OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/PAKISTAN’S AGRIBUSINESS PROJECT

AUDIT REPORT NO. G-391-13-004-P
JUNE 12, 2013

ISLAMABAD, PAKISTAN

Office of Inspector General

June 12, 2013

MEMORANDUM

TO: USAID/Pakistan Mission Director, Jonathan M. Conly

FROM: Office of Inspector General/Pakistan Director, Matthew Rathgeber /s/

SUBJECT: Audit of USAID/Pakistan's Agribusiness Project (Report No. G-391-13-004-P)

This memorandum transmits our final report on the subject audit. We have carefully considered your comments on the draft report and have included them in their entirety in Appendix II.

This report contains nine recommendations to help the mission improve the Agribusiness Project. Based on your written comments in response to our draft report, a management decision has been reached on Recommendation 2. Management decisions have not been reached on the other eight recommendations. The mission should coordinate with USAID's Audit Performance and Compliance Division concerning final action on Recommendation 2.

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

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SUMMARY OF RESULTS

Pakistan's economy depends on agriculture, which makes up about 20 percent of the gross domestic product.[1] However, the country does not have a vibrant agribusiness subsector to link farmers to markets. That subsector suffers from poor product quality, low productivity, and a lack of packaging, storage, and processing facilities. Farmers find it challenging to produce, process, store, and sell high-quality, lucrative crops.

USAID is implementing the Agribusiness Project to develop agriculture value chains, which link all those involved in producing the crop or animal, processing it, and selling the product. The project's goals are to facilitate broad-based economic growth, create jobs, and contribute to eliminating poverty by improving the competitiveness of horticulture and livestock value chains. To achieve them, the project has two components:

- Technical assistance for building capacity and supporting programs
- Cost-sharing grants

In November 2011, USAID/Pakistan awarded a 5-year, $89.4 million sole-source (or noncompetitive bid) cooperative agreement to a local NGO, the Agribusiness Support Fund (ASF), to carry out the Agribusiness Project. Under this agreement, ASF awarded a $5.3 million subagreement to Citizens Network for Foreign Affairs (CNFA), a U.S.-based international organization, to provide technical assistance and services. As of December 2012, USAID had obligated approximately $27.3 million and spent $7.8 million for the project.

The Office of Inspector General (OIG) conducted this audit to determine whether USAID/Pakistan's Agribusiness Project was facilitating broad-based economic growth and creating jobs—two of its three goals. The audit team found that it has not had much success in achieving the two goals. Additional time may be needed, since many planned activities are scheduled to be completed over 5 years, and most grants awarded to build capacity and create jobs began after August 2012—10 months into the 5-year project.

ASF had limited experience managing a project that awards grants to subrecipients and beneficiaries. When it received the award, it did not have procurement and finance policies that complied with USAID regulations; so the staff spent the first year developing manuals, working out the best approaches to designing and implementing activities, and developing work plans.

However, ASF made some progress. As of March 2013, 11 subrecipients[2] charged with the key activity of forming farmer groups that will receive agribusiness training and grants from ASF had formed 605 groups. Additionally ASF had begun to support 272 existing groups it formed before implementing the Agribusiness Project.

[1] CIA, *The World Factbook*.
[2] USAID's Automated Directives System (ADS) defines a subrecipient as any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other subrecipient.

ASF did not make progress toward achieving the second goal. It had not developed a system to monitor and track jobs created. Even though the project had awarded 110 grants as of February 2013, it had not created any permanent jobs. Additionally, the five grant activities that auditors visited may not be sustainable. For example, four farmer groups had limited access to markets; thus, the audit team could not determine whether the activities would increase employment in the surrounding community.

The audit identified seven other problems, listed below.

- ASF lacked capacity to manage the project (page 4). As a result, the project is delayed, which could prevent it from achieving its goals.

- ASF did not correct material weaknesses (page 5). It did not improve its processes or correct weaknesses identified in a preaward assessment report within the set time frame. As a result, funds may be at an increased risk of waste or misuse. In addition, ASF may not be able to achieve project goals as intended.

- The project did not implement an information system as required in its preaward assessment (page 7). As of March 2013, the project had not implemented an information system. As a result, information is not centralized and recording errors could occur, which could prevent ASF from reporting accurate project information to USAID/Pakistan.

- The project was late and did not meet targets for awarding cost-sharing grants (page 8). If ASF continues to be late, the project may not achieve its goal of improving broad-based economic growth and creating jobs.

- The project did not assess subrecipients' eligibility thoroughly (page 10). As a result, subrecipients may not have the internal controls required to implement the activities, and they may not be able to track the resources used.

- The grant activities the audit team observed may not be sustainable (page 11). If these and future grant activities continue to lack sustainability, the project may not achieve its targets for improving broad-based economic growth and creating jobs.

- ASF did not record project income properly (page 12). It recorded application fees in a reserve account rather than as project income. As a result, these funds might not be used for the project.

To strengthen the Agribusiness Project, we recommend that the mission:

1. Develop an action plan to make sure project goals can be reached by the end of 2016, or, if they cannot, determine whether the agreement signed with the Agribusiness Support Fund should be discontinued (page 4).

2. Prior to making future awards, implement mission-wide procedures to verify independently that corrective actions are sufficient to address weaknesses identified in preaward assessments (page 7).

3. Implement a plan to confirm that the policies and procedures of the Agribusiness Support Fund related to governance, procurement, human resources, information technology, and agribusiness operations comply with USAID regulations (page 7).

4. Follow up with the Agribusiness Support Fund to correct the weaknesses identified in the second preaward assessment (page 7).

5. Implement a strategy to work with the Agribusiness Support Fund to update its finance and procurement manuals and implement the integrated management information system (page 8).

6. *Implement a plan to monitor the second-year annual plan to confirm that the project can meet its targets, outcomes, and goals* (page 10).

7. Require the Agribusiness Support Fund to stop advance payments to subrecipients responsible for forming farmer groups until it conducts a thorough preaward responsibility determination (page 10).

8. Obtain a revised annual plan from the Agribusiness Support Fund to include specific grant activities that it plans to implement during the year, with benchmarks and milestones, and expected outputs and outcomes (page 12).

9. Require the Agribusiness Support Fund to record the nonrefundable application fee received from the grantees as income in the project accounts (page 12).

Detailed findings appear in the following section, and the scope and methodology appear in Appendix I. Our evaluation of management comments is included on page 13, and the full text of management comments will appear in Appendix II.

AUDIT FINDINGS

Implementer Lacked Capacity to Manage Project

Automated Directives System (ADS) 303.3.9, "Preaward Responsibility Determination,"[3] states that before making an award, the agreement officer should be satisfied that the applicant could perform the award in compliance with USAID regulations. According to ADS 303.3.9.2, if, after conducting a comprehensive review of a potential recipient, USAID cannot affirm that the recipient has the capacity to manage USAID funds responsibly, the Agency can deny the award or make it with "special award conditions." USAID may consider using the latter option only if it appears likely that the potential recipient can correct its deficiencies within a reasonable amount of time.

USAID/Pakistan granted a sole-source award to ASF even though it had limited experience issuing grants and managing an $89.4 million project. To determine whether ASF was eligible, the mission conducted market research and concluded that it was the only local organization that might be capable of implementing the project. In June 2011 mission officials decided to work with ASF after a January 2011 preaward assessment rated ASF as a high risk and before an October 2011 follow-up preaward assessment was completed. The award was made subsequently in November 2011.

According to USAID/Pakistan officials, when this project was designed, the mission was under pressure from the Embassy also to use only Pakistani groups as implementers, and the Embassy favored ASF. In addition, USAID/Pakistan had time constraints to select an organization for the project and could not visit some of the potential candidates because of security concerns.

ASF could not manage the project. It did not correct material weaknesses identified in a preaward assessment in a timely manner and has been operating with several organizational weaknesses, as discussed in the next finding. In addition, the project did not meet any of its targets during the first year of implementation (page 8). Furthermore, ASF issued advance payments to subrecipients even though it did not assess them thoroughly to be sure they were eligible (page 10). Equally important, the activities that the audit team visited are not sustainable (page 11). All of these problems indicate that the project may not be able to achieve its goals, and funds could be spent incorrectly. For this reason we make the following recommendation.

> ***Recommendation 1.*** *We recommend that USAID/Pakistan develop an action plan to make sure project goals can be reached by the end of 2016, or, if they cannot, determine whether the agreement signed with the Agribusiness Support Fund should be discontinued.*

[3] The guidance at the time of the award was dated June 2011. The latest version is dated July 2012.

Implementer Did Not Correct Material Weaknesses

As discussed in the previous finding, ADS 303.3.9 states that before making an award, the agreement officer should be satisfied that the applicant could perform the award in compliance with USAID regulations. According to ADS 303.3.9.2, if after conducting a comprehensive review of a potential recipient, USAID cannot confirm that the recipient has the capacity to manage USAID funds responsibly, the Agency can deny the award or make it with "special award conditions."

Contrary to this guidance, USAID/Pakistan did not take the necessary steps to make sure ASF had the capacity to manage USAID funds responsibly. ASF did not correct deficiencies that it agreed to fix within a certain time frame. In January 2011, before USAID/Pakistan made the award, the first preaward assessment identified significant weaknesses in governance, internal controls, accounting and financial management, human resource management, procurement, information technology, and agribusiness operations.

The second preaward assessment—completed 9 months later in October 2011—noted improvements in some processes and lowered the overall risk from high to medium. However, the accounting firm that conducted the assessment reduced the risk based on unverified statements from ASF that it had corrected the weaknesses. According to the firm, it did not verify the information because ASF was not operating at full capacity. Some examples of problems with the assessment are listed below.

- It relied on ASF's board of directors' approval of procedures manuals for procurement and human resources. However, the manuals lacked detailed information and did not comply with USAID regulations for full and open competition.

- It relied on ASF statements that it would overcome the weaknesses by hiring an international firm to train its staff. However, that firm's scope of work showed it was not responsible for providing capacity building for some of the weaknesses.

Despite the improved overall assessment, the accounting firm found six weaknesses and recommended adding six conditions to the award, which were repeated also in the negotiation memorandum between USAID/Pakistan and ASF. Although ASF agreed to correct the weaknesses by a certain time, as of the time of the audit, it had not corrected two and only partially corrected one (shown in Table 1).

Table 1. Significant Weaknesses Not Corrected

Weaknesses	Deadline	Status
ASF did not have an internal audit department.	3 months from date of first disbursement	Partially corrected. Although it has established an internal audit department, ASF has not produced any internal audit reports as of March 2013.
ASF had weaknesses in design and operations of the grant management system, which is part of the information technology system.	3 months from date of first disbursement	not corrected
ASF had weaknesses in the information technology system.	6 months from date of first disbursement	not corrected

Source: Negotiation memorandum (audited).

The weaknesses were not corrected because USAID/Pakistan did not have a procedure to verify whether ASF had taken the appropriate corrective actions. In addition, ASF provided inaccurate information in the second preaward assessment since its actual practices were different from those reported. For example, the assessment stated that ASF would advertise for vendors when the value of goods and services exceeded $5,000; however, ASF's procurement policy did not require it to advertise. In addition, ASF's actual monetary thresholds for getting written quotations from vendors differed from those in the assessment. Further, the mission did not verify whether ASF's procurement policy reflected what was reported in the preaward assessment.

Moreover, the mission did not verify whether weaknesses found in a 2011 OIG audit report for this project were corrected; nor did it did follow through on the following recommendations.[4]

- Implement a risk-assessment model to use when determining which of the weaknesses identified in the preaward assessments should be addressed before or after funds were disbursed.

- Implement a comprehensive tracking system with benchmarks and time frames for measuring the progress on resolving weaknesses that are identified in the preaward assessment reports.

- Issue written guidelines to follow when determining whether pre-disbursement recommendations have been addressed adequately.

Last, a USAID/Pakistan official said the mission did not verify whether ASF corrected the weaknesses identified in the second preaward assessment within an agreed-upon time frame since the requirement to correct the weaknesses was not included in the cooperative agreement. ADS 303.3.9.2 did not require the mission to include the conditions in the agreement if the preaward assessment risk rating is medium or lower. In the case of ASF, the second preaward assessment lowered the risk from high to medium.

[4] *Audit of USAID/Pakistan's Management of Preaward Assessments*, Audit Report G-391-11-004-P, May 6, 2011.

Because the mission did not verify whether ASF corrected its identified weaknesses, USAID funds could be at risk of waste or misuse. In addition, ASF may not be able to achieve its goals as intended if it does not have the necessary controls in place to implement the project. Therefore, we make the following recommendations.

Recommendation 2. *We recommend that prior to making future awards, USAID/Pakistan implement mission-wide procedures to verify independently that corrective actions are sufficient to address weaknesses identified in its preaward assessments.*

Recommendation 3. *We recommend that USAID/Pakistan implement a plan to confirm that the policies and procedures of the Agribusiness Support Fund related to governance, procurement, human resource, information technology, and agribusiness operations comply with USAID regulations*.

Recommendation 4. *We recommend that USAID/Pakistan follow up with the Agribusiness Support Fund to correct the weaknesses identified in the second preaward assessment report.*

Project Did Not Implement Its Information System

According to the negotiation memorandum between USAID and ASF, ASF agreed to install an integrated management information system 6 months after receiving the first disbursement for the Agribusiness Project.

In March 2012 ASF received the first disbursement; however, as of March 2013—12 months later—it had not installed the system. According to ASF officials, the information system will not be ready until October 2013.

Since ASF does not have an information system to monitor and track project results, it is using a master database to store grant-related information that the staff plans to transfer into the system once it is launched. However, data were stored in several different files and not in a centralized database. For example:

- The database does not disaggregate data for certain indicators that ASF should track, like the percentage of women who are members of farmer groups.

- The database does not include each grant recipient's government identification number that ASF officials say is required to make sure that the correct people are receiving the grants.

- ASF did not include the grantees' addresses so it could track and monitor the activities.

ASF officials admitted that some data were missing from the database. They explained that since they started working on these activities, they were aware of the information and could keep track of projects without including everything in the database. However, the information should be in a master database that includes information about each grantee, such as name, identification number, and gender. This would enable ASF to send USAID/Pakistan accurate information.

The delays with the information system occurred for a variety of reasons. First, the Pakistani Government took 2 to 3 months to give a visa to the contractor who would install it. ASF officials said the contractor was scheduled to arrive in April 2013 and plan to complete the system by October 2013.

Second, bids for the system were higher than expected. As a result, ASF had to resolicit bids for the project.

Third, ASF did not prepare and obtain approval for grant, finance, and procurement procedure manuals in time to install in the information system. For example, USAID/Pakistan approved the grants manual—which the fund needed to develop the information system—in May 2012, 6 months after the project started. ASF's staff needed information from that manual to enable the system to support the grants management function of the project. ASF also needed the financial and procurement manuals to develop those portions of the system. Although ASF prepared both in 2012, the contractor collecting the information for the system said they did not include enough standardized procedures to be useful.

Because of these delays, information is not centralized and recording errors could occur, which could result in inaccurate project information being reported to USAID/Pakistan. It also hinders ASF's staff from monitoring grantees. For this reason, we make the following recommendation.

> ***Recommendation 5.*** *We recommend that USAID/Pakistan implement a strategy to work with the Agribusiness Support Fund to update its finance and procurement manuals and implement the integrated management information system.*

Project Was Late and Did Not Meet Targets

According to the Agribusiness Project's first-year work plan, ASF should have started four activities by November 2012, listed in Table 2.

Table 2. First-Year Activities for Cost-Sharing Grants Component

	Targets	Actual Numbers	Target Completion Date
Formation of farmer groups	700	0	August 15, 2012
Support to existing farmer groups	300	0	September 15, 2012
Cost-share grant support to associations, cooperatives, and farm service centers*	20	0	September 15, 2012
Cost-share grant support to individual farmers/corporate farming	20	0	October 15, 2012

Source: Agribusiness Project fourth quarterly work plan (audited).

* The cost-sharing grants are to be provided to and implemented in partnership with the agribusinesses, farmers, and farmer groups.

ASF did not meet its targets for cost-sharing grants during its first year and has experienced delays. As Table 2 shows, the project did not create any of the 700 farmer groups that it was charged with forming by August 2012. However, in the second year, it began to support 272 farmer groups that were established before the project began.

For cost-share grant support to associations, cooperatives, and farm service centers, ASF approved one proposal in the first year but did not provide the grant until the second; hence, it was not able to meet its target of 20 for that year. ASF did not provide any matching grant support to individual farmers or corporate farms in the first year. However, during the second year, it selected 54 recipients for milk chillers and 24 recipients for solar food dryers, and signed contracts with them. ASF officials said they plan to provide the equipment to grantees between March and April 2013.

Officials from ASF and the mission acknowledged that the project did not meet its first-year targets for cost-sharing grants and provided several reasons for the delays.

ASF set unrealistic targets in its first-year work plan because the staff believed they could achieve them. USAID/Pakistan approved that plan because, when the project started, officials said they felt ASF was qualified to implement the project on time. In addition, they said they believed ASF was qualified based on the results from the market research conducted during the project's planning phase.

However, USAID/Pakistan officials said that during implementation they realized ASF did not have much experience making grants and that it was not aware of the Agency's standards. In addition, ASF needed significant capacity building and did not have several necessary procedures in place. Mission officials said the staff did not have the capacity to prepare environmental assessment forms, which were required at the time of the audit.[5] Therefore, USAID/Pakistan and a consultant it hired had to work extensively with ASF's staff and provided sample templates so they could understand how to complete the forms.

To further address ASF's lack of experience, the mission asked ASF officials to recruit an international consultant to work as deputy chief of party. USAID/Pakistan collaborated with ASF's staff in preparing terms of reference and scope of work to hire this person, who would be responsible for planning, implementing, and monitoring the project, and could address pertinent issues in an objective manner.

However, ASF officials said that having an international consultant in this role would not help because it would be difficult for the consultant to travel to certain areas of the country because of security concerns and the person might not understand Pakistani culture. Nevertheless, ASF agreed to do so to continue implementing the project.

ASF officials attributed the project's delays to USAID/Pakistan adding tasks that were not in the proposal or agreement. For example, the mission required ASF to move its project office from Lahore to Islamabad, which took 3 months and delayed work. The ASF officials also said the previous donor—Asian Development Bank— provided them with all manuals and forms to use while implementing their project. In contrast, ASF must prepare its own manuals and forms when implementing USAID's Agribusiness Project.

If ASF continues to be delayed, the project may not achieve its goals of improving broad-based economic growth and creating jobs. For this reason, we make the following recommendation.

[5] USAID no longer requires the implementer to submit an environmental form for approval. Instead, it completed an environmental assessment, which should enable grants to be approved in a timely manner.

> ***Recommendations 6.*** *We recommend that USAID/Pakistan implement a plan to monitor the second-year annual plan to confirm that the project can meet its targets, outcomes, and goals.*

Project Did Not Assess Subrecipient Eligibility Thoroughly

Both ASF and the mission agreed that ASF would assess subrecipients' eligibility before submitting their bids to the mission for final approval. ASF must assess an applicant's internal controls, organizational structure, and capacity to evaluate their management, financial, and administrative ability to implement a subrecipient award.

According to the cooperative agreement between USAID/Pakistan and ASF, the recipient must determine that the subrecipient possesses the ability to perform successfully under the terms and conditions of a proposed award, taking into consideration the subrecipient's integrity, record of past performance, financial and technical resources, and accessibility to other necessary resources. The recipient must verify that subawards are made in compliance with the Agency's standard provisions "Debarment and Suspension" and "Preventing Terrorist Financing."

However, ASF did not assess subrecipients thoroughly. It awarded $2.6 million to 11 subrecipients and has disbursed advance payments to 7. For the four subrecipients tested, several documents were missing or not provided. Three received advances totaling $76,000, but did not provide documentation to prove that their senior managers reviewed and approved their monthly financial statements. One of the three subrecipients received a total of $35,000 in advances; however, the subrecipient never provided ASF with documentation as support that its bank account was in the organization's name and not in the name of an individual. Further, none of the four subrecipients provided documentation showing that they were capable of accounting for advance payments or implementing the work.

ASF officials agreed with OIG that they did not perform a thorough review of the subrecipients. They blamed this on not having enough time to test controls and on pressure from USAID/Pakistan to select subrecipients and begin forming the farmer groups. The officials said the purpose of the preaward responsibility determination assessment was to get the subrecipients' input on whether their organizations had procedures in place so ASF could review their files later. The officials said they planned to check on the missing documents when their staff visited the subrecipients' offices. However, this was never done.

Because ASF did not perform thorough reviews of subrecipients, it may not know whether some of them have operational weaknesses. Consequently, the subrecipients could misuse the advance payments or may not be able to track their resources. For these reasons, we make the following recommendation.

> ***Recommendation 7.*** *We recommend that USAID/Pakistan require the Agribusiness Support Fund to stop advance payments to subrecipients responsible for forming farmer groups until it conducts a thorough preaward responsibility determination*.

Grant Activities Visited May Not Be Sustainable

ADS 201.3.4.2, "Role of Partners, Customers, and Stakeholders," states that USAID should work closely with its host-country implementers to make sure development objectives address problems, are achievable, and result in sustainable benefits after the Agency's funding ends.

In addition, the cooperative agreement with ASF states:

> The work plans shall include the activities planned to be conducted, the site(s) where they would be conducted, and benchmarks/milestones; the outputs or outcomes which the Recipient expects to achieve; and the inputs planned to be provided by the Recipient, during the work-plan period. Included shall be an explanation of how those inputs are expected to achieve the outputs/outcomes and benchmarks/milestones.

OIG assessed five grant activities totaling $36,206 and found that none of them was sustainable. Although this is a small number, ASF was in the process of awarding 110 similar grants as of February 2013. Four of the five we assessed were farmer groups and received different in-kind donations for activities, such as pickle production, growing vegetables, and goat breeding. The fifth recipient, though not a farmer group, received solar dryers to dry chili peppers. The following examples illustrate the problems these activities encountered.

- The members of the farmer groups in pickle production had limited access to the market to sell their products. They said that although the project's staff took them to several stores in the area to sell their products, this activity was unsuccessful, and they eventually sold the goods to contacts and family members.

- Two groups received only female goats. Without a male goat, it would be impossible to breed goats as the activity intended. Furthermore, a week after distributing the goats, the NGO implementing this activity began to receive reports that some were sick. NGO officials said they might have gotten ill because they were from a different climate. Although the project prescribed medicine for the goats, some farmers could not afford it or travel into town to obtain it. Furthermore, the grant did not include the cost of the medication.

- Members of one group received horticultural tunnels to use to grow vegetables. However, they did not produce enough crops to sell because the tunnels were too small to grow large quantities of crops. The beneficiaries also complained that the materials used were of poor quality. Farmers said the heavy rains that occurred in this region during the time of the audit had damaged some of the tunnels. However, USAID officials said the structures were supposed to resist environmental damage. In addition, although the audit team observed that the neighboring farmers attempted to duplicate building similar horticultural tunnels, the farmers were not successful in replicating the tunnels with their own resources.

- The company that received dryers for chili peppers intended to look for new business opportunities and to obtain the knowledge needed to make the new agriculture venture successful. However, the project did not provide the group with any training or information, such as advice on what types of chili peppers to grow.

Because ASF did not include the grant activities in its first-year work plan or identify how grant activities would achieve results, USAID did not know what kind of activities were planned until after AFS chose grantees. Since the cooperative agreement limits USAID's level of oversight of grant activities worth less than $5,000, about 83 percent of the project's grants do not need Agency approval.

Based on these examples and ASF's lack of experience, other grant activities may not be sustainable, and the project may not achieve its goals of improving broad-based economic growth, and creating jobs. For this reason, and to help the project meet its objectives, we make the following recommendation.

> ***Recommendation 8.*** *We recommend that USAID/Pakistan obtain a revised annual plan from the Agribusiness Support Fund to include specific grant activities that it plans to implement during the year, with benchmarks, milestones, and expected outputs and outcomes.*

Implementer Did Not Record All Project Income

According to the agreement, income earned during the project must be added to the total amount of revenue. Some agreements require grantees to submit an application fee of approximately $100 to the implementer, along with the grant application. If the implementer selects the grantee, the application fee is not refundable. However, the implementer should record the application fee in a separate account from the one for the project.

As of February 2013, ASF received deposits from 107 grantees totaling approximately $11,000. This amount will increase as the project continues to issue grants. The nonrefundable application fees were not recorded as income because ASF planned to use them as a reserve for monitoring activities after the project ends. However, ASF's management said they were willing to adjust how it records the funds if required by USAID.

USAID/Pakistan had not provided clear guidance as of the time of the audit on how ASF should record the funds. As a result, there is a risk that these funds might not be used for project purposes. For this reason, we make the following recommendation.

> ***Recommendation 9.*** *We recommend that USAID/Pakistan require the Agricultural Support Fund to record the nonrefundable application fees received from the grantees as income in the project accounts.*

EVALUATION OF MANAGEMENT COMMENTS

USAID/Pakistan agreed with the nine recommendations in the draft report and made a management decision on Recommendation 2. The mission has not made management decisions on Recommendations 1, 3, 4, 5, 6, 7, 8, and 9.

Recommendation 1. USAID/Pakistan agreed with the recommendation. It received a plan from ASF to reduce the number of value chains from 16 to 10 and will reduce the total estimated cost of the award to reflect the project's reduced scope. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project.

USAID/Pakistan did not agree with the statement that ASF lacked experience to manage the project. Officials said they made a positive responsibility determination and noted several of ASF's experiences.

However, the mission selected ASF after the first preaward assessment rated the organization as high risk in all functions, which include finance, procurement, information systems, and internal controls. In addition, the mission admitted that ASF had limited experience in two internal documents. In the first, the mission wrote that the project was delayed because ASF needed more experience issuing grants. In addition, in the second, it explained that as a local organization, ASF and its staff needed significant capacity building.

Recommendation 2. USAID/Pakistan agreed with the recommendation. It stated that many of the weaknesses that OIG identified have been or are in the process of being corrected. The mission agreed to review the extent to which the risks identified in the risk mitigation frameworks are being managed to make sure that corrective actions identified during the preaward assessments are resolved within the time frame. The mission plans to complete the review by July 19, 2013. Mission officials have reached a management decision.

Recommendation 3. USAID/Pakistan agreed with the recommendation. If the mission decides to continue with the Agribusiness Project, it will ask ASF to provide its policies relevant to this award for review. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

Recommendation 4. USAID/Pakistan agrees with the recommendation. If the mission decides to continue with the project, it will review the findings of the second preaward assessment report to identify any weaknesses for which special award conditions would need to be incorporated into the award. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

Recommendation 5. USAID/Pakistan agreed with the recommendation. If the mission decides to continue with the project, it will continue the work it has begun with ASF to develop a work plan, which would include a specific schedule for completing the required manuals and implementing the information management system. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

Recommendation 6. USAID/Pakistan agreed with the recommendation. If the mission decides to continue with the project, it will require ASF to submit a revised second-year work plan with realistic targets and objectives; once the plan is approved, the mission will monitor progress through regular site visits. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

Recommendation 7. USAID/Pakistan agreed with the recommendation. If the mission decides to continue with the project, it will require ASF to submit a file checklist detailing the documentation that must be in each subaward file to make an affirmative responsibility determination that is in line with the grants manual. Based on the results of the review, the mission may ask ASF to terminate its awards with subrecipients that do not appear to be responsible. However, the mission does not believe suspending all advances to subrecipients would be suitable because it would severely disrupt the project implementation and cause more delays.

Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

Recommendation 8. USAID/Pakistan agreed with the recommendation in principle, but disagreed with the technical analysis in the finding.

If the mission decides to continue with the project, it will require ASF to submit a revised second-year work plan that includes specific grant activities it plans to implement during the year, with benchmarks, milestones, and expected outputs and outcomes. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

Regarding the technical analysis for the finding, USAID/Pakistan officials said that sampling five grants did not approach the level of certainty to conclude that other grants may not be sustainable, and they felt that a larger sample was required to make such a conclusion.

OIG agrees that it could not make such a statement without reviewing a larger sample. However, the finding limited its analyses to the activities that OIG visited. The purpose of the finding was to alert the mission to problems that OIG found with the sample so the mission could address them and make sure that future grant activities do not have similar problems.

Regarding the pickle production activity, although the mission disagreed with the fact that it was unsustainable, it agreed that more work should be done to make sure farmers are producing what the market wants. For the tunnel production, the mission stated that neighboring farmers were able to replicate the tunnels. However, during OIG’s site visit, the team observed that the neighboring farmers were not successful in replicating the tunnels with their own resources.

Recommendation 9. If the mission decides to continue with the project, it will require ASF to treat application fees as program income and apply them toward the award’s cost share requirement. Mission officials said they will decide by July 8, 2013, whether they should modify the award by reducing the scope or terminate the Agribusiness Project. Therefore, a management decision has not been reached.

The mission should coordinate with USAID's Audit Performance and Compliance Division concerning final action on the remaining recommendations. The complete text of management comments is included in Appendix II.

SCOPE AND METHODOLOGY

Scope

We conducted this performance audit in accordance with generally accepted government auditing standards. They require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with our audit objective. We believe that the evidence obtained provides that reasonable basis.

The purpose of this audit was to determine whether USAID/Pakistan's Agribusiness Project was improving conditions for broad-based economic growth and creating jobs—two of three goals. No previous audits have addressed the areas reviewed.

The audit covered activities implemented from November 10, 2011, to March 30, 2013. The project started on November 10, 2011, and will end on November 9, 2016. As of December 2012, USAID had obligated approximately $27.3 million and spent $7.8 million for the project. OIG visited 5 grantees, totaling approximately $34,206, and tested 4 out of 11 subrecipients, totaling $1.4 million, to understand the selection process and determine whether they were using the grants as intended.

We reviewed applicable laws and regulations as well as USAID policies and procedures pertaining to the project, including ADS Chapters 201 and 303. The audit relied on the following sources of evidence: the cooperative agreement, annual plans, performance monitoring plan, quarterly progress reports, and interviews with officials from USAID/Pakistan, ASF, and CNFA, the international consultant, and beneficiaries. We reviewed and analyzed documentation maintained at the mission and at ASF's offices in Islamabad and Lahore. Audit fieldwork was performed at the USAID/Pakistan mission and at ASF's project offices in Islamabad. The audit also included field visits to rural areas near Islamabad, Lahore, and the Punjab region from February 25, 2013, through March 1, 2013.

In planning and performing the audit, the audit team assessed significant controls that ASF used to manage the project and to make sure it provided adequate oversight of project activities. These controls included reviewing ASF's selection criteria for its subrecipients to assess whether it followed its procedures, how it procured in-kind grants, and how it collected data from grant recipients.

Methodology

To answer the audit objective, the audit team interviewed officials from USAID/Pakistan, ASF, CNFA, the international consultant, and beneficiaries. The audit team also reviewed mission and ASF documentation used to manage and monitor the project. To validate the results reported, the audit team verified key reported results with supporting data maintained by ASF.

The audit team had a materiality threshold of plus or minus 10 percent. The audit team judgmentally selected 5 of 110 grant recipients to visit and assess their activities. The team could conduct only a limited number of site visits because of security restrictions. In addition, the audit team tested 4 of 11 subrecipients to verify their eligibility for receiving subawards. The results from our judgmental sampling cannot be projected to the universe.

Additionally, through interviews, documentation reviews, and data analysis, the audit team obtained an understanding of (1) the project's main goals, (2) how the mission monitors the implementation of the project, (3) the quality of the data reported, and (4) allegations of fraud or other potential illegal acts or noncompliance with laws and regulations.

USAID | PAKISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

Date: May 29, 2013

To: Matthew Rathgeber
Director OIG/Pakistan

From: Jonathan M. Conly /s/
Mission Director USAID/Pakistan

Subject: Management Comments on the Audit of USAID/Pakistan's Agribusiness Project

Reference: Draft Report No. G-391-13-00x-P dated May 03, 2013

The USAID/Pakistan mission would like to thank the OIG/Pakistan audit team for undertaking the audit of the USAID/Pakistan's Agribusiness Project implemented by the Agribusiness Support Fund (ASF). This memorandum contains USAID/Pakistan's response to the draft audit report. While USAID/Pakistan does not fully agree with the all of the audit findings, the Mission believes that the recommended actions will further strengthen the activities under this award. In fact, some of the stated corrective actions were already under way when this audit was conducted.

<u>Audit Finding: "Implementer Lacked Capacity to Manage the Project"</u>

Mission does not agree with the characterization on page 4 of the draft audit report, "The mission selected the implementer even though it lacked the experience necessary to manage the project." It is true that the Mission was directed by the Assist Coordinator to make awards to local organizations during the time in question; however the Mission did make a positive responsibility determination. The Mission noted that ASF had:

1) A track record of expanding existing agribusinesses and stimulating creation of new agribusinesses
2) National coverage
3) A program for skill development required for profitable business management.
4) Access to cadre of technical experts to assist new and expanding agribusinesses
5) Experience managing program funds, and
6) Qualified, experienced and stable leadership with reputation of efficient management.

While the Mission recognized there would be challenges in the implementation of the award, these challenges were not deemed so insurmountable as to exclude ASF from receiving the award. In addition, prior to making the award, the Mission conducted a pre-award assessment to determine amongst other issues, what if any assistance ASF might require in implementing the award. In hindsight, the Mission could have scoped the award differently to allow more time for the rollout of services in a more limited number of value chains.

Below are the specific comments with regard to the recommendations under this finding:
<u>Recommendation No. 1</u>
We recommend that USAID/Pakistan develop an action plan to ensure program goals will be reached by the end of 2016, or, if the goals cannot be reached, determine if the agreement signed with the Agribusiness Support Fund should be discontinued.

The Mission agrees with this recommendation. The Mission has requested and received a plan from Agribusiness Support Fund (ASF) to reduce the number of value chains from sixteen to ten and an associated reduction in the total estimated cost of the award consummate with the reduced scope. The Mission is currently evaluating the viability and practicality of the plan with ASF. By July 8, 2013, the Mission will make a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project.

<u>Recommendation No. 2</u>
We recommend that prior to making future awards, USAID/Pakistan implement mission-wide procedures to verify independently that corrective actions are sufficient to address weaknesses identified in its pre-award assessments.

The Mission agrees with the intent of the finding and recommendation. Pre-award assessments may identify corrective actions that are determined to be required prior to award, a set of corrective actions which are required to be completed within a specified period after the award, or both. ADS 303.3.9 specifically allows risks identified in pre-award assessments/surveys to be addressed in awards by special award conditions that must be met in a reasonable timeframe after the award is made. Once the weaknesses have been mitigated, the special award conditions will be removed from the award. In the case of non-compliance, additional measures will be considered including the possibility of award termination. The Mission will continue to affect its awards within the context of this guidance while emphasizing the need to monitor and manage implementing partners whose awards contain risk mitigation steps.

The Mission has in place a process and procedures to ensure pre-award assessments are conducted prior to award, that the risks are reviewed and addressed in a risk mitigation framework and that the conditions of the award are followed up (Mission Notice No.44/2011). This process is not acknowledged in the audit finding. This process was put into place as a result of the prior OIG audit “Audit of USAID/Pakistan’s Management of Pre-award Assessments,” dated May 6, 2011. The pre-award assessment and the risk mitigation framework the OIG reviewed for this activity during the course of the audit was a direct result of the implementation of the audit recommendations.

We believe the underlying question raised by this audit finding and the intent of the recommendation is to determine whether the established process is working to ensure risks are identified and sufficient corrective actions are taken to address the weaknesses identified. To answer this question, we will review the extent to which the risks identified in the risk mitigation frameworks are being managed to ensure the corrective actions identified are resolved within the identified timeframes. This review will be conducted as a part of our internal control testing for the Federal Managers Financial Integrity act (FMFIA). This testing will take place in June 2013. Based on the outcome of this testing the Mission will determine if the processes and procedures in Mission Notice No.44/2011 are sufficient to ensure that corrective actions are taken to address the weaknesses identified in the pre-award assessments and initiate corrective action as necessary. This work will be completed by July 19, 2013.

Based on the above, the Mission requests OIG's acknowledgement that a management decision has been reached.

Recommendation No. 3

We recommend that USAID/Pakistan implement a plan to confirm that the policies and procedures of the Agribusiness Support Fund related to governance, procurement, human resource, information technology and agribusiness operations comply with USAID regulations.

The Mission agrees with this recommendation in principle. Should the Mission decide to continue with this activity (see management response to Recommendation No.1), the Mission will request ASF to provide its policies relevant to this award, such as procurement, personnel, travel (the project's Grants Manual has already been extensively reviewed by USAID), for review, comment and concurrence. However, the Mission remains concerned that policies such as "agribusiness operations" do not directly correspond to USAID requirements and, as such, it may not be within the purview of USAID to review this area under an Assistance agreement.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

Audit Finding: "Implementer did not Correct Material Weaknesses"

The Mission would like to note that many of the weaknesses identified in the pre-award assessment have been corrected (e.g. recruitment policies) or are on the verge of being corrected (e.g. internal audit).

Below are the specific comments with regard to the recommendations under this finding:

Recommendation No. 4

We recommend that USAID/Pakistan follow up with the Agribusiness Support Fund to correct the weaknesses identified in the second pre-award assessment report.

The Mission agrees with this recommendation in principle. Should the Mission decide to continue with this activity (see management response to Recommendation No.1), the Mission will review the findings of the second pre-award assessment report to identify any weaknesses which may remain for which Special Award Conditions will be incorporated into the award to outline the specific steps which ASF must take to satisfactorily address each weakness. If the Mission does not continue the program, the remaining weaknesses will be recommended for ASF's own action as good management practices.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

Recommendation No. 5
Implement a strategy to work with Agribusiness Support Fund to update its finance and procurement manuals and implement the Integrated Management Information System

The Mission agrees with this recommendation in principle. Should the Mission decide to continue with this activity (see management response to Recommendation No.1), the Mission will continue the work it has already started with ASF to develop a new work plan. Part of this work plan will include a specific timeline for the completion of the required manuals and the completion of the implementation of the information management system.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

Recommendation No. 6
We recommend that USAID/Pakistan implement a plan to monitor the second year annual plan to ensure that the project can meet its targets, outcomes, and goals.

The Mission agrees with this recommendation in principle. Should the Mission decide to continue with this activity (see management response to Recommendation No.1), the Mission will require ASF to submit a revised second-year Work Plan with realistic targets and objectives. Once the Work Plan is approved, USAID will monitor progress through regular site visits.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

Audit Finding: "Project did not Thoroughly Assess Sub-recipient Eligibility"

On Page 11, the audit report cites ADS 303.3.9 as the criteria for the finding. However, this criterion applies to the USAID Agreement Officer for a USAID direct award, not to a USAID implementer who makes sub-awards/grants. As an implementer, ASF is required to perform the following responsibility determination (from the standard provision SUBAWARDS (June 2012) :

"The recipient must determine that the sub-recipient possesses the ability to perform successfully under the terms and conditions of a proposed award, taking into consideration the sub-recipient's integrity, record of past performance, financial and technical resources, and accessibility to other necessary resources. The recipients must ensure sub-awards are made in compliance with the Standard Provision "Suspension and Debarment," and the Standard Provision "Prevention of Terrorist Financing."

Below are the specific comments with regard to the recommendations under this finding:

<u>Recommendation No. 7</u>

We recommend that USAID/Pakistan require the Agribusiness Support Fund to stop advance payments to sub-recipients responsible for forming farmer groups until the Agribusiness Support Fund conducts a thorough pre-award responsibility determination.

The Mission agrees with this recommendation in principle. ASF must comply with the "sub-awards" provision of the Cooperative Agreement for which ASF's procedures for conducting a responsibility determination are codified in its Grants Manual which was approved by USAID in May 2012. Should the Mission decide to continue with this activity (see management response to Recommendation No.1), the Mission will require ASF to submit a file checklist detailing the documentation that must be in each sub-award file to make an affirmative responsibility determination, in line with ASF's Grants Manual. The Mission will schedule a review of a representative sample of sub-grantees documentation to ensure that the necessary documentation is in the file and that sub-awards are supported by appropriate responsibility determinations. Based on the results of the file review, the Mission may request that ASF terminate its awards with sub-recipients that do not appear responsible.

The Mission believes that suspending all advances to sub-recipients would not be suitable, as this would be severely disruptive to the project interventions that are currently underway, thus compounding the delays in implementation.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

<u>Audit Finding: "Activities Funded by the Project May not be Sustainable"</u>

The Mission would like to point out that a sampling of 5 grants does not approach the level of certainty to conclude that other grants may not be sustainable. The authors of the report also misunderstand the type of support provided and its expected results. Blanket statements on failure or potential unsustainability of activities require review of a larger sample and also require analysis by people with the requisite technical skills.

1. Pickle production: The audit report states that while the project provided some market support, the farmers were unable to sell their products to those markets. It should be noted that the project does not guarantee market sales. It facilitates connections to farmers to begin building relationships with end markets. The fact that these particular farmers were unable to sell their products should not be an indication that the activity is unsustainable or that it failed. It is however an indication that more work needs to be conducted to ensure that farmers are producing what the market requires and this work is being followed up in the current work cycle.
2. Tunnel production: USAID disagrees with the statement on tunnel production. The tunnel technology used is appropriate for the size and scale of operation at the sites. Additionally, the tunnels have since been replicated by neighboring farmers without support from the project or USAID. This effort has been one of the more successful operations to date of the project.
3. Goats: We agree that this was an ill-conceived grant and it will not be repeated.

4. Solar dryers: It is unclear from the auditor statement what the issue is they are raising. Is the problem that the recipient did not receive proper information or that the recipient was using the money to offset his research costs? This should be clarified if it is to be used as an example of an unsustainable activity. The project does provide grants to help offset costs of business looking to explore new ventures and technologies. This is considered as helping catalyze the industry and an important need in a risk adverse business climate. The grant was therefore appropriate in that sense. However, we do agree that if technical assistance was not provided it should have been and will follow-up to ensure that it happens.

Below are the specific comments with regard to the recommendations under this finding:

Recommendation No. 8
We recommend that USAID/Pakistan obtain a revised annual plan from the Agribusiness Support Fund to include specific grant activities that it plans to implement during the year, with benchmarks, milestones, and expected outputs and outcomes.

The Mission agrees with this recommendation in principle. Should the Mission decide to continue with this activity (see management response to Recommendation No. 1), the Mission will require ASF to submit a revised second-year Work Plan. The Mission will ensure it includes specific grant activities that ASF plans to implement during the year, with benchmarks, milestones, and expected outputs and outcomes.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

Recommendation No. 9
We recommend that USAID/Pakistan require the implementer to record the nonrefundable application fees received from the grantees as income in the project accounts.

The Mission agrees with this recommendation in principle. Should the Mission decide to continue with this activity (see management response to Recommendation No. 1), the Mission will require ASF to treat application fees as program income and apply it towards the award's cost share requirement.

Based on the above, the Mission requests OIG's acknowledgement that a management decision will be reached when the Mission makes a determination as to whether it is in the best interest of the government to modify the award and reduce its scope or terminate the USAID Agribusiness Project. This decision will be made by July 8, 2013.

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