OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/PAKISTAN'S LIVELIHOOD DEVELOPMENT PROGRAM FOR THE UPPER REGION OF THE FEDERALLY ADMINISTERED TRIBAL AREAS

AUDIT REPORT NO. G-391-11-002-P
DECEMBER 10, 2010

ISLAMABAD, PAKISTAN

Office of Inspector General

December 10, 2010

MEMORANDUM

TO: USAID/Pakistan Mission Director Acting, Denise Herbol

FROM: Office of Inspector General/Pakistan, Audit Manager, Michael Hutchinson /s/

SUBJECT: Audit of USAID/Pakistan's Livelihood Development Program for the Upper Region of the Federally Administered Tribal Areas (Report No. G-391-11-002-P)

This memorandum transmits our final report on the subject audit. In finalizing the report, we considered your comments on the draft report and included your response, without attachments, in Appendix II.

The report contains five recommendations to help the mission improve various aspects of the program. On the basis of your written comments, we determined that final action has been taken on two recommendations, and management decisions have been made on the remaining three recommendations. Please provide the Audit Performance and Compliance Division in the USAID Office of the Chief Financial Officer (M/CFO/APC) with the necessary documentation to achieve final action on the recommendations.

I want to thank you and your staff for the cooperation and courtesies extended to us during this audit.

U.S. Agency for International Development
American Embassy, Diplomatic Enclave
Ramna 5, Islamabad, Pakistan
www.usaid.gov/oig

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SUMMARY OF RESULTS

The Federally Administered Tribal Areas (FATA) of Pakistan, with an estimated population of 3.1 million, has high unemployment, widespread poverty, and separate legal structures. Located in northwestern Pakistan, FATA shares its rugged and mountainous border with Afghanistan. Extremist and terrorist groups take advantage of the geographic and social isolation and lack of governing systems to exert their influence on the people of this region. According to the Government of Pakistan (GOP), a development lag keeps this region in a perpetual state of poverty, conflict, and isolation.

Development in FATA has become vital to Pakistan's progress in fighting insurgents. Whereas only 1 percent of U.S. funding went toward development in FATA from 2002 through 2007, in September 2007, the U.S. Government and the GOP prepared a development program that supports Pakistan's Sustainable Development Plan for FATA. As part of this joint effort, in 2008 USAID/Pakistan initiated the $300 million Livelihood Development Program (LDP) to address the problems in FATA and neighboring Khyber Pakhtunkhwa (formerly known as the North-West Frontier Province).[1]

The main goal of the Livelihood Development Program is to provide social and economic stabilization in FATA to counter the growing influence of extremist and terrorist groups. LDP is a community-based program to improve living conditions and opportunities for residents of selected communities. The program was structured with an initial focus on youths aged 14–30, but the program has broadened its focus. Program implementers coordinate with the mission's strategic partners: GOP officials, political agents, the FATA Secretariat, the FATA Development Authority, and community and tribal leaders. According to USAID/Pakistan, increasing incomes and generating employment are important undertakings to counter the growing influence of extremist and terrorists groups in FATA.

On April 30, 2008, USAID/Pakistan signed a 5-year, $150 million cooperative agreement with a U.S.-based nongovernmental organization for work in upper FATA.[2] As of June 2010, the program for upper FATA had expended $46.8 million of the $60 million obligated. USAID also signed a cooperative agreement with another U.S.-based nongovernmental organization that covered the remaining ("lower") FATA. The program has three components:

- Creating jobs, increasing incomes, and teaching employable skills with a focus on unemployed youth.
- Revitalizing community infrastructure and essential services.
- Supporting established businesses and developing new sustainable businesses.

[1] When the cooperative agreement was signed, Pakhtunkhwa was known as the North-West Frontier Province, and all program documentation refers to this area as "NWFP."

[2] The program for upper FATA covers the three tribal agencies of Bajaur, Mohmand, and Khyber as well as areas around Peshawar formerly known as the Frontier Region Peshawar and NWFP Peshawar.

After a review of the first 2 years of activities, OIG/Pakistan found that the program has not achieved its main goal of social and economic stabilization to counter the growing influence of extremist and terrorist groups in upper FATA. The mission had no baseline data to determine progress toward countering the influence of these groups. In addition, the program had executed only 53 percent of planned activities, and program outcomes were weak. Security issues and allegations of wrongdoing overshadowed and impeded program progress. Other factors directly affecting the program included a change in focus toward humanitarian and disaster assistance and the announcement of a shift in U.S. Government strategy toward including more Pakistani institutions in program implementation.

Security issues were the main cause of the poor performance. Specific incidents included the assassination of the chief of party for lower FATA's implementer, the kidnapping of an aid worker, and threats to monitoring teams. Throughout FATA, armed conflict and acts of terrorism increased during this period, limiting access to many areas. In November 2008, after the assassination, all senior staff for U.S.-based organizations relocated from Peshawar to Islamabad at the request of the U.S. Embassy. Implementers found that operating the program from a distance under tight security constraints created problems, including increased security and operational costs, yet the program budget did not increase.[3]

Allegations of wrongdoing also impeded progress. The implementer stated that program activities were delayed because the implementer had to counter allegations and because of additional tiers of oversight put in place to ensure greater accountability. The implementer changed management and dismissed some of its contractors. Nevertheless, during audit fieldwork USAID/Pakistan terminated the cooperative agreement for upper FATA on June 4, 2010. USAID stopped all work at that point to determine the effect of the contractor's default.[4] OIG investigations continued throughout the audit.

Two additional factors contributed to program delays. First, USAID/Pakistan used program resources to provide humanitarian and disaster assistance to flood victims and internally displaced persons fleeing conflict areas of FATA. The assistance began in August 2008, only months after the upper FATA program started, and continued until the implementer's termination. Mission officials acknowledged that the work diverted time and resources from LDP activities. USAID/Pakistan provided no additional funding to cover the costs. Approximately $7.9 million was attributed to this work. Second, in September 2009 the U.S. Department of State (State Department) initiated a shift in strategy toward using more Pakistani institutions to implement USAID programs. During this time, all USAID/Pakistan incremental funding requests went through the State Department for approval. The delays in incremental funding created more budgetary problems for the program.[5] Furthermore, relying on directions from mission staff, the

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[3] USAID/Pakistan requested and approved security enhancement plans with adjusted budget requests from LDP implementers, but the implementers never received the approved funding.

[4] At the time of this audit, USAID/Pakistan intended to resume program work in upper FATA with other implementers.

[5] USAID/Pakistan documents show that, because of monthly spending rates, the LDP implementers were under budgetary constraints caused by the State Department's approval process for incremental funding.

implementer reduced or entirely eliminated many LDP activities because of uncertainty about future funding for the program. A mission official noted that the directions were erroneous and should not have been issued to the implementer. FATA community leaders and the Government of Pakistan had selected many of these activities.

USAID/Pakistan officials commented that program implementers had engaged in heroic work for the people of FATA, despite the many problems and obstacles. The following are two examples of livelihood activities that, although small in terms of dollars, produced quick and tangible results. Furthermore, these activities made some progress toward bringing women into the mainstream development process in a region where cultural constraints often limit women's involvement.

Literacy Centers. The implementer's reports show that approximately $336,286 was spent toward enhancing literacy and numeracy skills for 8,026 males and 3,231 females in upper FATA. With an average family size of 10 children and a 3 percent literacy rate for women, the potential effect of teaching parents to read and write can be critical. According to the implementer, low literacy is the single factor most likely to cause insurgency to rise within FATA. In response, the program established 454 literacy centers and employed 341 male teachers and 113 female teachers.

Agriculture. After 2 years, 2,639 farmers had improved agricultural yields and successfully gained higher prices for their produce as a result of extension and marketing efforts that cost approximately $261,000. The poorest families in upper FATA earn their living from small farms as sharecroppers or through agricultural wage labor. Women of FATA provide much of the labor for agriculture, although their contribution is not officially recognized. LDP focused development efforts on land areas with higher potential yields. Farmers planted selected cash crops that they could sell directly to markets outside of FATA. This value-chain approach optimized the farmers' return on capital and labor. Farmers also took opportunities to sell their produce collectively through farm service centers or other marketing associations.

Despite these encouraging successes, overall progress for program activities was slow, largely because of the intervening factors already mentioned. Although some factors were beyond USAID/Pakistan's management control, USAID/Pakistan needs to address the following problems that are within its control:

- **Staff overrode management controls.** USAID/Pakistan staff did not follow management controls. Technical staff in the mission addressed contractual matters that should be handled only by the agreement officer or took action without proper approvals. Clearly articulating lines of authority, responsibility, and accountability will help prevent staff from acting outside their authority. (See page 5.)

- **Overreliance on contractors created risks.** USAID/Pakistan relied on contractors to perform services closely related to inherently governmental functions. A third-party contractor's conflict of interest in overseeing another contractor's work created risks when the mission did not address the gap in services created by the conflict. Furthermore, a PSC contractor on which the mission relied to perform important contract management functions for the $300 million program was terminated for ethical violations. The mission needs to heighten the level of scrutiny of third-party contractors who monitor other contractors. The mission should also supervise PSCs closely as they perform contract management functions. (See page 7.)

- **Communications and planning for shift in strategy fell short.** The announcement of the shift in strategy to de-emphasize the use of U.S.-based contractors in Pakistan affected LDP operations because the staff misconstrued information and reacted without authorized plans from the mission. USAID/Pakistan needs to plan for the transition and communicate its plans to implementers, the FATA Secretariat, and the FATA Development Authority. (See page 10.)

In consideration of our audit findings, we recommend that USAID/Pakistan take the following actions:

1. Develop and implement a periodic training program for mission staff that clearly defines the authority, responsibility, and accountability of agreement officers, technical representatives, and program staff, including their communications with implementers, to support effective management. In addition, the training program should be available on the Intranet for rotating staff to review in the interim between training sessions. (See page 7.)
2. Develop a plan, in compliance with Federal Acquisition Regulation 37.114 and the Office of Management and Budget (OMB) guidance to provide proper oversight and management of contractors that support contract and agreement administration. (See page 10.)
3. Analyze the mission's internal capability for control and management of contractors working on the Livelihood Development Program, taking into account the goals of the program, the complexity of the work, the need for specialized skills, and the effect of contactor default on the program performance. Further, use this analysis as a template for the mission. (See page 10)
4. Develop and implement a mission workforce plan with guidelines for the consideration of using more U.S. federal personnel (known as U.S. direct hires) for positions involved in services closely associated with inherently governmental functions. (See page 10.)
5. Develop and implement definitive plans for the Livelihood Development Program regarding the shift toward more direct funding to Pakistani institutions, including incremental funding, budgets, transition plans, and any other information that requires modifications of relevant agreements and contracts. Further, designate appropriate personnel to communicate these plans to implementers and the Government of Pakistan. (See page 12.)

The audit scope and methodology are described in Appendix I, and USAID/Pakistan's comments are found in Appendix II.

The OIG evaluation of management comments begins on page 13. On the basis of an evaluation of the mission's response to the draft report, we determined that final action has been taken on two recommendations, and management decisions have been reached on the remaining three recommendations.

AUDIT FINDINGS

Staff Overrode Management Controls

According to the U.S. Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government*, a good management control environment requires that organizational structures clearly define key areas of authority and responsibility and establish appropriate lines of reporting. Controls are also affected by delegations of authority and responsibility for operating activities, reporting relationships, and authorization protocols. Good human capital policies and practices are also critical factors, including a proper amount of supervision. However, GAO notes that factors outside the control or influence of management can affect the achievement of goals. For example, errors of judgment and acts of collusion to circumvent controls can affect objectives. Although management controls cannot provide absolute assurance that all objectives will be met, established controls provide a reasonable assurance of meeting objectives.

Furthermore, management controls should provide reasonable assurance of compliance with applicable laws and regulations. For example, USAID's Automated Directives System (ADS) prescribes that USAID and U.S. Government policy prohibits U.S. officials from acting without proper authority in a way that leads a recipient or potential recipient acting in good faith to believe that USAID has changed the amount of an existing award or revised an existing award budget, program description, or any of the terms and conditions of the award (ADS 303.3.18). Such actions could rise to the level of an unauthorized commitment.

We found that USAID/Pakistan staff overrode management controls by conducting work reserved for the agreement officer, such as administering and making determinations regarding a cooperative agreement, and taking action without authorized approval. For example, in August 2008, shortly after starting work in upper FATA, USAID/Pakistan directed the implementer to provide disaster response and emergency relief services that were not part of the Livelihood Development Program (LDP) scope of work or budget.[6] The services included response to the flood victims in Khyber Agency and response to internally displaced persons coming into the Peshawar region as a result of conflict. At that time, no other U.S. Government response was available in the area, and the mission determined that LDP resources should be used for this work. However, the mission made no revisions to the program to reflect this change in program focus. The work, which spun off into infrastructure activities that extended into the second year of implementation, diverted resources from program activities, changed the scope of work, and affected LDP's budget.[7] The implementer attributed $7.9 million to the disaster and relief work from August 2008 to March 2010.

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[6] The mission still needed to address reported problems with procurements and payments for work.

[7] The implementing partner did receive approximately $225,000 for a volunteer program, but that was a fraction of the amount of resources used for emergency relief.

In another instance, technical staff bypassed proper lines of authority to start work on the Barang-Kot Road (Barang Road) project. USAID staff members stated that they felt “pressure” to complete this road work quickly. This road reconstruction, identified as a priority project by tribal community consensus, is the single largest LDP infrastructure project to date, with an estimated cost of $3.7 million. The Barang Road is a 22-kilometer stretch of road connecting Barang, Bajaur Agency, and Kot, Malakand, and it is considered strategically important for economic development in this region because it links southeastern Bajaur with settled areas. A prior USAID engineer reviewed and approved the preaward cost estimates for construction funding, and the agreement officer approved them. Following up on the award process, a contract engineer in the USAID Peshawar office reviewed design and technical documents for the subcontract work in late July 2009 and discovered several problems, including omissions of important construction contract clauses, missing criteria for the subcontractor’s final evaluation, and the need for verifications related to certain cost estimates.

According to the cooperative agreement, the contracting officer should handle contract issues directly related to construction work—including the selection of subcontractors—and review contract clauses. However, the engineer communicated his concerns only to the implementer and the technical office. In response, a mission official in the technical office declared that these concerns might be addressed in future projects, but there must be no delays with the Barang Road project. After attempting to follow up on the contractual issues in September 2009, the engineer had minimal involvement.[8]

No one in the technical office notified the agreement officer of the contract concerns raised by the engineer—concerns that became serious problems later in the project. We found allegations of overpayment for earthwork, issues with the quality of the work, and reports of substitution of materials. Monitoring teams also reported problems from December 2009 until June 2010, when USAID/Pakistan terminated the work.

A third example occurred in early October 2009, when USAID/Pakistan staff instructed the implementing partners (the one for upper and the one for lower FATA) to develop plans to transition program work to the Government of Pakistan and local nongovernmental organizations, in response to the shift in strategy announced by the State Department. (See page 10.) Although mission officials other than the agreement officer may communicate planning and implementation decisions, a transition plan changes the terms of the agreement and, according to a mission official, should be handled only through the contracting office once the mission has approved the contract. Relying on mission documents, the technical staff, including the agreement officer’s technical representative (AOTR) who reports to the Peshawar office, asked the implementer to end tasks by December 2009, then moved the date to March 2010, and later moved the date again to September 2010. The staff also told implementers that USAID/Pakistan had planned for a 40 percent reduction in the budget for LDP. The implementer adopted this budget reduction and presented it in reporting documents. Assuming a reduction in funds, the staff and the implementers dropped or reduced many activities, apparently without consulting USAID’s strategic partners. (See page 10.) Therefore, some activities were cut to months and others to weeks, becoming tasks with short deadlines. Meanwhile, mission staff added new tasks for the implementing partner,

[8] The mission engineer first visited the site in February 2010. USAID/Pakistan terminated the contract before the engineer could make another visit, scheduled for June 2010.

requiring the partner to revise plans and perform new tasks in short time periods—again without the agreement officer’s approval.

In these three instances, the lines of authority and responsibility for mission staff were not clear, particularly when the staff communicated directly with implementing partners. The partners presumed that the AOTR and staff in the Peshawar office had the authority to direct certain actions, yet as the examples above indicate, the staff did not always have this authority. In some instances, directions to the implementers came from the technical staff, when the proper line of authority and responsibility for such communications rested with the agreement officer. Furthermore, one USAID/Pakistan official implied that directing implementers and contractors to develop and operate under transition work plans with reduced budgets and without proper authority came very close to an unauthorized commitment. The official further implied that work performed by the implementers on transition plans was merely a “drill” that diverted time and resources from the program.

Program performance deteriorated when USAID/Pakistan staff overrode management controls and bypassed organizational structures. Much time and funding went toward disaster response and emergency relief efforts, draining resources from the planned LDP activities. In addition, allowing outside pressures to take precedence over important management controls led to poor results in work such as the Barang Road project; and the shift in strategy and the drills of drafting transition plans without proper authority diverted more time and resources from LDP. We recommend the following:

> ***Recommendation 1.*** *We recommend that USAID/Pakistan develop and implement a periodic training program for mission staff that clearly defines the authority, responsibility, and accountability of agreement officers, technical representatives, and program staff, including their communications with implementers, to support an effective management control environment. Because of the constant changes in personnel, we recommend that the training materials be made available on USAID/Pakistan’s Intranet for all new arrivals to review in the interim between training sessions.*

Overreliance on Contractors Created Risks

According to the Federal Acquisition Regulation (FAR), federal agencies using nonpersonal service contracts[9], such as third-party contractors, need to exercise greater scrutiny and provide more management oversight by U.S. direct-hire personnel when performing functions closely associated with inherently governmental functions.[10] Although not explicitly excluded from performing governmental functions, according to

[9] FAR 37.101. Nonpersonal service contractors are not subject, either by the contract’s terms or by the manner of its administration, to the supervision and control generally found in relationships between the Government and its employees.

[10] FAR 37.114(b). In this report, the term “contractors” includes contractors, implementers, and grantees. Although the FAR does not refer specifically to grants and cooperative agreements, the substantive policies on “inherently governmental” restrictions are important and relevant to all work performed on behalf of USAID. With the clear examples of functions closely associated with inherently governmental functions, this audit applies the regulations by analogy to cooperative agreements and grants.

the FAR, a personal service contractor (PSC) has more of an employer–employee relationship with U.S. direct-hire personnel, who provide close and continual supervision and control, when the contractor performs services closely associated with inherently governmental functions.

"Inherently governmental functions" are defined as being so intimately related to the public interest as to require performance by federal employees. In addition, other functions, though not restricted to federal employees, are considered to be closely supporting inherently governmental functions. These functions include supporting acquisition planning, providing assistance in contract management, providing technical evaluation of contract proposals, providing assistance in the development of statements of work, and performing services that involve or relate to the evaluation of another contractor's performance.

Additionally, OMB recently introduced a policy letter with a uniform definition of "inherently governmental functions" for all federal agencies. The policy also clarified the functions that are closely associated with inherently governmental functions.[11] OMB emphasizes the need to mitigate risk by avoiding conflicts of interest and assigning a sufficient number of qualified direct-hire federal personnel (known as U.S. direct hires) with appropriate expertise to administer the work and give heightened management attention to ensure that contractors' services do not expand to include inherently governmental functions. The policy letter also points out that inappropriate or excessive reliance on contractors to perform functions may put internal controls and operations at risk.

According to these criteria, the audit found that USAID/Pakistan did not properly manage contractors performing services closely associated with inherently governmental functions for LDP by mitigating risks. The audit found two examples of these functions: USAID/Pakistan (1) retained a third-party contractor to monitor the performance of another USAID nonpersonal service contractor and (2) hired a PSC to provide support in the administration of contracts.

In May 2009, the mission retained a third-party, U.S.-based contractor to perform onsite monitoring and evaluation of program activities carried out by other USAID/Pakistan contractors.[12] The third-party contractor immediately informed the mission of its potential conflict of interest in evaluating the work of other contractors working in the same region. As a result of the conflict, the third-party contractor limited its scope of work to onsite

[11] OMB issued a proposed policy letter dated March 31, 2010, through the Office of Federal Procurement Policy to define *inherently governmental function* as a function that is so intimately related to the public interest as to require performance by federal employees. This definition was adopted from Section 5 of the Federal Activities Inventory Reform Act, Public Law 105-270. The proposed policy letter also strengthens guidance on functions closely associated with inherently governmental functions. Although the OMB letter was at the draft stage at the time of the audit, based on our analysis, the letter serves as additional support because it provided clearly articulated guidance without the introduction of any substantive changes to existing policies and guidance. Upon finalization, the policy letter will result in appropriate changes to the Federal Acquisition Regulation.

[12] Generally, the mission relies on third-party contractors to perform this important government function because of security concerns about U.S. personnel traveling to high-threat areas in Pakistan, in accordance with Agency regulations.

monitoring and verification of activities. Although the evaluation of activities remained the mission's responsibility, the mission never addressed the gap in services created by the third-party contractor's conflict of interest. As of June 2010, no evaluations of program activities had taken place.

Furthermore, the third-party contractor's conflict of interest left to the mission the responsibility for following up on reported deficiencies. The mission relied on one PSC serving as the AOTR to handle deficiencies noted in 355 reports issued from July 2009 to May 2010 covering infrastructure, literacy, agricultural, and livestock activities for all three agencies in upper FATA. Unfortunately, the AOTR failed to report consequential deficiencies to the agreement officer, relying instead on the implementers to address the issues raised in the reports, regardless of the level of deficiency. The AOTR exercised discretion beyond his authority. For instance, from December 2009 to April 2010, the third-party contractor reported on problems with the Barang Road project related to contractual conditions and performance, but the AOTR never elevated these issues to the agreement officer or other mission officials with the proper authority to address the problems. Reported problems included poor workmanship, substitution of materials, and base-course thickness that did not meet specifications. OIG Investigations had informed the implementer previously of fraud allegations associated with infrastructure projects, and the implementer had retained its own oversight experts who reported regularly to the mission agreement officer but mentioned none of the problems reported by USAID's third-party contractor. However, although monitoring teams for the mission and mission staff continued to report issues, mission staff did not coordinate with one another and did not follow up to evaluate the reports and determine whether the contractor was in breach. Roadwork continued until it was almost 96 percent complete, when USAID terminated all contracts for LDP. Subsequently, USAID/Pakistan also terminated the AOTR's personal services contract for ethics violations.

The mission relied heavily on the PSC to perform program functions closely associated with inherently governmental functions. Some functions that the PSC performed or participated in, along with other team members, included:

- Performing program development before becoming the AOTR.
- Providing assistance in the development of statements of work.
- Supporting acquisition planning, including technical evaluation of LDP contract proposals.
- Providing assistance in contract management as the single AOTR for LDP, a program with a total budget of $300 million.
- Overseeing third-party monitoring reports of another contractor's performance.

The functions listed above are closely associated with inherently governmental functions, and although a PSC is permitted to perform or participate as a team member, the mission needs to provide close and continual supervision of the contractor engaged in these functions. The mission also needs to consider the risks involved when a PSC performs these functions.

In response, USAID/Pakistan officials replied that the mission relies on contractors to support contract administration largely because of the shortage of U.S. direct hires in

Pakistan. Personnel shortages occur because of frequent staff rotations and positions left unfilled for extended periods. The deteriorating security environment makes recruitment difficult, particularly for offices in areas such as Peshawar where the security threat is high. USAID/Pakistan has not prepared a mission workforce plan to address the shortage of U.S. direct hires who can monitor and evaluate contractors in Pakistan. A mission workforce plan would help identify and mitigate risks associated with reliance on contractors providing services that closely support inherently governmental functions. A workforce plan would also ensure that sufficient personnel are available to manage and oversee contractors' performance.

USAID/Pakistan's overreliance on contractors to support contract administration for LDP gave rise to risks of conflicts of interest and of contractors performing contract administration functions. The mission never addressed the gaps created by the potential conflict of interest raised by the third-party contractor, such as the lack of evaluations and the need to follow up on reported deficiencies. USAID/Pakistan did not follow up on the validation reports, even though third-party contractors had identified problems with the Barang Road project. In addition, because the mission did not administer adequate management controls or supervise the PSC adequately, the mission was at risk of failing to identify and correct poor contractor performance. The AOTR's failure to report problems promptly to persons with proper authority led to the loss of performance accountability and possible overpayment of services, especially because of the allegations of fraud associated with the roadwork. We recommend the following:

Recommendation 2. *We recommend that USAID/Pakistan develop and implement a plan, in compliance with Federal Acquisition Regulation 37.114 and Office of Management and Budget guidance, to provide proper oversight and management of contractors that support contract and agreement administration.*

Recommendation 3. *We recommend that USAID/Pakistan perform an analysis, as a template for the mission, to establish the sufficiency of the mission's internal capability for control and management of contractors working on the Livelihood Development Program, taking into account the goals of the program, the complexity of the work, the need for specialized skills, and the effect of contactor default on program performance.*

Recommendation 4. *We recommend that USAID/Pakistan develop and implement a mission workforce plan with guidelines for the consideration of increasing the use of U.S. direct-hire personnel for positions engaged in services closely associated with inherently governmental functions.*

Communications and Planning for Shift in Strategy Fell Short

According to USAID's Automated Directives System, USAID plays a critical role with respect to coordination of its partners and host-country governments (ADS 202.3.5.3). Open communication and planning with the implementing partners and host governments help to achieve foreign assistance results. In addition, the cooperative agreement indicates that USAID should work closely with the FATA Secretariat and the FATA Development Authority to achieve development improvements.

On September 30, 2009, a year after the program started, the U.S. Department of State announced its decision to transfer contracts to Pakistani implementing partners whenever feasible, intending that the transition to implementation by Pakistanis would take place as quickly as possible. The announcement listed several activities in which funding requests were not supported, and both upper and lower FATA LDP were on the list. The State Department gave the LDP implementers 3-month extensions to transfer contracts to Pakistani partners. The audit identified two instances in which the initiation of the shift in strategy affected the Livelihood Development Program.

First, on receiving notice of the shift in strategy in early October 2009, mission staff reacted instantly, with no guidance or plans authorized by appropriate personnel. The State Department's unexpected decision to limit funding for the upper FATA program to 3 months prompted the mission's contracting office first to ask the implementing partner to start planning for a demobilization plan, then several weeks later to request a demobilization plan within 11 days. However, despite the request for a demobilization plan, the mission instructed the implementers to continue program activities on the basis of the approved work plan.[13] Also during this period, and apparently without authority from the contracting office, technical staff instructed the implementing partner to prepare a transition plan with reduced scopes of work and reduced budgets to phase out the U.S.-based implementer and pass work off to the GOP and local organizations. Technical staff also asked the implementer to conduct a capacity evaluation of local organizations that could take over the program activities. Relying on the instructions from the technical staff, the implementer prepared the transition work plan with reduced scopes of work and reduced budgets, which kept changing from September 2009 up until June 2010, when the mission terminated the implementer's agreement. According to the mission, staff members misconstrued the plans and intentions of the State Department's announcement. The mission emphasized that planning for the transition was an internal issue, and staff members should not have gone to implementers to do the mission's work.[14] The mission further emphasized that this situation illustrates the mission's lack of capacity and its need to set clear policy on the roles and responsibilities of staff.

Second, the mission did not work closely with the FATA Secretariat and FATA Development Authority to communicate the intended shift in policy. As late as June 2010, a Secretariat official stated that U.S. officials had not consulted with the FATA Secretariat on the new policy to shift programs over to the Secretariat. He expressed the organization's concerns for taking over existing projects by September 2010, which one subcontractor told him was the end date. According to the Secretariat official, the FATA Secretariat needs at least 1 year of preparation to take over program activities, and the mission should provide a detailed implementation plan that clearly defines the requirements for his office. He was pleased with the work of the U.S.-based implementer and noted the difficulties involved in finding local organizations to take over this work.

[13] An approved work plan was not in place in October 2009. The implementer's second-year work plan was not approved until March 2010.

[14] Other USAID officials, through a dissent letter, questioned the efficiency and effectiveness of the Department of State's mandate over these programs. The confusion prompted Senators John Kerry and Richard Lugar to address this issue in a letter to the State Department and USAID dated March 5, 2010.

A representative from the Development Authority also stated that no one had consulted with the Development Authority on the transition timetables, and it too had only recently become aware of the effect this shift would have on current projects. According to the official, the Development Authority handed over approximately 46 projects for the program to develop, but performance was slower than expected, and many projects were not completed as of June 2010. The Development Authority had not communicated with mission officials in the last several months, which USAID officials confirmed.

These problems occurred because the mission did not plan for or coordinate the shift in strategy, for instance by preparing an overall transition policy that would include procedures, timelines, and budgets. Moreover, USAID/Pakistan did not communicate the shift in strategy effectively to mission personnel, implementing partners, and the Government of Pakistan.

The mission needs to improve communications and planning for the transfer of programs to Pakistani institutions to protect resources and operate programs effectively. Strategic partners such as the FATA Secretariat and the FATA Development Authority must be kept informed. Furthermore, implementing partners faced uncertainty about whether they should go ahead with the program or discontinue program work and demobilize because of the reduced focus on U.S.-based organizations. The implementers were instructed erroneously to stop work, and they faced idle periods from September to December 2009 and incurred costs to keep personnel employed. Delays for incremental funding occurred from September 2009 to May 2010, when requests went through various channels before approval by officials in the State Department. In this period, program activities were reduced or dropped, and no long-term projects started although local communities had selected many of these program activities as priority projects. A representative from the FATA Development Authority indicated that the lack of activities reflects poorly on it because the work is performed under GOP branding. Pakistani and USAID officials raised concerns that the people of Pakistan may begin to lose confidence and may question the U.S. Government's commitment to FATA. Therefore, we recommend the following:

> ***Recommendation 5.*** *We recommend that USAID/Pakistan develop and implement definitive plans for the Livelihood Development Program in regard to the shift toward more direct funding to Pakistani institutions, including incremental funding, budgets, transition plans, and any other information that may require modifications of relevant agreements and contracts. Moreover, we recommend that USAID/Pakistan designate appropriate personnel to communicate these plans to implementers and the Government of Pakistan.*

EVALUATION OF MANAGEMENT COMMENTS

USAID/Pakistan agreed with all recommendations included in the draft report. On the basis of an evaluation of the mission's response to the draft report, we determined that final action has been taken on two recommendations, and management decisions have been reached on the remaining three recommendations. The status of each of the five recommendations is shown below.

Final action—Recommendations 1 and 5.

Management decision—Recommendations 2, 3, and 4.

Recommendation 2. The mission agreed with the recommendation and plans to develop a matrix to assist with the mission's oversight and management of contractors, including supervisors of technical representatives. Once the mission compiles the matrix and it is vetted among mission offices, the matrix will be implemented as a tool to determine whether or not each contractor has an acceptable level of adequate oversight. Action will then be taken to rectify any oversight gaps. The mission's target date for completing this plan is June 30, 2011.

Recommendation 3. The mission agreed with the recommendation and plans to complete its analysis by June 30, 2011.

Recommendation 4. The mission agreed with the recommendation and has scheduled a team to review the mission's staffing levels in December 2010. This team will suggest changes as necessary to the mission director on staffing levels, with the goal of optimizing overall programmatic and support staff levels based on the current workload and other relevant issues. The target date to complete this review is March 31, 2011.

We consider that management decisions have been reached on Recommendations 2, 3, and 4. The Audit Performance and Compliance Division will make a determination of final actions on completion of the planned corrective actions.

The mission's written comments on the draft report are included in their entirety, without attachments, as Appendix II to this report.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The purpose of this audit was to determine whether the LDP is achieving its main goal of social and economic stabilization to counter the growing influence of extremist and terrorist groups in upper FATA. The audit was conducted at USAID/Pakistan in Islamabad covering the period from April 2008 through June 2010 and addressing the activities implemented under the LDP for upper FATA. To implement the program in upper FATA, USAID/Pakistan awarded a 5-year, $150 million cooperative agreement to a U.S.-based nongovernmental organization in April 2008. The purpose of the agreement is to support the implementation of a social and economic stabilization and development program to help FATA and Khyber Pakhtunkhwa (formerly known as the North-West Frontier Province or NWFP). The specific geographic areas include FATA Agencies Bajaur, Mohmand, Khyber, Frontier Region Peshawar, and NWFP District Peshawar. As of June 2010, cumulative obligations under the program totaled approximately $60 million, and expenditures came to $46.8 million.

To answer the audit objective, we reviewed mission documentation related to managing and monitoring the LDP—country operational plans, performance management plans, implementing partner agreements, performance measures, actual performance results, certifications required under the Federal Managers' Financial Integrity Act of 1982, financial reports, data-quality assessments, and site visit and monitoring reports prepared by third-party U.S. contractors. As part of the audit, we assessed management controls used by USAID/Pakistan to monitor program activities. The assessment included controls related to whether the mission approved implementation plans, conducted and documented site visits, and reviewed monitoring and progress reports and whether the mission compared reported progress to planned progress. We also interviewed mission officials, implementing partners, and host-government officials. We reviewed and compared program targets with actual results reported. We performed audit fieldwork at USAID/Pakistan and the implementer's main program office in Islamabad from May 26 through July 28, 2010.

Methodology

To answer the audit objective and determine whether the program was achieving its main goal, the audit team interviewed staff at USAID/Pakistan and staff at the implementer's country office to gain an understanding of the program and determine the roles and responsibilities of USAID/Pakistan and the implementing partners. Through the interview process, the audit team also learned of the reporting controls, procedures, and processes in place for monitoring the program.

In planning and performing the audit, the audit team assessed management controls that the mission used to manage the program. These controls included criteria set out in Agency regulations and the cooperative agreement. We also reviewed all relevant documents produced by the implementers and documents and correspondence from mission officials. These documents provided an overview of the status of activities in upper FATA, including any significant issues, challenges, or changes in program implementation. Additionally, the auditors examined the mission's FY 2009 and FY 2010 annual self-assessment of management controls, which the mission must perform to comply with the Federal Managers' Financial Integrity Act of 1982, to determine whether the assessment cited any relevant weaknesses.

We reviewed applicable laws, regulations, and standards including the Federal Acquisition Regulation, the Government Accountability Office *Standards for Internal Control*, and Office of Management and Budget policies—as well as USAID policies and procedures pertaining to USAID/Pakistan's LDP (ADS Chapters 103, 202, 203, 303, and 601). The audit relied on the following sources of evidence: reviews of the Federal Acquisition Regulation, Agency policies, internal controls, prior audits, and interviews with and responses to information requests of implementing partners and USAID/Pakistan.

In assessing the status of the activities during the program's first and second years of operations, the auditors relied on interviews conducted with USAID, implementing partner staff, and representatives from the Government of Pakistan regarding specific implementation problems and issues reflected in the documents reviewed. Activity results were supported by published documentation from the implementer, as required under the cooperative agreement. The audit included the validation of key reported results of the program's activities, including literacy and skills trainings, road improvements and constructions, disaster response and emergency services, revitalization of community and household infrastructure, and agricultural, livestock, and microenterprise interventions. Specifically, the audit validated nine outcome indicators, 20 result indicators, and 36 activity indicators. In validating the program's reported results, the auditors checked supporting information contained in a database and examined, on a random test basis, supporting documents maintained by the implementing partner.

MANAGEMENT COMMENTS

USAID | PAKISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

Date: November 29, 2010

To: Michael Hutchinson
Audit Manager, OIG/Pakistan

From: Denise Herbol
Mission Director (A) /s/

Subject: Management Comments
Audit of USAID/Pakistan's Livelihood Development Program for the Upper Regions of the Federally Administered Tribal Areas
(Report No. G-391-11-00X-P)

Reference: Michael Hutchinson's memo dated October 18, 2010

In response to the referred memo, please find below the management comments on the five recommendations included therein:

Recommendation No 1: We recommend that USAID/Pakistan develop and implement a periodic training program for mission staff that clearly defines the authority, responsibility, and accountability of agreement officers, technical representatives, and program staff, including their communications with implementers, to support an effective management control environment. Because of the constant changes in personnel, we recommend that the training materials be made available on USAID/Pakistan's Intranet for all new arrivals to review in the interim between training sessions.

Management Comments:
Mission management concurs with this recommendation. The Office of Acquisition and Assistance at USAID/Pakistan has already issued three Acquisition and Assistance Notices subsequent to issuance of this audit report that establish clear policies for mission staff on these matters. A notice regarding conflict of interest was issued on 7/08/2010; A notice on out of scope changes was issued on 7/08/2010, and finally a notice on Continuing Education for Contracting and Assistance Officer Technical Representatives (COTR/AOTR) was issued on 9/17/2010. Copies have been included with this correspondence (Annex A) and uploaded on the USAID/Pakistan intranet. COTR/AOTR training was recently given to the Mission on July 14, 2010. In addition, the

Mission will host two COTR/AOTR training sessions in February and March of 2011. The list of participants attending this training is attached as Annex – B. This training can be made available to supervisors of AOTR's and COTR's and continued online training and resources are available at USAID/University and other websites.

Therefore, Mission requests closure of this recommendation.

Recommendation No 2: We recommend that USAID/Pakistan develop and implement a plan, in compliance with Federal Acquisition Regulation (FAR) 37.114 and Office of Management and Budget (OMB) guidance, to provide proper oversight and management of contractors that support contract and agreement administration.

Management Comments

Mission management concurs with this recommendation. The Office of Acquisition and Assistance (Pakistan) is in compliance with Federal Acquisition Regulation 37.114 and Office of Management and Budget (OMB) guidance regarding proper oversight and management of contractors that support contracts and agreements. All personnel designated to oversee and direct contractor's performance are certified and trained in accordance with USAID's Automated Directive System (ADS) 302, Procedures for Designating the Contracting Officer's Technical Representative (COTR) for Contracts and Task Orders and ADS 303, Agreement Officer's Technical Representatives Appointment Procedures.

In order to assure that the mission is providing proper oversight and management of contractors, the mission will develop a plan to periodically identify the following: Technical Team, Activity, Contractor or Grantee for said activity, AOTR/COTR for each Contractor/Grantee and employee type (DH or PSC), and supervisor for each AOTR/COTR and employee type, compiled using a matrix format. Third party contractors will be noted for additional review. After the matrix is compiled and vetted amongst mission offices, the matrix will be implemented as a tool to determine whether or not each contractor has an acceptable level of adequate oversight. Action will then be taken to rectify any oversight issues that would occur as a result of the findings. The mission plans to have this exercise completed by June 30, 2011.

Recommendation No 3: We recommend that USAID/Pakistan perform an analysis, as a template for the mission, to establish the sufficiency of the mission's internal capability for control and management of contractors working on the Livelihood Development Program, taking into account the goals of the program, the complexity of the work, the need for specialized skills, and the effect of contactor default on the program performance.

Management Comments

Mission management concurs with this recommendation and the Office of Acquisition and Assistance is planning to perform this analysis for the Mission by June 30th 2011.

Recommendation No 4: We recommend that USAID/Pakistan develop and implement a mission workforce plan with guidelines for the consideration of increasing the use of U.S. direct-hire personnel for positions engaged in services closely associated with inherently governmental functions.

Management Comments
Mission Management concurs with this recommendation. While U.S. direct-hires are not permitted to work in certain areas of the country, the mission is bringing in a two person team for two weeks in December 2010 to review USAID/Pakistan staffing levels and to suggest/make changes as necessary to the Mission Director on staffing levels, with the goal of optimizing overall programmatic and support staff levels based on the current workload and other relevant issues. The mission plans to have this analysis completed by March 31, 2011.

Recommendation No 5: We recommend that USAID/Pakistan develop and implement definitive plans for the Livelihood Development Program in regard to the shift toward more direct funding to Pakistani institutions, including incremental funding, budgets, transition plans, and any other information that may requires modifications of relevant agreements and contracts. Moreover, we recommend that USAID/Pakistan designate appropriate personnel to communicate these plans to implementers and the Government of Pakistan.

Management Comments
Mission management concurs with this recommendation. Cooperative Agreement No. 391-A-00-08-01107 for FATA Livelihood Development Programs was terminated on June 4, 2010. In addition, it is noteworthy to mention that a Deputy Mission Director has since been assigned to the Peshawar Consulate to communicate changes to implementation plans/strategy as a direct representative of USAID/Pakistan. USAID intends to continue its work in the Upper FATA for the foreseeable future.

Therefore, Mission requests closure of this recommendation.

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Avenue, NW
Washington, DC 20523
Tel.: 202-712-1150
Fax: 202-216-3047
www.usaid.gov/oig