



INTERNAL AUDIT DIVISION

OFFICE OF INTERNAL OVERSIGHT SERVICES

AUDIT REPORT

Audit of System Contracts

21 November 2007

Assignment No. AP2006/560/02

United Nations  Nations Unies

INTEROFFICE MEMORANDUM

MEMORANDUM INTERIEUR

INTERNAL AUDIT DIVISION · DIVISION DE L'AUDIT INTERNE

OIOS · BSCI

TO: Ms. Alicia Bárcena, Under-Secretary-General

DATE: 21 November 2007

A: for Management

REFERENCE: AUD-8-3:1 (07- 00769)

Mr. Jean-Marie Guéhenno, Under-Secretary-General
for Peacekeeping Operations

Ms. Jane Holl Lute, Assistant Secretary-General and
Officer-in-Charge of the Department of Field Support

FROM: *for William Paterson*
Dagfinn Knutsen, Director

DE: Internal Audit Division, OIOS

SUBJECT: **Assignment No. AP2006/600/02 – Audit of Systems Contracts**

OBJET:

1. I am pleased to present the report on the above-mentioned audit, which was conducted from November 2006 to March 2007.

2. Based on your comments, we are pleased to inform you that we have closed recommendations 5, 7, 14, 17, 19, 20 and 21 in the OIOS recommendations database as indicated in Annex 1. In order for us to close the remaining recommendations, we request that you provide us with the additional information as discussed in the text of the report and also summarized in Annex 1.

3. Please note that OIOS will report on the progress made to implement its recommendations, particularly those designated as critical (i.e., recommendations 1- 4, 7, 9, 10, 13, 16 and 20), in its annual report to the General Assembly and semi-annual report to the Secretary-General.

4. IAD is assessing the overall quality of its audit process and kindly requests that you consult with your managers who dealt directly with the auditors and complete the attached client satisfaction survey form.

cc: Mr. Warren Sach, Assistant Secretary-General and the Controller, OPPBA, DM
Mr. Philip Cooper, Director, DFS
Mr. Jonathan Childerley, Chief, Oversight Support Unit, DM
Mr. Swatantra Goolsarran, Executive Secretary, UN Board of Auditors
Mr. Byung-Kun Min, Programme Officer, OIOS

INTERNAL AUDIT DIVISION

FUNCTION

“The Office shall, in accordance with the relevant provisions of the Financial Regulations and Rules of the United Nations examine, review and appraise the use of financial resources of the United Nations in order to guarantee the implementation of programmes and legislative mandates, ascertain compliance of programme managers with the financial and administrative regulations and rules, as well as with the approved recommendations of external oversight bodies, undertake management audits, reviews and surveys to improve the structure of the Organization and its responsiveness to the requirements of programmes and legislative mandates, and monitor the effectiveness of the systems of internal control of the Organization” (General Assembly Resolution 48/218 B).

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EXECUTIVE SUMMARY

Audit of Systems Contracts

The Office of Internal Oversight Services (OIOS) carried out an audit of peacekeeping systems contracts from November 2006 to March 2007. The audit was carried out at the Procurement Service, Department of Management (PS/DM) and the Logistics Support Division, Department of Peacekeeping Operations (LSD/DPKO¹). The main objectives of the audit were to: (i) assess the adequacy of policies and procedures for managing systems contracts; (ii) review the whole cycle of systems contracts administration and management in terms of efficiency, effectiveness and compliance with existing regulations, rules and policies; and (iii) assess the adequacy of related internal controls. The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

Systems contracts are used for purchasing products and services required on a recurring basis and for an extended period of time, usually not exceeding five years. The use of system contracts facilitates the prompt processing of procurement requirements and minimizes the number of time-consuming and repetitive solicitation processes. As of 29 January 2007, there were 150 active systems contracts with a value of \$1.6 billion.

While OIOS acknowledged the efforts and measures recently initiated by Department of Field Service (DFS) and DM to improve the procurement process at United Nations Headquarters and in the field, the audit concluded that the management and administration of systems contracts needed further improvements with respect to internal controls and operational efficacy. OIOS identified the following critical areas and shortcomings which should be addressed by DFS and DM management on a priority basis:

The systems contracts procurement cycle

- There is a need to improve the planning and monitoring of the systems contracts procurement process;
- Vendor performance reports were absent from all case files reviewed at the Procurement Service;
- The original Not-To-Exceed amount of one systems contract was increased from \$32 million to \$95 million within a five-year period through various amendments without re-bidding;
- Delivery lead times of goods procured through systems contracts were not monitored; and
- There was a systematic delay in invoice payments. This was attributed to a lack of receipt of mission R&I reports even when delivery was made to the shipment port in compliance with INCOTERMS 2000.

¹ Since 1 July 2007, the newly established Department of Field Support (DFS) is responsible for administrative and logistical support to field missions.

Policies and procedures in management of systems contracts

- The terms “Contract management” and “contract administration” need to be defined in the Procurement Manual as well as a clear delineation of roles and responsibilities of all parties involved in the systems contract process;
- There is a need for a new methodology for assessing all cost parameters pertaining to freight forwarding to enable a fair evaluation of bids;
- A lack of methodology for determining the amount of performance bonds resulted in inconsistencies in calculating the bond amount. A performance bond of \$6.8 million was collected after OIOS requested for the immediate action on collection of a pending bond identified during the audit;
- Frequent delays in delivery of systems contracts goods were attributed to a failure to evaluate vendors’ production capacity; and
- The Procurement Manual did not include the description of direct purchasing agreements and procedures for their use, as well as a provision for the use of prototypes;

Internal control review

- The IT applications used by parties involved in the systems contracts process were not interfaced and could not be used as a monitoring tool;
- Full details of existing procurement contracts were disclosed on the Intranet creating a risk for the Organization by providing competitive and commercial information to vendors;
- Controls in place were not sufficient to prevent the exceeding of Not-to-Exceed limits of the systems contracts;
- In one case, the vendor increased the prices before the expiration of the contract resulting in additional costs of \$1.4 million to the Organization;
- In communications with vendors, a coordinated approach by DPKO missions and the Procurement Service is required to protect the interests of the Organization;
- Interim contracts were issued and contract agreements were signed many months after the contract start dates exposing the Organization to the risk of financial losses if contract terms are not implemented by the vendors; and

OIOS made a series of recommendations to correct the above deficiencies intended to improve the procurement and management of systems contracts.

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I. INTRODUCTION

1. The Office of Internal Oversight Services (OIOS) conducted an audit of system contracts from November 2006 to January 2007 at United Nations Headquarters in the Procurement Service (PS) of the Department of Management (DM) and in the Logistics Support Division (LSD) of the Department of Peacekeeping Operations (DPKO).²

2. According to the Procurement Manual (PM), system contracts are used for products and services required on a recurring basis and for an extended period of time, usually not to exceed five years. They facilitate prompt processing of procurement requirements and minimize the number of time-consuming and repetitive solicitation processes for the same items. Systems contracts require intensive monitoring and administrative support, primarily by the requisitioning office to ensure that contractors perform satisfactorily and in accordance with the terms and conditions of the contract. According to the Financial Regulations and Rules, the Under-Secretary-General for Management may determine for a particular procurement action that using formal methods of solicitation is not in the best interest of the United Nations when there has been a previous determination or there is a need to standardize equipment.

3. As of 29 January 2007, there were 150 active system contracts, of which 100 contracts with a value of \$1.2 billion were administered by the Field Procurement Section and 42 contracts with a value of \$437 million were administered by the Headquarters Section of the Procurement Service, DM. The planning and management of systems contracts for peacekeeping missions is the function of LSD together with the field missions responsible for local procurement.

4. Comments made by the Department of Management and by the Department of Field Support (DFS) are shown in *italics*.

II. AUDIT OBJECTIVES

5. The major objectives of the audit were to:

(a) Assess the adequacy of policies and procedures for managing system contracts;

(b) Review the whole cycle of system contracts including the assessment of requirements, requisitioning, contracting, administration and evaluation phases of the process in terms of efficiency, effectiveness and compliance with existing policies, rules and regulations; and

(c) Assess the adequacy of the related internal controls.

² Since 1 July 2007, the newly established Department of Field Support (DFS) is responsible for administrative and logistical support to field missions.

III. AUDIT SCOPE AND METHODOLOGY

6. The audit focused on peacekeeping systems contracts and reviewed the whole cycle of selected system contracts that were active for the period 2003 to 2006. While the audit was conducted primarily at the Procurement Service, OIOS also interviewed DPKO (DFS since July 2007) officials involved in planning, and managing system contracts representing such commodity groups as supplies (various general service supplies), engineering (prefabricated living accommodations and generators) and CITS (servers, desktop computers, software). OIOS reviewed 10 peacekeeping systems contracts with purchase orders having a total value of \$220.8 million and a not to exceed (NTE) total value of \$308 million.

IV. AUDIT FINDINGS AND RECOMMENDATIONS

A. The Systems Contracts Procurement Cycle

Planning and requisitioning

7. Procurement planning is essential for the effective and timely solicitation of bids or proposals, award of contracts and delivery of goods and services required. As a requisitioner, DFS is responsible for the development of procurement plans and for cooperation with PS and Chief Procurement Officers (CPO) in the field in making these plans available in a timely manner. The Procurement Manual requires that, in the planning phase, the requisitioner shall use best efforts to accurately describe the need and to develop the scope of requirements through generic technical specifications that would allow a prospective vendor to meet the identified needs.

8. Based on a review of the planning process and interviews with LSD staff involved, OIOS noted that there was a need for a more sophisticated approach to procurement planning by DFS.

9. The audit found that the various LSD units used their own planning tools to establish and project requirements for systems contracts. When initiating a new systems contract LSD takes into consideration the acquisition plans for the field missions and SDS requirements for the next budget period. However, planning for new missions and future requirements in each commodity group based on a combination of the past experience and estimates of future requirements proved to be difficult due to the unpredictability of new mission start-ups which were often dependent on urgent political decisions. Currently, some LSD units are in the process of developing graphic presentations to clarify and better manage the different stages of the systems contracts under their direction, and to better project future requirements.

10. While the use of systems contracts have largely addressed the issue of lag time between the identification of a requirement and the actual delivery by

shortening the process, it is the view of OIOS that more systematic and scientific modeling of future requirements needs to be made by DFS. This is essential in view of the expanding use of systems contracts and the increasing amount of funds spent on goods and service provided under systems contracts. Such modeling would require expertise which may not be available within DFS to scientifically develop either individual or universal requirements planning schemes for use by various DFS commodity-based units. Key issues such as estimating needs based on historical data, requirement analysis, scoping, budgeting and controlling would be beneficial to DFS to better project systems contracts requirements.

Recommendation 1

(1) The Department of Field Support should review its procurement planning methodology for systems contracts, comparing it to industry best practices, and consider implementing the forecasting models to more effectively project future goods and service requirements.

11. *The Department of Field Support accepted recommendation 1 and stated that it would benefit from the development of a forecasting tool, which, based on planning assumptions, could more effectively project future goods and services requirements. Such a tool would be integrated with SDS and mission inventory holdings, and consider current system contract capacities and delivery lead times.* Recommendation 1 remains open pending the results of DFS' review and development of planning tools to forecast future requirements.

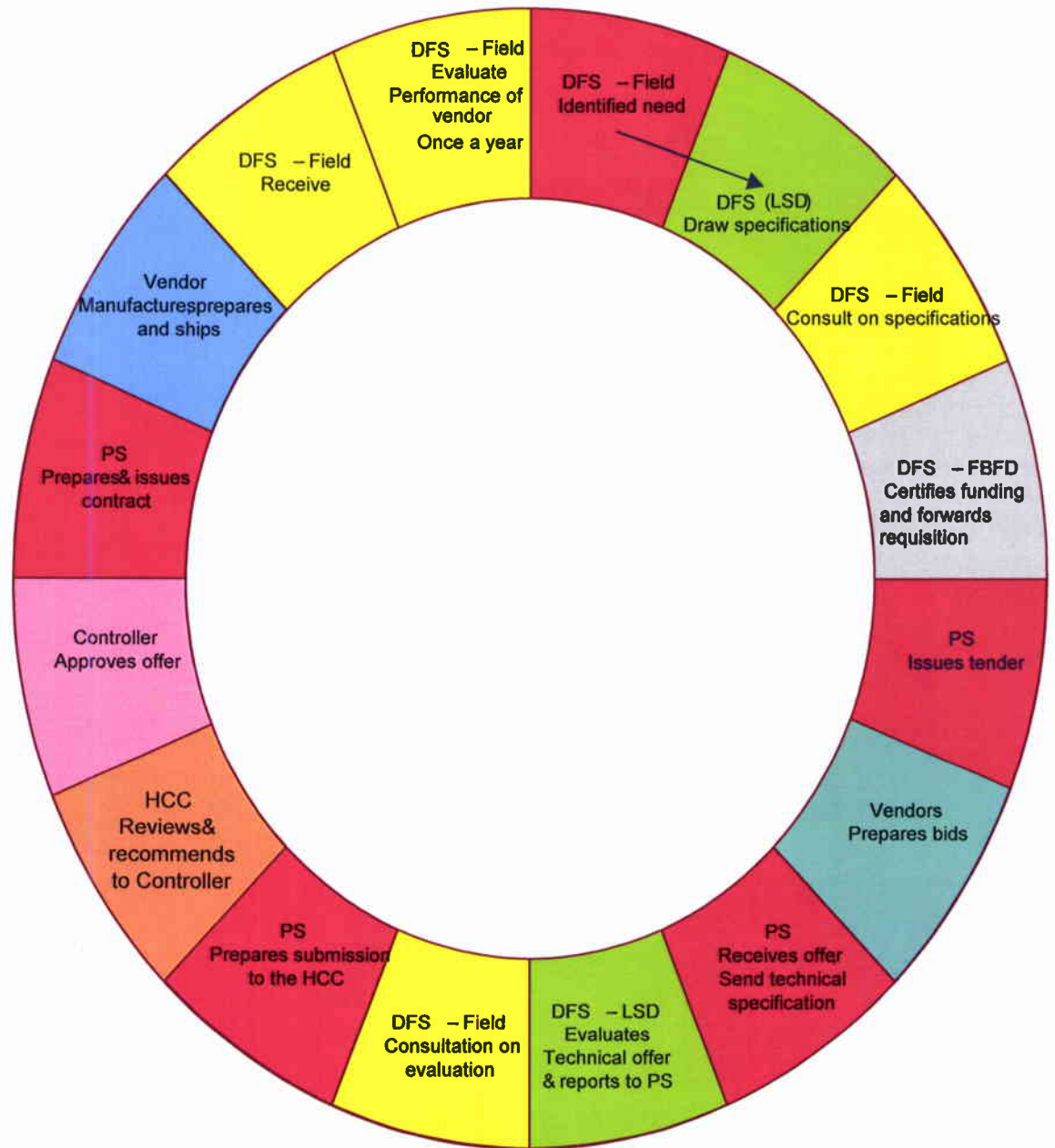
DM and DFS responsibilities in the procurement process

12. The relationship between DM and DFS in the support of peacekeeping operations was outlined in the 2001 report of the Secretary-General on the findings of the first comprehensive managerial examination of the ways in which the Organization plans, deploys, conducts and supports peacekeeping operations (A/55/977). The report described the divisions of labour between the two departments in the area of procurement and identified the need for more close coordination in their work.

13. Taking into consideration the results of the above-mentioned report as well as prior audit findings and recommendations in the procurement area, OIOS reviewed the whole cycle of systems contracts and identified some control weaknesses and opportunities for improvement in the systems contracts mechanism used by the Organization.

14. OIOS assessed the division of responsibilities noted in A/55/977 and the flow of the acquisition process as described in the Procurement Manual. OIOS noted that one of the essential elements of systems contracts, which needed attention by both DFS and PS, was the management of vendor performance. As shown below, in Figure 1, the procurement cycle starts with the needs identification by DFS and ends with the vendor performance evaluation. The various phases of the cycle are discussed in the respective sections of the report.

Figure 1. Procurement life cycle



Vendor performance evaluations

15. With regard to vendor performance evaluation, the PM (7.11.2-c) states that a performance report is required once a year for contracts that exceed \$200,000 or for long-term contracts with a two to three year duration. In addition, the Procurement Manual (15.1-3) states “The Procurement Officer shall ensure, before amending a contract that ... a satisfactory Vendor Performance Report in accordance with Section 7.11 is on file ... if appropriate, a comparative cost estimate has been undertaken, to determine if the costs are still competitive and

to find out what the commercial cost would have been if the UN were to engage in formal competitive bidding.”

16. The review of individual systems contracts showed that performance reports were missing in the entire system contract files reviewed. OIOS is of the opinion that the main reason for this oversight is the unclear and fragmented division of responsibilities in carrying out this function. OIOS noted that the Procurement Manual requires the preparation of standard reports in which the requisitioners grade vendors’ performance with “yes” or “no” ratings in five areas. The report (Form PD.3) also has a space for PS’ input and has to be signed off by the Chief, Procurement Service and then by a PS vendor roster officer. OIOS also observed that the Special Support Services (SSS) of LSD had designed its own format for vendor performance reports as well as a point system to rate vendors. In this regard, the role of contract management officers in the field should be strengthened regarding their responsibility for preparing timely, standardized and meaningful vendor performance reports and their timely submission to DM and DFS Headquarters. DFS indicated that exception reports in the case of poor performance or contractual disputes did take place as and when negative contract issues occurred. In OIOS’ opinion, more frequent and regular vendor performance reporting by the end users in an improved standardized format is required.

Recommendation 2

(2) The Department of Management and the Department of Field Support should ensure the timely submission of periodic performance reports using standardized forms as part of the contract management cycle. These reports should be normally filed as part of the contract file since contract performance records constitute proof of performance, evidence in case of disputes, and a basis for institutional memory and audit purposes.

17. *The Department of Management accepted recommendation 2 and stated that it had already instituted a requirement that performance reports should be maintained and that it would only approve extensions of contracts based on a satisfactory performance report. Further, DM wished to emphasize the fact that particularly in the case of field operations, DM can at best only remind end-users of the obligation to submit performance reports. Thus, the initiative should belong to the end users. PD will send a letter of reminder to the field missions regarding the requirement to prepare and submit performance reports in a timely manner.*

18. *The Department of Field Support accepted recommendation 2 and stated that it would benefit from DM developing a suite of standardized vendor evaluation forms. It would also benefit from the development of an electronic datapoint through which these evaluations could be submitted and monitored for timely submission. Recommendation 2 remains open pending DM’s sending letters of reminder to the field missions concerning timely preparation and submission of performance reports.*

Advance planning for systems contracts establishment and their extension

19. To initiate a systems contract and/or to renew an existing systems contract, DFS sends a formal request to PS through a memorandum. An existing systems contract is no longer valid when the expiry date of the term of the contract is reached, or the Not-to Exceed (NTE) amount is fully utilized, even though the contract term has not yet expired.

20. Based on the sample case files reviewed and interviews with PS staff, OIOS concluded that DFS should be more proactive in sending advance requests to PS for a new procurement action, when systems contracts become invalid. A tender process usually requires significant lead time, and if the process does not start early enough before the expiration of an existing contract, there is a risk of a gap in providing goods/services. For example, establishing a system contract for 250, 500 and 750 KVA generators took almost 15 months, as can be seen in Figure 2. In the meanwhile, some missions requested local procurement authority (LPA) in order to do the bidding themselves in order to procure urgently needed generator sets.

Figure 2. Timeline of generator contracting (Contract PD/C034/06)



The system contract on Uninterrupted Power Supplies (UPS) is an example of late requests by DPKO (DFS since July 2007). The two existing contracts expired on 31 October 2004 and 31 December 2004, but DPKO sent a request for renewal/extension of the contracts only three weeks before the expiry of the first contract. There were some cases, as shown in Figure 3, when the Statement of Work (SOW), a part of solicitation documents, was not ready although the Expression of Interest (EOI) had been posted on the UN website months ago.

Figure 3. Cases of Delayed Statements of Works

Commodity	EOI Closing Date	Date SOW was received from DPKO
Prefabricated Kitchens	07/09/2006	20/12/2006
Plumbing Materials	03/10/2006	03/11/2006
Prefabricated Bridges	12/09/2006	30/11/2006

21. As mentioned above, systems contracts become invalid not only upon contract expiration, but also when the full utilization of NTE amount occurs. OIOS observed delays in taking actions early enough with regard to NTE ceiling

amounts. On two occasions, the missions could not raise purchase orders through the system contract for prefabricated buildings (PD/C0074/02) due to the full utilization of NTE amounts. Being unable to use the system contract, the peacekeeping mission (ONUCI) asked permission from Headquarters to proceed with its purchase orders, in order not to lose the obligated funds as there was insufficient time to do a new bidding exercise before the end of the financial period.

22. OIOS noted on the other hand that there were attempts by DFS to send requisitions early enough to give sufficient procurement lead time to PS. OIOS was also informed that PS officers usually sent reminders to DFS asking the Department to submit a request for procurement action, if a certain system contract was to be renewed or extended. However, a holistic and standard approach should be developed and applied not only for peacekeeping but for all systems contracts.

Recommendation 3

(3) The Department of Field Support should develop an internal mechanism to ensure that requests for renewal/extension of system contracts are sent to the Procurement Service with sufficient lead time to enable timely procurement action.

23. *The Department of Field Support accepted recommendation 3 stating that LSD services continued to monitor their expenditures under existing service contracts with known lead time for renewal in mind. DFS is currently piloting a traffic light reporting format to apprise senior management of the current capacity of systems contracts and their expiration date. However, for new and continuing requirements, DFS would benefit from PS developing and advising on its procurement strategy and on associated lead times. Recommendation 3 remains open pending DFS' development and utilization of the traffic light reporting format to apprise senior management of the current capacity and expiration dates of systems contracts.*

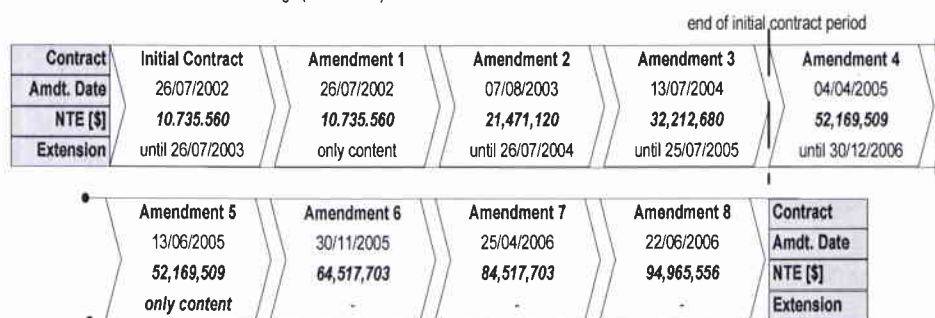
Frequent contract amendments

24. The Procurement Manual (12.1.1) requires the recommendation of HCC and approval of the ASG/OCSS for any proposed amendment, modification or renewal of a contract previously reviewed by the HCC, where the amendment, modification, or renewal, increases the contractual amount by more than 20 per cent or US\$200,000 whichever is lower.

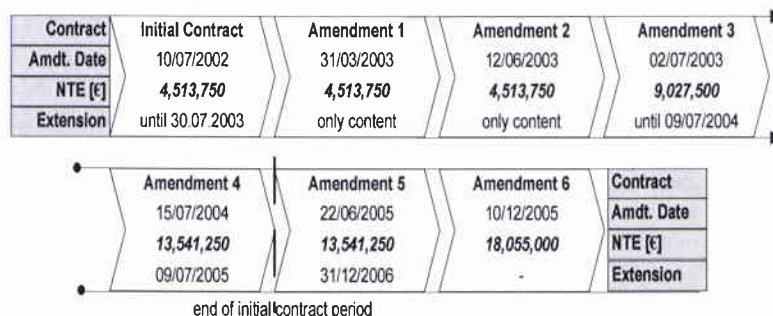
25. As seen in Figure 4 below, two systems contracts for prefabricated buildings had been amended and extended many times with no new bidding exercise. As a result, one contract's original NTE amount of \$10.7 million (PD/C0074/02) increased to \$95 million, whereas the other contract's initial NTE amount of \$4.5 million (PD/C0105/02) increased to \$18 million.

Figure 4. NTE Increases

PD/C0074/02 Prefabricated Buildings (3*6 module) - CORIMEC



PD/C0105/02 Prefabricated Buildings (single module) - CORIMEC



26. OIOS concluded that the main reason for resorting to contract amendments rather than bidding out the requirement was due to inadequate planning and management of systems contracts. OIOS notes that the emergence of new missions makes it difficult to forecast requirements, however, in this case, the requisitions were usually received late and no evidence of planning and coordination was found. HCC, at its meetings on 22 March 2005 (HCC/05/18) and 25 October 2005 (HCC/05/67) queried the options of new bidding rather than amending the contracts. The response to the first query was that a new bidding exercise that reached the RFP phase had not been approved by DPKO (DFS since July 2007) senior management. In response to another query, PS commented that a new bidding exercise was ongoing but more time was required for its finalization. At the time of the audit, the bidding was not yet finalized, and there were no valid systems contracts in place for prefabricated buildings.

27. Frequent requests for the NTE increase of the systems contract (PD/C0074/02) urged PS to communicate its concerns to DPKO. In its 1 March 2006 memorandum addressed to DPKO, PS commented that within a four-month period a request for another amendment have been received from DPKO. In this regard, PS asked DPKO to undertake a thorough review of the requirements prior to the presentation to HCC. In its response to this request, DPKO commented that requirement changes in UNIFIL, MONUC and especially the accommodation policy change in UNMIS, forced them to increase the NTE amount of the systems contract for prefabricated buildings. OIOS is of the opinion that the practice of amending an existing contract many times without a new bidding exercise and increasing the NTE amount to multiples of the first

award value undermines the fair competition and transparency policies of the Organization.

Recommendation 4

(4) The Department of Management and the Department of Field Support should stop the practice of making multiple amendments of the systems contracts, thereby considerably increasing original NTE amounts, without undertaking a new bidding process. Any such amendments, if warranted, should require conducting due diligence market surveys to ensure that the prices of the existing systems contracts remain competitive and that all potential bidders are treated fairly.

28. *The Department of Management commented that systems contracts were only extended if warranted and if prices were competitive. DM acknowledged that there was a need to explore markets before increasing NTE amounts. DM further pointed out that requests to extend NTE contracts for operational reasons had been approved by the Controller upon the recommendation of the HCC. Prior to extension, DM conducts market research in order to determine whether a new solicitation should be conducted. Extension of NTE amounts should be considered within the context of the exponential growth in critical peacekeeping operations accompanied by immediate operational requirements. Since the decision to extend NTE contracts is based on organizational interests, DM was not in a position to accept the portion of the recommendation which recommended prohibiting amendments to system contracts. DM would issue a reminder to buyers at Headquarters and in the field that there was a need to perform “due diligence” market research prior to the execution of amendments which exceed NTE amounts and to document information pertinent to such research in the case files.*

29. *The Department of Field Support stated that the principle of having a systems contract was that the Organization can respond to its changing volume needs on the premise that DM had already contracted the lowest acceptable bidder for a certain period of time. DFS would benefit from DM requesting vendors to consider the impact of increases in volume requirements over the lifetime of the contract, and for the HCC to consider the inclusion of ‘not yet mandated’ missions in those requirements. OIOS clarifies that recommendation 4 does not prohibit the extension of contracts, but provides for a requirement that amendments to the contracts, if warranted, should be done only after due diligence market surveys. This is in agreement with DM’s comments, as indicated in paragraph 29 of this report. New bidding should take place in those cases where market surveys indicate that prices are not or may not be competitive. Recommendation 4 remains open pending DM’s issuance of a reminder to buyers at HQs and field missions about the requirement to perform “due diligence” market research prior to the execution of contract amendments.*

Evaluation criteria/special instructions of solicitation documents

30. There were inconsistencies in the evaluation criteria used for similar types of procurement action. For example, for two similar tenders for prefabricated buildings, which were carried out at very close dates, five years of experience and a minimum of three references were required in the tender for PD/C0074/02, while only “related experience” was required in the tender for PD/C0105/02. OIOS was not able to ascertain whether the requirement for five years of experience and three references disqualified any potential vendor. In both tenders, the same vendor, Corimec SPA was awarded the contract. However, OIOS found no evidence in the case/vendor database files indicating the number of years of experience and the references of the awardee. The basis for defining the experience requirement was not documented in the case files. Moreover, OIOS believes that experience requirements should be consistently applied to all system contracts bidding activities.

Recommendation 5

(5) The Department of Field Support, in coordination with the Procurement Service, should ensure that consistent evaluation criteria, such as the years of experience, are used in bidding process; and that the basis for such criteria is documented.

31. *The Department of Field Support accepted recommendation 5 and indicated that it would benefit from DM’s advice as to what industry standards are considered prudent to assure access to both quality and quantity of acceptable vendors.*

32. *The Department of Management agreed that it was desirable to apply consistent evaluation criteria in the procurement process. DM will issue a reminder letter emphasizing the need to document changes in evaluation criteria. Based on the responses from both DFS and DM, recommendation 5 has been closed. However, OIOS would like to stress the point that evaluation criteria have to be consistently used to avoid the recurrence of the cases cited in paragraph 30 of this report, where inconsistent criteria had been used for two similar tenders for prefabricated buildings. In addition, it should be noted that this contract had been referred to the Procurement Task Force for investigation.*

Delays in invoice payments

33. Most systems contracts reviewed had a provision requiring payments to be made 30 days after the receipt of invoices with supporting documentation showing that the ordered goods were delivered to the designated shipment point. However, there were frequent delays in payments to vendors. For example, the delivery against PO 4CI-300077 for prefabricated buildings was made in December 2004, whereas the payment was still pending as of November 2005 when the vendor issued the fourth payment reminder.

34. OIOS found that these payment delays were systematic due to untimely issuance of Receipt and Inspection (R&I) reports. If, for any reason, the issuance of R&I reports is delayed by a mission, the payment to the vendor will also be delayed pending the R&I report.

35. In OIOS' opinion, this practice might have an additional indirect cost to the Organization. First of all, the reputation of the UN is hampered by such delays in payments. Second, there were cases where the decision was made not to apply any liquidated damages due to a delay in deliveries of goods because of the frequent delays of payments on the part of the Organization. Third, the vendors might be adding a cost premium to their price proposals to compensate for payment delays. Vendors are also reluctant to give additional discounts to the UN even if the NTE amount of an existing contract is increased. Some vendors offer discounts only on early payments.

36. In another case, OIOS observed that a contractor complained about a delay of more than six months in the payment of two invoices by UNMIS with respective amounts of \$6 million and €1.5 million. The procurement officer, in a communication to UNMIS, stated that due to late payments of vendor invoices by the mission would make it difficult for PS to achieve good results in negotiations for planned NTE increase of the contract.

Recommendation 6

(6) The Department of Field Support should review the internal procedures on payments for goods and services procured and request the field missions to ensure that payments to the vendors are done in accordance with contractual terms and conditions.

37. *The Department of Field Support agreed that any delay in payment to vendors was not a sound commercial practice. However, DFS did not accept the recommendation and stated that DFS' approving officers adhered to the procedures, prescribed by the Controller, regardless of the type of delivery or contracted payment term. According to DFS, this observation is amplified where purchases are based on FCA or FOB INCOTERMS, as the ownership for goods passes at the port of lading and not upon receipt of the goods in the mission, in which case there is an inherent risk that a mission will not meet its obligations to make payments in accordance with contractual terms.*

38. In this regard, OIOS would like to refer to the Field Finance Procedure Guidelines issued by DM and DPKO in February 2006, which states that "there are cases where invoices need to be paid without any attached R&I reports. For example, in accordance with contractual terms, certain invoices may be paid upon confirmation of shipment by the UN's designated freight forwarder (provision 2.3.1)". In view of this, OIOS reiterates recommendation 6 and will keep it open pending the issuance of DFS' reminder to field missions about the requirement to make payments in accordance with contractual terms.

Delivery lead times and liquidated damages

39. Reduced delivery lead time is one of the main objectives of systems contracts. In most of the contracts reviewed, the delivery lead times are included in the contractual terms. However, OIOS found that the actual lead times, starting from the issuance of POs until the delivery of the goods to the designated shipment point, were never monitored and measured. Consequently, liquidated damages linked to non-observance of the delivery lead times had never been applied, although there were many cases of late delivery (e.g. CORIMEC SPA prefabricated buildings systems contract).

Recommendation 7

(7) Department of Field Support should develop a mechanism for measuring and monitoring the actual delivery lead times in systems contracts and apply the liquidated damages provision of the contracts, when necessary.

40. *The Department of Field Support accepted recommendation 7 and stated that it would assist the Procurement Service where required in applying liquidated damages when necessary. The procurement systems employed in the field have the capacity to record delivery times against due delivery dates. Based on DFS' response, recommendation 7 has been closed. OIOS will verify the level of implementation of this recommendation during its follow-up audit of systems contracts.*

B. Systems contracts policies and procedures

Contract administration vs. contract management

41. The Procurement Manual describes contract administration responsibilities as those related to processing amendments of contracts, vendor performance evaluations, contract closeout, and storage and tracking of files. In the "UN Procurement Practitioner's Handbook" (the Handbook) issued in November 2006, the terms "contract management" and "contract administration" are often used synonymously. "Contract management" is commonly understood as a broader and more strategic concept that covers the whole procurement cycle including planning, formation, execution, administration and the close out of a contract that goes beyond the day-to-day activities in the procurement cycle. The Handbook further notes that contract management is similar to project management in that each contract has a unique goal, consumes resources, has a beginning and end date, and requires coordination and planning, as well as documentation in a contract file throughout the process.

42. For this report, OIOS has adopted the terminology of the Handbook in using the term "contract management" to cover the whole procurement cycle. However, OIOS noted that there was some confusion concerning the responsibilities for contract management and contract administration. In the opinion of OIOS, PS should therefore clarify the definition of contract administration and contract management responsibilities clearly indicating the

process ownership at each operational stage of the whole procurement process within the context of the Handbook and specify those particular aspects of contracting which can be defined as “contract administration” matters.

Recommendation 8

(8) The Department of Management should clarify the definition of “contract administration” and “contract management” and specify the responsibilities and the process ownership at each operational stage of the whole procurement process in the “UN Procurement Practitioner’s Handbook” and the Procurement Manual.

43. *The Department of Management accepted recommendation 8 and stated that the terms and definitions of “contract management” and “contract administration” would be clarified in the 2008 revision of the Procurement Manual. The 2008 revision of the Procurement Manual will also clearly define the respective roles and responsibilities of requisitioners and procurement officers within the context of contract management. Recommendation 8 remains open pending the revision of the Procurement Manual and its availability to staff on the DM website.*

Shipment terms used in bid evaluations

44. The Procurement Manual (9.12.5-3) requires that:

“For Systems Contracts, the price comparison shall be based on a combination of FCA/FOB price and a “weighted” DDU price. The Procurement Officer shall request the price of the goods FCA/FOB as well as DDU. Using the

Similarly, regarding the delivery terms in proposals/bids, the Procurement Manual (11.6.10-2) states: estimated quantity needed for each Mission or office benefiting from the Systems Contract, an average shipping cost shall be established, which shall form the basis for the Commercial evaluation.”

“When the Solicitation Document specifies an alternate delivery point, the Procurement Officer shall establish the transportation cost of the deliverables to the final destination, through the UN designated freight forwarder or the UN/PD Freight Forwarding Team. Such freight cost shall be added on the Solicitation Abstract Sheet to establish the total landed cost to the Organization at the site of use, and thereby the Submissions will be compared on an equal basis. If prices are given for various transportation scenarios, e.g. FCA and DDU, the Procurement Officer shall verify that the cost difference is acceptable, and select the best value offer to the Organization.”

45. OIOS found that the majority of bid evaluations for systems contracts were made on a Delivery Duty Unpaid (DDU, Brindisi) basis, and for some others, Free Carrier Along (FCA) or Ex Works (EXW) were used for the

evaluations (e.g. PD/C0125, PD/C0127). It should be noted that the FCA/EXW (origin of shipment) prices do not assign the shipment responsibility to the vendors, whereas DDU, Brindisi prices include the shipment cost to destination, which is Brindisi, Italy. Strategic Deployment Stocks (SDS) items are procured through system contracts and these are shipped directly to Brindisi to be used in start-up missions. However, routine/recurring requirements of existing missions procured through system contracts do not require shipment to Brindisi, but rather, are shipped directly to the missions. Therefore, using price terms DDU, Brindisi in the bid evaluation process does not reflect the actual situation, and there is a high risk of miscalculating the best value for money proposal. Besides, this approach gives a competitive advantage to companies located in or close to Italy.

46. One way to avoid this problem is to conduct evaluations merely based on the cost of items or services, excluding the freight cost factor. However, the shortcoming of this option is that not all cost factors are taken into consideration while doing an assessment which is an approach that might conflict with the total cost of ownership (TCO) concept.

47. Another way is to bring all the bid proposals on a comparable basis. A prerequisite for this analysis is to know the requirements of all existing missions and SDS requirements as well, which can be derived from annual procurement plans. All the proposals should include freight costs FCA/EXW, DDU, Brindisi and DDU direct shipment destinations (e.g. commonly used ports in West Africa, East Africa regions etc). Moreover, the shipment costs (DDU-destination cost minus FCA/EXW-vendor's place cost) should be compared with those of other shipping agencies and, if the shipping agencies' quotations are better, only the lowest bidder with FCA/EXW should be awarded. The Figure 5 shows the criticality of shipment terms in decision-making and bid awarding.

Figure 5. Prices for pre-fabricated ablution modules (PD/C0198/04)

Company	FCA/EXW price	DDU Price
SETA	€ 7,415 (\$8,675) (Dulce, Turkey)	€ 8,876 (\$10,385) (Brindisi)
G. FERON	€ 8,100 (FCA Rabean/Italy or EXW Mirandola, Italy)	€ 8,550 (Brindisi)
COGIM	€ 8,570 (FCA, Brindisi)	€ 8,570 (Brindisi)

* 1 Euro = 1.17 USD (November 2003)

48. In this case, only DDU, Brindisi price was used for commercial evaluation and, therefore, G. Feron was awarded the contract. Had FCA prices been taken into consideration (or an average of FCA and DDU, as mentioned in the Procurement Manual) another company (SETA) should have been awarded the contract. In reality, many purchases through this contract were made on FOB/FCA basis where the UN bore the cost of direct shipment to the missions, therefore, the evaluation made on DDU, Brindisi assumption did not reflect the real life situation. OIOS found that among the 17 sampled POs for procurement of 752 units of ablution modules with a total value of \$6,424,625, only 3 POs for 132 units valued \$1,128,600 were issued on a DDU, Brindisi price basis, whereas the others were as follows:

-
- Seven POs for 400 units with a value of \$3,240,000 (FCR Mirandola, Italy and FCA Ravenna, Italy)
 - Seven POs for 220 units with a value of \$2,056,025 (CIF Abidjan, CIF Bagdad, CIF Entebbe, CIF Mersin, Turkey and CIF Monrovia).

49. Another problem associated with freight forwarding terms was a lack of sufficient information in the missions to decide which shipment terms were most beneficial to the Organization. For example, when UNMIS raised a PO (6MIS-1107) for generators, the shipment terms were indicated as DDU, Brindisi. However, the vendor suggested that an FCA, China option would be more cost effective for the UN since the shipment could be made directly to Port Sudan from China. UNMIS requested a quotation for shipment cost directly from China to Sudan, and the vendor recommended a local logistics company in China which initially offered \$3,900 but then revised the offer to \$2,200, explaining the revision as a calculation mistake. The vendor's freight price for DDU, Brindisi was \$1,145, which is much cheaper than the direct freight cost to Sudan. However, the shipment cost from Brindisi to Sudan had to be added to make it comparable with the direct shipment cost. The Procurement Officer asked PS for advice which shipment terms were more economical; however, PS Freight Forwarding Unit provided only an average freight cost from China to Sudan. This information was useful only for benchmarking the shipping agency's quotation, but was not sufficient to help in deciding whether to use FCA, China or DDU, Brindisi terms. In the absence of a clear cost/benefit analysis, the Procurement Officer decided to order using DDU, Brindisi shipment terms.

Recommendation 9

(9) The Department of Management should develop a new methodology to assess cost parameters pertaining to freight terms in order to make bid proposals comparable for commercial evaluation. The Procurement Manual should be updated accordingly with clear examples showing how shipment terms are used in bid evaluation.

50. *The Department of Management accepted recommendation 9 stating that as part of the procurement training programme, all procurement staff at headquarters will receive training on INCOTERMS. Clear understanding of these terms will help Procurement staff to develop cost models and to evaluate the different options possible. Further guidelines to improve evaluation will be included in the next version of the Procurement Manual. Recommendation 9 remains open pending the completion of the 2008 edition of the Procurement Manual.*

Performance bonds

51. Performance bonds are a form of guarantee, usually issued by a bank or similar financial institution in favor of the United Nations to secure the vendor's performance of a contract. OIOS found that the responsibility and methodology to decide on the amount of performance bonds was not clearly indicated in the Procurement Manual (9.9.13), which states:

“The Procurement Officer shall exercise professional judgment to ensure that adequate safeguards are in place to protect the interests of the Organization”, and, “...the decision to require a bond shall be based on factors such as the contractor’s reputation experience, as well as the cost of the bond weighed against the perceived potential risk to the UN should the contractor fail to perform the contract satisfactorily”.

52. OIOS, however, noted that no formula or methodology had been developed to use these factors for calculating a performance bond amount. The lack of a clear formula or methodology caused inconsistent practices and confusion among procurement officers. Procurement officers also informed OIOS that the performance bonds section of the PM required further clarification. For example, in the case of a system contract for prefabricated buildings (PD/C0074/02) with the NTE amount of \$32,212,680, a \$500,000 performance bond was collected (1.5% of NTE). In another contract for prefabricated buildings (PD/C0105/02) with the NTE amount of €13,541,250, a \$50,000 performance bond was collected which represented only 0.037% of the NTE amount. Considering that the selected vendor was the same for both contracts and the biddings were done in close time proximity, there is no apparent reason for this inconsistency in the amount of the performance bonds. OIOS, therefore, attributed the disparity to the handling the procurement cases by two different procurement officers without sufficient guidance. Moreover, the Procurement Manual (13.6.3 j) states that performance bonds should usually range between 10 to 30 per cent of the contract value.

53. Another area requiring clarification is the base amount used for determining the performance bond. Many contracts are signed for a certain period of time with an option to extend for one or more years. It remains unclear whether the original NTE amount should be used as a base for the initial contract period or whether the performance bond should be adjusted as the NTE amount increases for the whole contract period including the options to extend.

54. OIOS is of the view that PS, in consultation with the Office of Legal Affairs (OLA), should develop a better methodology for establishing the requirement for performance bonds based on commercial best practices incorporating factors such as reputation and previous experience with the company, financial solidity and nature of the contract. The decision whether to collect a performance bond and, if so, in what monetary amount, should be based on this methodology. The goal of the review should be to address the current confusion regarding performance bonds and to standardize the practice of collecting performance bonds.

Recommendation 10

(10) The Department of Management should develop a risk assessment methodology to determine the requirement for and value of a performance bond, incorporating evaluation factors such as vendors’ past experience with the

United Nations, financial solidity, nature of the contract, etc. The Procurement Manual should be updated accordingly and guidance provided as to whether the base amount of the performance bond should be the initial contract value or the whole contract value when options to extend are used.

55. *The Department of Management accepted recommendation 10 stating that the Department was currently reviewing its policy on the use of performance bonds. DM will consult with the Office of Legal Affairs in regard to the liability aspects of the revised performance bond policy. The outcome of this revision will affect the terms and conditions of the bid module documents which will be revised in June 2008. Recommendation 10 remains open pending the issuance of the revised performance bonds policy.*

Performance bond not collected for a current contract

56. OIOS found that a performance bond with a value of \$6.8 million was not collected for the \$34 million contract for generators (PD/C0034/06). Taking into account the fact that this is a new systems contract with the vendor, and the first deliveries of the 500 KVA generators were substandard and unacceptable, the performance bond should be collected. A performance bond of \$6.8 million was collected after OIOS requested DM to take immediate action on the pending performance bond identified during the audit.

Recommendation 11

(11) The Department of Management should ensure that the collection of performance bonds is closely monitored and immediate actions are taken when the use of the bond is warranted.

57. *The Department of Management accepted recommendation 11 and stated that the collection of performance bonds was being monitored by case officers and action was taken, when necessary. The Department of Management is preparing a letter reminding staff of the requirement to obtain performance bonds from the vendors and an advice from OLA on whether the contract performance justifies the use of the bond. Recommendation 11 remains open pending OIOS' receipt of a copy of DM's reminder letter on performance bonds to be circulated to staff involved.*

Direct Purchasing Agreements

58. Based on discussions with PS, OIOS was informed that three Direct Purchasing Agreements (also known as Direct Marketing Agreements) were used as a contractual arrangement with an NTE amount, although they were not considered as systems contracts. OIOS reviewed one of those agreements during the audit noting that the vendor, CISCO, had a large contract with an NTE amount of \$90 million. The language of the agreement was similar to that of systems contracts but due to the specialized nature of the items supplied and the delivery of goods to the United States, the contract was defined as a Direct

Purchasing Agreement. However, neither the Procurement Manual nor the UN Procurement Practitioner's Handbook mentioned this form of contractual arrangement. In OIOS' opinion, for clarity and consistency in using various forms of contractual arrangements, the Procurement Manual needs to be revised accordingly.

Recommendation 12

(12) The Department of Management should amend its Procurement Manual to include the definition, purpose and procedures for use of Direct Purchasing Agreements.

59. *The Department of Management accepted recommendation 12 stating that the term "Direct Purchasing Agreement" refers to situations where the agreement is executed directly by the manufacturer and the customer rather than the situation where products are distributed through different sales channels such as distributors or re-sale partners. The recommendation will be addressed in the next version of the Procurement Manual which will be finalized by September 2008. Recommendation 12 remains open pending the completion of the 2008 edition of the Procurement Manual.*

Production capacity of vendors

60. The main rationale behind establishing a systems contract is to reduce time-consuming contracting and to obtain better prices through economies of scale. Therefore, the vendor's production capacity can be critical to meeting the needs of the Organization.

61. OIOS found that there was no systematic evaluation of vendor production capacities regarding systems contracts. For example, Corimec SPA Italiana was awarded two contracts on single module and multi-module prefabricated buildings, however, there was no evidence that an assessment of their production capacities had been made. Due to frequent delays in deliveries of the prefabricated modules to the missions, DPKO (DFS since July 2007) had to coordinate and define the priorities of missions because of vendor capacity limitations. However, some missions were not satisfied with the production and delivery schedule and sought to do their own procurement of prefabricated buildings. For example, MINUSTAH requested local procurement authority to find another vendor and ONUCI and ONUB asked for the revision of delivery priorities on the basis that their operational deployment schedules could be significantly delayed. ONUB further stated that the delay in providing accommodations for the troops cost \$309,940 per month for using alternate accommodations.

62. Similarly, in a 29 July 2005 memo addressed to OPPBA, FMSS (FBFD since July 2007) explained the retention of unliquidated obligations pertaining to the 2003-2004 fiscal year stating that:

“...POs 15217, 16329 and 16597 were raised in November 2003 and June 2004 for prefabricated buildings for SDS replenishment to be

supplied by the vendor Corimec SPA under a systems contract. These goods were manufactured with significant delay and are now expected to be received in September and October 2005. Their production was deferred because the manufacturing capacity of the vendor was limited and priority was given to expanding and start-up missions.”

OIOS is of the view that late deliveries due to production capacity limitations (within the provisions of a given contract) is unacceptable since one of the main reasons for establishing a systems contract is to reduce delivery lead times.

Recommendation 13

(13) The Department of Management should ensure that production capacities of critical suppliers are assessed before awarding a systems contract. The assessments should be performed by third party experts or the capacity reports should be verified by authorized third parties.

63. *The Department of Management did not accept recommendation 13 stating that the recommended procedure would be costly and time-consuming and would negatively impact delivery rates. Thus, it is not feasible from an operational perspective. Furthermore, it is unclear from this recommendation whether DM is being called upon to assess all suppliers considered for each systems contract. Assuming that this assessment is recommended to be performed prior to the bidding exercise, DM wishes to advise that the relevant bidding procedure may be perceived as unfair and lacking transparency. Assessment of production capacities of suppliers should also be determined on a case by case basis and should be done internally; it should not be outsourced.* OIOS would like to clarify that it recommends assessing the production capacity of a proposed awardee before the award of contracts. In OIOS’ opinion, due diligence assessment will give reasonable assurance that the vendors will have the capacity to deliver goods or services in accordance with agreed terms. OIOS reiterates the recommendation and requests DM to reconsider its response. Recommendation 13 will remain open pending its implementation and providing OIOS with documentation supporting that assessments of vendors’ capacities have been conducted.

C. Internal Controls

64. OIOS reviewed the internal controls in the Procurement Service to determine if they were adequate and if the staff was aware of them and their intended purpose. In general, the Procurement Manual notes at the outset that the United Nations Financial Regulations and Rules govern procurement activities, especially Regulation 5.12 that states that the following general principles shall be given due consideration when exercising the procurement function:

- Best value for money;
- Fairness, integrity and transparency;
- Effective international competition;
- The interest of the United Nations

OIOS further noted that the Procurement Manual incorporated basic internal controls including the separation of duties between the requisitioning and procurement function, the vendor registration and database system, the solicitation process including the requirement to invite a minimum number of vendors based on contract size and equitable geographical representation of vendors.

IT system controls

65. OIOS' review of databases used to process information concerning existing systems contracts found that the IT systems used to monitor and administer systems contracts were fragmented in DFS, PS and field missions. DFS is using a systems contract database (LSD database), which is accessible through Lotus Notes in the field. However, this database has the following shortcomings:

- It is manually updated, has a risk of human errors and might not be updated on a timely basis; and,
- It does not show the actual expenditures.

OIOS found that there were only 64 systems contracts in the LSD database as of the audit date, whereas the actual number in the PS database was 150 systems contracts. This difference proved that not each entity was using and updating this database.

66. The Procurement Service is also using a separate contract tracking system and updating it on its Intranet website. The advantage of this database is that it has a link to the Mercury system which is the field procurement database. Therefore, the actual expenditures are reflected in the Mercury System with a 24-hour delay, and the contract information such as a copy of contract, amendments to contracts, etc. were available to the missions. However, there are two major shortcomings. First, the contract details are entered manually by the General Administration Unit of PS, and second, there might be delays or oversights in updating the system.

67. For example, OIOS found that only the second amendment for the contract PD/C0105/02 was available in the system, whereas there were in fact six amendments to the original contract. OIOS was also informed that there were backlogs in the work of this unit due to high volume of work and understaffing. Second, all details of a contract, including the prices, discounts, etc. are disclosed on the Intranet (accessible by all UN agencies). OIOS was informed that the full disclosure of contract information was requested by the Department of Management for the purpose of transparency. However, in order to protect the interests of the Organization, OIOS believes that OLA should be consulted to review if this practice is in the best interest of the Organization.

68. The prices in a contract are either fixed during the term of the contract or indexed to certain references. However, prices can be revised by an amendment to the contract. OIOS concluded that there was no systematic control and

monitoring of prices actually charged by vendors to ensure that they comply with the contract terms. For example, ONUCI had to allocate additional funds and revise the original PO after learning that the price of the containers for prefabricated buildings had been increased (Invoice no.242/05 and PO 6OCI-300109). The reason was that an amendment made to the contract increased the price of sea containers; however, the mission was not aware of it. OIOS was informed that procurement officers occasionally checked the prices while raising POs at Headquarters, but it was not done systematically and there were no copies of invoices in the procurement files.

Recommendations 14 and 15

(14) The Department of Management should consult with the Office of Legal Affairs on the issue of providing full details of existing procurement contracts on the Intranet and consider more secure data access controls for the authorized users in order to protect the interests of the Organization.

(15) The Department of Management in cooperation with the Department of Field Support should develop an internal control mechanism to ensure that all contracts and amendments are posted to a database that can be accessed by the field missions so that they are aware of changes in contract prices.

69. *The Department of Management acknowledged that there were legal and policy considerations relevant to the publication of details of procurement contracts on the Intranet, but emphasized that very limited contract details were provided on either the Intranet or the Extranet. DM confirmed that the technical specifications and contract documents were accessible to authorized users (procurement staff) in the field missions via Mercury, the application used by field missions. The feasibility of developing more secure data access controls depends on technical capability. DM will consult with the Information Technology Services Division (ITSD) rather than OLA, in order to determine whether ITSD can provide secure Intranet access to such information to users in the peacekeeping missions and other locations. While OIOS acknowledges DM's response and intent to consult with ITSD on the Intranet access controls, OIOS still believes that the issue needs to be addressed to OLA to ensure that the interests of the Organization are protected. OIOS would like to advise that in accordance with the International Standards for the Professional Practice of Internal Auditing, senior management may decide to assume the risk of not correcting the reported condition because of cost or other considerations. In this regard, OIOS has closed recommendation 14; however, the risk and consequences related to the non-implementation of this recommendation rest with the DM management.*

70. *Regarding recommendation 15, the Department of Management commented that it has already developed an internal control mechanism for the posting of contracts, the Mercury system, accessible by field missions. The Department of Management is currently revising the procedures governing the*

use of this database and will implement measures to ensure that contracts and amendments are posted to the Mercury system in a timely manner and that related contracts are grouped together for easy reference. The Department of Field Support also accepted recommendation 15 and stated that it currently relies on its own LotusNotes based databases, yet would benefit from an integrated database with the Procurement Service that can be accessed by the field missions. Recommendation 15 remains open pending DM's revision of the procedures governing the use of the integrated databases and setting the requirement for the timely posting of the contracts and amendments to the Mercury system.

Monitoring NTE limits in systems contracts

71. The NTE limit of systems contracts serve as a control point. By monitoring the actual expenditures against a contract's NTE limit, actions are taken to obtain authorization to increase the NTE amount or do a new bidding. In this regard, there is a provision in the contracts requiring the contractor to provide a written notice to the UN when the value of the POs issued by the UN reaches 75 per cent of the NTE. PS and DFS also developed an internal control mechanism such that the Mercury system will not allow the issuance of a purchase order when 75 per cent limit is reached, unless authorized by PS. However, there is a control gap in this feature such that the missions might not click on the 'systems contracts' button but 'regular contracts' button in the Mercury system, when raising a purchase order thereby by-passing the controls. OIOS found 50 such POs not shown in the Mercury system, which had to be later added manually by UNLB. It is likely that the reason for this was choosing the incorrect option in the system. Some examples of these POs are shown in Figure 6.

Figure 6. Manually processed Pos

Contract	PO Ref Number	Amount (\$)
PD/C0306/04	5MIL-200783	686,507
PD/C0303/04	5NUB-205646	142,976
PD/C0198/04	5NUB-205448	1,383,480
PD/C0198/04	5HSA-200342	247,050
PD/C0099/03	5MIS-752	543,070
PD/C0074/02	5NUB-205553	6,041,647
PD/C0074/02	5MIS-805	2,073,415
PD/C0105/02	3KIN-200013	874,800*

(* in Euro)

72. The NTE for the contract for prefabricated buildings (PD/C0074/02) was exceeded because of the reason explained above. In a communication addressed to the contractor dated 12 September 2005, the procurement officer requested that:

“The situation looks worse than what we had thought yesterday in that we are actually over and above the approved expenditure for this contract. On our side, we have to give explanation to senior management highlighting how we came to such. It would

be appreciated if the expenditure information could be provided as per the sample.”

As of 15 September 2005, actual expenditures were \$52,768,425 while the NTE limit was \$52,169,509 for this contract. Similarly, actual expenditures were €13,645,523 for the contract PD/C0105/02 as of 14 October 2005 while the NTE was €13,541,250, and the NTE limit was once again exceeded by €800,000 as of 25 April 2006.

73. OIOS found that there were other cases when NTE amounts were exceeded, as shown in Figure 7. As of the audit date, these included the following:

Figure 7. Contracts with NTE amounts greater than 100 per cent

Contract No.	Subject	Start Date	Expiry date	NTE Amt (in US\$)	Expenditure (in US\$)	% of NTE
PD/C0105/02	Prefab buildings	10-Jul-02	31-Dec-06	17,764,556	20,049,194	113%
PD/C0105/03	Lease of photocopiers	19-May-03	18-May-08	4,926,957	7,376,881	150%
PD/C0138/04	Galvanized barbed iron	29-Jun-04	28-Jun-07	1,854,200	2,022,503	109%
PD/C0069/03	Night vision binoculars	01-May-03	30-Apr-07	1,614,760	1,634,396	101%
PD/C0149/06	Dormitory equipment	15-Sep-06	14-Aug-09	1,208,150	1,398,073	116%

74. The HCC, in its meeting on 25 April 2006 (HCC/06/27), commented that the discrepancies between PS and vendor’s expenditure records were a result of the lack of a uniform and robust database or system that would allow the users to track aggregate systems contract expenditures for internal control purposes. The HCC further stated that the UN does not have control of expenditure information for such high value contracts and relies on the good will and recordkeeping of contractors to reconcile expenditures.

Recommendation 16

(16) The Department of Management should closely monitor NTE amounts and establish internal controls to ensure that NTE amounts are not exceeded.

75. *The Department of Management commented that it closely monitored NTE amounts and provided weekly reports to Team Leaders to eliminate the risk of exceeding NTE amounts. Three levels of internal control were employed by assigning responsibility to the vendor, DM itself and to the contract manager. DM aspires to maintain the highest level of internal control and expressed the desire that an integrated IT system would facilitate more robust control. This would eventually take place with the introduction of the ERP system forthcoming. In the interim, DM noted that the introduction of the Mercury system and the development of an interface between the Procureplus and the Mercury systems*

for the exchange of data between the field missions and HQs was a useful internal control measure. The success of this control was dependent on buyers placing purchase orders in the Mercury system rather than in the LSD contract database. DM further stated that it would send a letter to DFS by 31 December 2007 requesting that buyers be reminded to ensure that purchase orders under systems contracts should be processed in the Mercury system rather than in the LSD contract database and that DFS promote compliance with this request. Recommendation 16 remains open pending OIOS' receipt of a copy of DM's request to DFS on processing systems contracts purchase orders in the Mercury system.

76. OIOS also found that three other contracts reviewed had been signed many months after contracts were put in place which exposed the Organization to potential legal risk if contractual violations took place prior to signing of the contracts. Figure 8 shows three such instances in the sample of 12 contracts reviewed indicating a high likelihood that other contracts might not have been signed prior to becoming active.

Figure 8 Contract signed late

Vendor	Item	NTE amount (USD)	System contract start period	Contract Signature Date
CISCO	Com. Equip.	90,000,000	01/03/2003	20/02/2004
GTSI Corp	UPS	1,997,400	15/09/2005	30/05/2006
Lan Lee Int.	UPS	527,160	15/09/2005	15/05/2006

Recommendation 17

(17) The Department of Management should ensure that systems contracts are signed before the vendors start the delivery of goods/services.

77. *The Department of Management agreed in principle and advised that this is normal practice; however, some exceptions may be warranted due to exigencies. DM stated that no further action was required in the cases cited by OIOS, and, therefore, requested that this recommendation be closed. Based on DM's response, OIOS has closed recommendation 17. However, the risk and consequences related to delivery of products with unsigned contracts rests with the DM management.*

Blood supply systems contract

78. OIOS noted that since September 2005, a systems contract for supply of blood units to support medical clinics in the peacekeeping missions had been planned with protracted negotiations between the PS and DFS. Despite the exchange of correspondence including clarification of the RFP by DFS to include improved safety requirements including temperature sensitive labels, at the time of the audit no systems contract had been finalized. As a result, individual missions had to rely on direct contracting with the vendor which may negate the advantages of a systems contract including improved oversight over the delivery of this highly important commodity for the peacekeeping missions.

Recommendation 18

(18) The Department of Management should expedite on an urgent basis the arrangement of the systems contract for the supply of blood due to the specialized and critical nature of blood units required for peacekeeping missions.

79. *The Department of Management commented on recommendation 18 that the reasons for the delay were not attributable to DM and that the reasons were documented in the case file. DM has now received the advice of OLA and the consequential advice of the Controller on this issue. As such, DM is negotiating the contract at this time, based on the advice received. DM wishes to note that the delays occurred outside of DM. Further, pending the execution of the systems contract, DM had authorized the missions to purchase blood supplies under local procurement authority. DM was currently negotiating the contract for the supply of blood and, given these circumstances, DM considers that the recommendation is not warranted and should be withdrawn.* OIOS noted the response and was of the opinion that the processing of this contract since September 2005 took an unacceptably long period of time. Recommendation 18 remains open pending DM's confirmation that the systems contract for the supply of blood has been signed.

Vendor's non-compliance with contract terms

80. OIOS noted that in the case of a systems contract for prefabricated buildings (PD/C0074/02), the vendor was not satisfied with the prices of the existing systems contract due to the increase in raw material prices in the market. The vendor notified the UN on 17 February 2005 that they would not accept any new purchase orders unless the prices of the systems contract were increased. During the period of negotiations between PS and the vendor regarding the price increases, ONUB sent a memo directly to the vendor stating that if their order was completed prior to the finalization of negotiations, ONUB would consider the vendor's adjusted price schedule and refer the case to HCC through LCC since this would be a purchase outside of the systems contract terms and conditions. ONUB further indicated that they wanted to ensure that the scheduled completion of ONUB's integrated mission headquarters in Bujumbura was not delayed due to Corimec SPA's failure to honor the original contract. Although OIOS noted that this initiative was intended to avoid further delays in construction of ONUB headquarters, it contradicts procurement procedures. Referring to this letter, DM correctly criticized ONUB mentioning that ONUB's suggestion that they might unilaterally accept the Corimec SPA's request for price increase was undermining the negotiations for all peacekeeping missions. OIOS believes that such communications have encouraged the vendor to insist on price increases, although it was in breach of the contract terms.

81. Relating to the same issue, even though the price was fixed and there were still four months to the expiry of the contract with a \$9,563,588 unused amount, the contract was extended on 4 April 2005 for another year with increased prices, which cost the UN an additional \$1,434,538. In OIOS' opinion, the vendor was bound by the contract terms and had no legal right to demand a

price increase. The Procurement Service should have used the performance bond unless the vendor agreed to abide by the contract terms. Furthermore, the price increase was a precedent for other vendors to use, and this risk was emphasized in an e-mail communication within DMS by a procurement officer.

Recommendation 19

(19) The Department of Management and the Department of Field Support should better coordinate their approach in disputes with vendors to ensure a unified position of the Organization in business negotiations and utilize performance bonds, if warranted, in cases where there is a breach of contract terms by the vendors.

82. *The Department of Field Support agreed with recommendation 19 commenting that this type of negotiations, as referred to in paragraph 80 of this report, should be agreed upon between Headquarters and field missions. Missions should seek permission from Headquarters to negotiate terms outside of existing systems contracts. As such, a unified approach would be ensued. DM also commented that it agreed that a unified approach to the resolution of disputes was desirable within the Organization. DM further stated that it was not in a position to prevent the dispatch of a memo to the vendor, which was not in compliance with procurement procedures.*

83. *As regards the liquidation of performance bonds, DM has received legal advice stipulating that this measure is a last resort in the event that other avenues of dispute settlement are exhausted. Particularly, in the case of operations such as peacekeeping, delivery of services is crucial. The liquidation of a performance bond does not guarantee the provision of the required services and may, on the contrary, lead to protracted and costly legal proceedings. DM will therefore obtain the advice of OLA on a case by case basis, prior to the liquidation of any performance bond. Based on the response from DM and DFS, recommendation 19 has been closed.*

Extra charges

84. The contractor for prefabricated buildings (PD/C0074/02 and PD/C0105/02) charged the UN \$197,040 in additional costs (stocking costs) for the late pick-up of the goods by the UN freight forwarding agent. OIOS found that the systems contract did not have any provision regarding charging of additional costs when goods are ready for delivery and not picked up in a timely manner.

85. OIOS concluded that this was a result of poor planning and coordination in placing orders and arranging shipments. The order was placed on an FCA basis, therefore, the United Nations had to arrange shipment of goods to the destination. However, the shipping agency did not pick up the prepared orders on time. There were many complaints on the vendor side as they had the limited capacity to stock containers and they charged the United Nations extra costs

because of late pick-ups. OIOS found five invoices totaling \$197,040 charged for stocking costs.

Recommendation 20

(20) The Department of Management should ensure that contractual terms fully protect the interests of the Organization and that coordination with shipping agencies is well organized in order to avoid additional costs and delays in the pickup and delivery of goods.

86. *The Department of Management accepted recommendation 20 and noted that this was standard practice. For further improvement, DM has provided procurement training to its operational staff in September 2007. In addition, DM has established the position of Contracts Officer and is currently creating a Contracts Unit to enhance contract drafting proficiency.* Based on the response from DM, recommendation 20 has been closed.

Source selection strategy

87. The Procurement Manual defines the source selection plan as an objective methodology for selecting the best source to fulfill an established need. Depending on the complexity of the acquisition, it may be summarized in a few lines, or consist of long and precise descriptions of the evaluation steps necessary to ensure best value to the Organization.

88. OIOS found that source selection plans were not clearly defined and documented for systems contracts. OIOS concluded that, in some cases, there was no clear strategy and advance planning for procurement action.

89. The systems contract for 250, 500 and 750 KVA generators is a good example for this observation. The deadline for RFP for 250, 500 and 750 KVA generator sets was 24 May 2005. The technical evaluation was completed on 20 July 2005, and the commercial evaluation was done on 26 July 2005. However, an internal PS memo dated 27 September 2005 listed various options for awarding the contract including: (i) make full award to the lowest overall bidder (Kangle); (ii) make full award to the lowest overall bidder (Kangle) and set up a back up contract with the second lowest bidder (Johs-Gram-Hanssen) with the latter being operational only if determination is made that the lowest bidder cannot meet the operational/contractual requirements for whatever reason; (iii) split the award between the lowest bidder (Kangle) and second lowest bidder (Johs-Gram-Hanssen) based on equal quantities for all range of generators; and (iv) split award to individual lowest bidder for each range of generators (250 KVA to Johs-Gram-Hanssen and 500 and 750 KVA to Kangle).

90. In DM's internal e-mail, the procurement officer quoted that "DPKO has no expressed requirement of a split-award, not even for strategic supply reasons. This occurred despite the recent experience with the PCP contract which required a back-up solution due to poor initial product quality despite initial prototype inspection. I believe there are operational risks associated with 100 per cent

award to a new vendor for a commodity of this nature, especially in the light of the above unknown issues.” The OIC of DM also refuted the proposal for splitting or establishing a back up contract.

91. Based on these facts, OIOS is of the opinion that before the tender process had commenced, there was no clear strategy in place regarding the decision to award a contract. As of the audit date, OIOS was informed that the awarded contractor’s first deliveries to UNLB were substandard and not accepted by UNLB.

Recommendation 21

(21) The Department of Management and the Department of Field Support should ensure that the source selection plans are properly prepared in accordance with the Procurement Manual.

92. *The Department of Management accepted recommendation 20 for the cases of major acquisitions. DM has already included the elements of this recommendation in its revised definition of Best Value for Money in the Procurement Manual. Based on DM’s response, recommendation 21 has been closed.*

V. ACKNOWLEDGEMENT

93. We wish to express our appreciation to the Management and staff of the Procurement Service of the Department of Management and the Logistics Support Division of the Department of Field Service for the assistance and cooperation extended to the auditors during this assignment.

STATUS OF AUDIT RECOMMENDATIONS

Recom. no.	C/O ¹	Actions needed to close recommendation	Implementation date
1	O	Results of DFS' review and development of planning tools to forecast future requirements.	Ongoing
2	O	DM's sending a reminder to the field missions concerning timely preparation and submission of performance reports.	31.12.2007
3	O	The traffic light reporting format is developed and utilized by DFS.	Ongoing
4	O	DM's issuance of a reminder to the buyers at HQs and field missions about the requirement to perform "due diligence" market research prior to the execution of contract amendments.	Ongoing
5	C	Completed.	Implemented
6	O	OIOS reiterates recommendation 6 and will keep it open pending the issuance of DFS' reminder to field missions about the requirement to make payments in accordance with contractual terms.	
7	C	Completed.	Implemented
8	O	Completion of the 2008 edition of the Procurement Manual.	30.09.2008
9	O	Completion of the 2008 edition of the Procurement Manual.	30.09.2008
10	O	DM's providing OIOS with a copy of the revised performance bonds policy and submission of related documentation to OIOS.	30.06.2008
11	O	DM's providing OIOS with a copy of the reminder on the use of performance bonds to be circulated to staff involved.	Ongoing
12	O	Completion of the 2008 edition of the Procurement Manual.	30.09.2008
13	O	OIOS reiterates recommendation 13 and requests DM to reconsider its response. Recommendation 13 will remain open pending DM's providing OIOS with documentation supporting that assessments of vendors' capacities have been conducted.	
14	C	Recommendation 14 has been closed with DM's assuming the risk of non-implementation	
15	O	DM's providing OIOS with a copy of the revised procedures governing the use of the integrated databases and setting the requirement for the timely posting of the contracts and amendments to the Mercury system.	31.12.2008
16	O	DM's providing OIOS with a copy of its request to DFS on processing systems contracts purchase orders in the Mercury system.	31.12.2007
17	C	Completed.	Implemented
18	O	DM's confirmation that the systems contract for the supply of blood has been signed.	Ongoing
19	C	Completed.	Implemented
20	C	Completed.	Implemented
21	C	Completed.	Implemented

1. C = closed, O = open

UNITED NATIONS



OIOS Client Satisfaction Survey

Assignment Title: Audit of Systems Contracts

Assignment No.: AP2006/600/02

	1	2	3	4	5
By checking the appropriate box, please rate:	Very Poor	Poor	Satisfactory	Good	Excellent
1. The extent to which the audit addressed your concerns as a manager.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The audit staff's understanding of your operations and objectives.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Professionalism of the audit staff (demeanour, communication and responsiveness).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. The quality of the Audit Report in terms of:					
• Accuracy and validity of findings and conclusions;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Clarity and conciseness;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Balance and objectivity;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Timeliness.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. The extent to which the audit recommendations were appropriate and helpful.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. The extent to which the auditors considered your comments.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Your overall satisfaction with the conduct of the audit and its results.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please add any further comments you may have on the audit process to let us know what we are doing well and what can be improved.

Name: _____ **Title:** _____ **Date:** _____

*Thank you for taking the time to fill out this survey. Please send the completed survey as soon as possible to:
 Director, Internal Audit Division, OIOS
 By mail: Room DC2-518, 2 UN Plaza, New York, NY 10017 USA
 By fax: (212) 963-3388*