



March 22, 2004

MEMORANDUM

TO: Acting AA/ANE, Gordon H. West
M/OP, Timothy T. Beans

FROM: AIG/A, Bruce N. Crandlemire /s/

SUBJECT: USAID's Compliance with Federal Regulations in Awarding the Contract for Economic Recovery, Reform and Sustained Growth Contract in Iraq (AIG/A Memorandum 04-005)

SUMMARY

The Office of Inspector General (OIG) has completed a review to determine compliance with federal regulations in awarding a contract for the promotion of economic recovery, reform and sustained growth in Iraq to BearingPoint, Inc. of McLean, Virginia.

The OIG determined that the U.S. Agency for International Development (USAID), in making its award to BearingPoint, complied with applicable federal regulations except for requirements to document and explain for the significant appearance of conflict of interest issues. The extensive involvement of BearingPoint in USAID's development of this program creates the appearance of unfair competitive advantage and we have concluded that USAID did not document and explain how this issue was resolved before proceeding with the award.

In addition, we are recommending that security costs be standardized in cost proposals for Iraq procurements because these costs are difficult for the offerors—or USAID—to accurately estimate. The wide disparity in proposed security costs of the two bidding firms in this procurement may have impacted on which firm was selected for the contract. However, USAID made no review or analysis of these costs.

BACKGROUND

USAID awarded ten contracts in an initial round of procurements for reconstruction activities in Iraq. These ten contracts, estimated to cost a total of \$1.5 billion, include awards for economic reform, personnel support, seaport administration, local governance, education, infrastructure reconstruction, monitoring and evaluation, health, airport administration and agriculture. In addition to these ten contracts, USAID has also awarded grants, cooperative agreements, and interagency agreements.

On January 16, 2003, the Office of the USAID Administrator authorized expedited acquisition and assistance procedures for activities and programs in response to the crisis in the Near East. This approval allowed USAID to award these contracts using other than full and open competition requirements as is authorized under 40 USC 474. This statutory authority requires the awarded contracts to be supported by written justifications and approvals as described in the Federal Acquisition Regulation (FAR). This statutory authority also requires that agencies shall request offers from as many potential sources as is practicable under the circumstances.

Because it reportedly had just over one month to award a contract, USAID initially intended to award this contract on a sole source basis to BearingPoint—the predominant firm used by USAID for economic reform programs. From January into May 2003, the statement of work (SOW) and estimated budget for this contract were revised numerous times as officials of USAID, other government agencies, and the Coalition Provisional Authority (CPA) revised program requirements and debated which government entity would ultimately manage the program. In April 2003, USAID officials revised their plan to use sole source to instead hold a limited competition for the award and give BearingPoint a smaller separate sole source contract to perform assessments and limited work in Iraq related to the program. On May 20, 2003, USAID decided to proceed only with a limited competition for one contract for the entire program.

From January into May 2003, officials of USAID's Bureau for Asia and Near East (ANE) had worked directly with BearingPoint on creating an SOW for this award based on the assumption it would be given a sole source award. According to the memorandum of negotiation, 16 versions of the SOW and budget were prepared during these months. USAID contracting officials consulted with USAID's Office of General Counsel (GC) on how they could proceed

with the competition and still include BearingPoint as a competitor.

GC recommended that USAID revert back to its original SOW (free of BearingPoint input) and provide all potential bidders with four weeks to prepare their proposals. GC's opinion was that this would provide "substantial fairness"¹ and an "adequately level playing field" to overcome any advantage received by one bidder having familiarity with a SOW for a longer period of time than the other potential contractors.

On May 28, 2003, USAID issued a draft Request for Proposal (RFP) to ten prospective offerors to bid on the contract for Iraq economic reform activities. The RFP, issued on June 6, 2003, provided a deadline of June 30, 2003 for responses. Although only two proposals were received, seven of the ten firms invited to bid were represented in the proposals as either prime contractors or subcontractors.

On July 24, 2003, USAID awarded BearingPoint a Cost-Plus-Fixed-Fee level of effort term contract for approximately \$79.6 million. In addition to this base year amount, the contract also provides for two option years for approximately \$160.6 million.

REVIEW RESULTS

In our opinion, USAID complied with applicable federal regulations except for requirements to document and explain the appearance of conflict of interest issues. The extensive involvement of BearingPoint in USAID's development of this program creates the appearance of unfair competitive advantage and we have concluded that USAID did not adequately document and explain how this issue was resolved before proceeding with the award.

Also, security costs should be standardized in cost proposals for Iraq procurements because these costs are difficult for the offerors—or USAID—to accurately estimate. USAID made no review or analysis of the wide disparity in proposed security costs of the two bidding firms which may have impacted on which firm was selected for the contract.

¹ FAR 1.102-2(c)(3) states that "The Government shall exercise discretion, use sound business judgment, and comply with applicable laws and regulations in dealing with contractors and prospective contractors. All contractors and prospective contractors shall be treated fairly and impartially but need not be treated the same."

Appearance of unfair competitive advantage

FAR 9.504 instructs contracting officers to "Identify and evaluate potential organizational conflicts of interest as early in the acquisition process as possible; and avoid, neutralize, or mitigate significant potential conflicts before contract award." FAR 9.505-2(b)(1) states that a contractor that prepares or assists in preparation of a work statement to be used in competitively acquiring a system or services may not provide the services if it "provides material leading directly, predictably, and without delay to such a work statement." FAR 9.505-2(b)(2) further states that "Agencies should normally prepare their own work statements ... To overcome the possibility of bias, contractors are prohibited from supplying a system or services acquired on the basis of work statements growing out of their services ..."

BearingPoint's extensive involvement in the development of the Iraq economic reform program creates the appearance of unfair competitive advantage in the contract award process. After reviewing contract files and interviewing USAID officials and representatives of both bidding contractors we have concluded that USAID did not adequately document and explain how the appearance of an unfair competitive advantage was resolved. The appearance of an unfair competitive advantage can create doubt in the integrity of the procurement process for this award. Areas of concern are described below.

It is unclear exactly what contributions BearingPoint made to the SOW and program budget estimates. ANE bureau officials did not retain correspondence or e-mail communications to or from BearingPoint to indicate what input the contractor provided to the initial 16 versions or any version of the SOW and program budget estimates during the months when BearingPoint was actively and extensively working with USAID. Without a record of the correspondence and communication, it is difficult to assess whether the SOW eventually used by USAID is free of BearingPoint's substantial input or did not grow out of their services.

BearingPoint's involvement with program design involved more than just early access to the SOW. As reported by USAID officials, BearingPoint held extensive conversations with USAID officials concerning the program and would have had the opportunity to obtain USAID officials' views on various technical approaches, preferences, and other areas that may not have been articulated in the SOW. BearingPoint also had the opportunity to begin developing subcontracting alliances with other firms, selecting key personnel, and possibly having some of these

personnel choices vetted or reviewed by USAID. ANE officials created or retained no documentation concerning their meetings and verbal contacts with BearingPoint officials. The competing firm had no similar access to USAID officials when preparing its proposal. In internal correspondence, USAID officials concede BearingPoint had a "leg up" on other bidders because of its ability to have already worked on preparing a proposal and putting a team together.

Also, BearingPoint received authorization to incur pre-contract costs on April 25, 2003—primarily for key personnel to attend chemical/biological/radioactive/nuclear (CBRN) training and related costs. With key personnel already having received mandatory training for work in Iraq and ready for immediate deployment, BearingPoint had another advantage in the competition.

Finally, a draft RFP was issued 33 days before proposals were due, giving the contractors the four weeks of preparation time recommended by GC. However, Amendment No. 1 to the RFP was issued to the contractors only one week before the closing date. Amendment No. 1 contained a substantial amount of information necessary for preparation of a contractor's technical and cost proposals including the level of effort, plug cost figures, and answers to 70 questions provided earlier by the contractors covering a wide range of technical, cost, and logistical topics. Allowing competitors one week to complete their proposals after receiving this amendment does not appear to be giving the contractors adequate time to respond.

Lack of documentation in contract files

FAR 9.504 (d) states that "The contracting officer's judgment need be formally documented only when a substantial issue concerning potential organizational conflict of interest exists." FAR 9.506 (b) states that "If the contracting officer decides that a particular acquisition involves a significant potential organizational conflict of interest, the contracting officer shall, before issuing the solicitation, submit for approval to the chief of the contracting office a written analysis, including a recommended course of action for avoiding, neutralizing, or mitigating the conflict ..."

The appearance of unfair competitive advantage in this procurement is heightened because Office of General Counsel (GC) and Office of Procurement (M/OP) officials did not retain or create documentation of their actions to allow independent review of whether an unfair competitive advantage existed or how USAID

addressed this issue. There are no notes or summaries in the contract files of the discussions among USAID officials on possible conflict of interest/unfair competitive advantage issues or how they planned to resolve such issues. There is no documentation or correspondence from GC in the contract files regarding its understanding of the situation that existed, its position or advice on the issue, or how its input was relayed to USAID officials working on the procurement. The memorandum of negotiation is silent regarding a potential conflict of interest, how it was handled or resolved, or that GC was consulted.

The lack of documentation in the contract files concerning this issue is particularly important because this is one of the largest procurements ever handled by USAID and the award was made during a period of intense outside scrutiny. M/OP needs to address all aspects of the appearance of an unfair competitive advantage and completely document its actions and conclusions in the contract files.

RECOMMENDATION No. 1:

The Office of Inspector General recommends that the Office of Procurement (M/OP) issue instructions to USAID technical offices and its contracting officers reminding them of the need to restrict contacts with contractors selected to receive a sole source award until a contract has actually been signed. If this is unavoidable, contacts with contractors—and any work products prepared by them—should be fully documented to allow effective mitigation of the appearance of an unfair competitive advantage should the award be subsequently opened to competition.

RECOMMENDATION No. 2:

The Office of Inspector General recommends that the Office of Procurement (M/OP):

- a. document its contract files concerning the actions it took with regards to addressing the appearance of an organizational conflict of interest; and
- b. determine whether an unfair competitive advantage existed for this award and whether it was properly mitigated, or if the contract should be cancelled and recompeted.

M/OP officials stated that they believed BearingPoint had only a competitive advantage (such as an incumbent firm would have) rather than an unfair competitive advantage. In addition, M/OP pointed out that by following GC's advice to (1) use an SOW devoid of any substantive input from BearingPoint, and (2) provide ample time to prepare a proposal, any perception of unfair competitive advantage was mitigated. M/OP officials stressed that this procurement was heavily influenced by factors outside the procurement process and that M/OP did everything it could to ensure an open and fair competition within limited time frames and a war situation.

To avoid similar situations in the future, Recommendation No. 1 calls for a different approach in working with contractors designated to receive sole source awards until USAID has actually signed a contract.

Regarding this specific award, the OIG believes there was the appearance of unfair competitive advantage and insufficient action taken to mitigate this appearance. The OIG understands the time pressures and external factors USAID and M/OP were dealing with regarding this procurement; however, we believe the requirements of the FAR take precedence. Without documentation of contacts with BearingPoint, it is difficult to demonstrate that the final SOW was free of substantial BearingPoint input. Allowing BearingPoint to actively assist USAID over a period of several weeks in preparing for a program of this size and importance—without a contract or reportedly the promise of a contract—adds to the appearance of unfair competitive advantage.

In response to Recommendation No. 2 in our draft report, M/OP prepared an addendum to its memorandum of negotiation that recounts details of its handling of the appearance of a conflict of interest and the actions taken by M/OP to address this. In addition, GC provided two subsequent E-mails that described and documented its earlier participation and counsel regarding the issue. Given the passage of time and the lack of contemporary documentation preparation during the procurement process, M/OP and the GC actions to document the files after the fact were the only alternative to address the deficiency.

The OIG does not believe that the documentation provided 6 months after the fact establishes that an unfair competitive did not exist. Therefore, the OIG continues to believe that there should be further deliberations of the circumstances surrounding the USAID's efforts to mitigate the appearance of an unfair

competitive advantage, and take any additional actions as a result of the deliberations.

Security costs should be standardized
in cost proposals for Iraq procurements

FAR 15.404-1(d) describes cost realism analysis as "the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements are realistic for the work to be performed; reflect a clear understanding of the requirements; and are consistent with the unique methods of performance and materials described in the offeror's technical proposal." FAR 15.404-1 (d)(2) states "Cost realism analyses shall be performed on cost reimbursement contracts to determine the probable cost of performance for each offeror. The probable cost may differ from the proposed cost and should reflect the Government's best estimate of the cost of any contract that is most likely to result from the offeror's proposal. The probable cost shall be used for purposes of evaluation to determine the best value."

Primarily due to the need to quickly award the contract, USAID's cost realism analysis for this contract did not include an assessment of the contractors' security costs. Without such an assessment it would be difficult to compare the two proposals and may have had an impact on which firm was selected for the contract.

Amendment No. 1 to the RFP issued on June 21, 2003 provided answers to several questions posed by the contractors. In response to an inquiry about security costs, USAID responded "Such costs are eligible for reimbursement in accordance with standard rules. Contractors are expected to provide their own security." The amendment also provided several "plug" figures to be used in preparing the cost proposals, but none of these "plugs" directly addresses or incorporates security costs.

In accordance with instructions, both bidding firms included provisions for security in their technical proposals—largely by hiring experienced firms to handle their security details. The technical proposals of both firms indicated their security firms would have a large staff available on the ground in Iraq to provide security. The technical panel expressed satisfaction with these arrangements.

Both bidding firms included security costs as part of their cost proposals although not presented consistently for easy comparison. The cost proposals were reviewed by the contracting officer with the assistance of the Office of Procurement's Contract Audit Management Branch (M/OP/PS/CAM). Several questions were raised on items in both proposals, however, no questions or concerns were raised concerning the two firms' security costs. M/OP officials point out that the short timeframe for awarding the contract did not allow for more than a few days to review the cost proposals and M/OP/PS/CAM's report stated that "due to time constraints, a cursory review was agreed upon."

The security aspect of the contract is a significant piece of the proposals and, in our opinion, the wide disparity in security costs should have been reviewed more closely. The differences in proposals raise the issue as to whether the proposals included costs consistent with the firms' technical presentations for security and were realistic for the security requirements. In this case it is particularly significant because the difference in technical scores and pricing between the two competing firms was extremely close.

RECOMMENDATION No. 3:

The Office of Inspector General recommends that when requesting proposals for future awards in Iraq, the Office of Procurement (M/OP) provide solicitation instructions that will allow for adequate documentation to properly evaluate the contractors' proposed security costs.

In response to Recommendation No. 3, M/OP stated it would include additional security details in future Iraq procurements as well as structuring future solicitation instructions to allow proper evaluation of security costs.

Please provide us within 15 days information related to actions planned or taken to implement recommendations contained in this report. We appreciate the courtesies extended to the OIG staff on this review.

cc: AA/LPA, E. Fox
AA/M, J. Marshall
GC, J. Gardner
M/OP/E, K. Triplett
ANE/SPO, L. Brady
ANE/SPO, A. Levenson
ANE/SPO, B. Krell
ANE/OIR, R. Wherry