the requisitioning unit. Furthermore, the delay in payment of invoices was due in part to the fact that they were being processed by the Procurement Section, which did not adequately control the timeliness of invoice payments. Control over invoice payments could be improved if the Finance Section received and recorded the invoices and then sent them to the requisitioning unit for verification.

25. *DPKO forwarded OIOS's observations to UNIFIL, UNDOF and UNFICYP.*

B. Invoices need to be paid in accordance with contract terms

26. The MONUA service contract provides for a prompt payment discount of 1.3 per cent if the invoice is paid within 7 days of receipt and 1 per cent if paid within 10 days. While the period allowed to process the invoices is very short, MONUA should make every effort to take advantage of these discounts. This would result in an

annual saving of approximately \$210,000. MONUA is currently making advance payments on receipt of the invoice, which enables it to obtain the major part of the discount. In future contracts of this nature, more realistic prompt payment discount terms should be negotiated to enable missions to take full advantage of them.

27. *PD informed OIOS that appropriate payment discount terms would be taken into account in bidding for future service and ration contracts.*

28. OIOS also found deficiencies in the timeliness of payments. In the case of the ration contracts at UNIFIL, UNDOF and UNFICYP, the audit indicated that, on 12 February 1998, the missions owed approximately \$3.25 million (UNIFIL \$2 million, UNDOF \$250,000 and UNFICYP \$1 million) to the same ration contractor for outstanding invoices, which in some cases dated back to June 1997. DPKO should advise missions of the importance of adhering to payment terms.

29. A review of invoices submitted by the service contractor revealed that claims totalling \$775,000 had been rejected by MONUA. In the opinion of OIOS, MONUA should promptly resolve the issue that resulted in the rejection of the invoices.

30. The review also found that invoices were not always accurately prepared and that contract amendment procedures could be improved. MONUA management has taken action to follow up on the errors, which included: (a) double invoicing; (b) calculation errors; (c) overpayment and underpayment of personnel allowances; (d) unauthorized payments; (e) inadequate documentation; and (f) deficiencies in contract amendments.

V. Monitoring and evaluation of contractor performance

A. Need to establish a methodology to assess contractor performance

31. In most of the contracts reviewed, the performance evaluation process was not sufficient to determine whether the contractor had satisfactorily completed its obligations under the contract. For example, the resident auditor at UNMIH found that procedures for the management and review of contracts had not been established. Furthermore, the review of the ration contracts in UNIFIL and UNDOF indicated a lack of adequate procedures to document the contractor's performance.

32. An OIOS report to the DPKO Field Administration and Logistics Division (A/49/959) asserted that:

“These [contracts] have highlighted the need to develop a capability to monitor and assess certain aspects of the performance of large-scale contracts, including review and analysis of progress reports. In response to this requirement, the team was brought to understand that the Division had drafted a plan of action for instituting the capacity to manage commercial contract-providing services to peacekeeping operations.”

The current audit indicated that that requirement still existed, but that appropriate guidelines in the form of standard operating procedures had not been established by DPKO.

B. A contract management capacity needs to be established in missions

33. It is recognized that managing complex multi-million-dollar service contracts is a difficult and time-consuming task. However, OIOS found that, of the missions reviewed, only MONUA had established appropriate organizational arrangements to manage contracts. In view of the weaknesses in the management of the contracts examined, OIOS believes that it would have been appropriate to establish contract management sections at all of these missions. In UNMIH, for example, instead of contract management being a part of the civilian component, this function was provided by a military contingent's personnel. This was not an effective arrangement since there was little incentive for these personnel, who rotated every three months, to take initiatives in the management process. The tasks of a contract management unit should include:

- Conducting assessments of the contractors' performance in accordance with standard operating procedures;
- Monitoring the payment of invoices and deduction of discounts;
- Resolving disputes with contractors or referring them to Headquarters;
- Coordinating contractors' requirements with relevant mission sections;
- Ensuring that the mission adheres to its contractual responsibilities;
- Assessing future contract requirements and identifying alternative arrangements.

34. In view of the above, OIOS is of the opinion that DPKO needs to establish contract management units in

future missions where complex service and ration contracts are used.

VI. Training programmes for contract management staff

35. In the view of OIOS, personnel who are responsible for receiving, inspecting and monitoring ration contracts should receive adequate training to enable them to perform their functions effectively. OIOS found that DPKO had initiated a training programme concerning the new food ration specifications at UNIFIL for the missions in the region. While this was a step in the right direction, OIOS believes that such training should be extended to other missions where ration contracts are used.

36. Training is also necessary for personnel managing service contracts. Recently, DPKO arranged a contract management course with the United States Naval Centre for Acquisition Training to provide MONUA personnel with skills in performance contracting and quality assurance. While this should prove valuable in preparing MONUA personnel to manage contracts adequately, a more coordinated approach to contract management training is needed and should be a basic requirement for contract personnel at all missions. DPKO should, therefore, review their training requirements and establish a programme to upgrade the knowledge of contract management personnel.

VII. Recommendations

37. As a result of the audit of service and ration contract management, OIOS made the following recommendations:

Recommendation 1

DPKO, in consultation with PD, should review the time-frames required for the procurement of service and ration contracts and take appropriate steps to shorten the time involved (AP99/78/9/01).

Recommendation 2

DPKO should complete the project for development of clear contract specifications for all categories of rations (AP99/78/9/02).

Recommendation 3

DPKO should develop standard operating procedures for managing service and ration contracts that should include appropriate guidelines for evaluating performance of contractors (AP99/78/9/03).

Recommendation 4

DPKO should consider establishing a contract management function within new missions with service and ration contracts (AP99/78/9/04).

Recommendation 5

DPKO should formulate a plan, with implementation time-frames, for developing a ration management receiving and inspection system and should adequately test the system before it is universally implemented (AP99/78/9/05).

Recommendation 6

DPKO should assess training requirements of mission contract management personnel and develop a programme to enable them to manage complex service and ration contracts successfully (AP99/78/9/06).

Recommendation 7

The Procurement Division should establish procedures to review cost proposals that are significantly lower than others in order to determine their reasonableness and validity (AP99/78/9/07).

Recommendation 8

The Procurement Division should negotiate appropriate prompt payment discount terms in future service and ration contracts that missions can be reasonably expected to meet (AP99/78/9/08).

38. *In its response to the draft report DPKO stated: "We have also taken note of the recommendations made in the draft report and agree that their implementation may help improve the procurement process in peacekeeping missions. However, the recent surge in peacekeeping activities is overstressing the resources of FALD to such an extent that we are barely able to address the immediate operational problems of the missions. Therefore, we expect to take up the development work required to create the systems and procedures recommended by the auditors as and when sufficient resources are available."* OIOS agrees with FALD that it is essential that adequate resources be available to implement the long overdue procedures recommended in the present report to improve the management of service and ration contracts. DPKO should, therefore, take the necessary action to request additional funds to enable it to develop the procedures on a timely basis.

(Signed) Karl Th. Paschke
Under-Secretary-General for
Internal Oversight Services

