



OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/PAKISTAN'S RECONSTRUCTION PROGRAM IN EARTHQUAKE-AFFECTED AREAS

AUDIT REPORT NO. G-391-12-007-P
AUGUST 16, 2012

ISLAMABAD, PAKISTAN



Office of Inspector General

August 16, 2012

MEMORANDUM

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

FROM: Office of Inspector General/Pakistan Director, Joseph Farinella /s/

SUBJECT: Audit of USAID/Pakistan's Reconstruction Program in Earthquake-Affected Areas
(Report No. G-391-12-007-P)

This memorandum transmits our final report on the subject audit. In finalizing the report, we considered your comments and included your response in Appendix II.

The final report contains four recommendations to help improve the reconstruction program. On the basis of the information provided by the mission in response to the draft report, we determined that final action has been taken on one recommendation, and management decisions have been reached on two recommendations. A management decision has not been reached on one recommendation. A determination of final action will be made by the Audit Performance and Compliance Division when the mission completes planned corrective actions on the remaining recommendations.

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

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SUMMARY OF RESULTS

On October 8, 2005, a 7.6-magnitude earthquake struck the mountainous region of northern Pakistan. In response to this disaster, the Government of Pakistan established the Earthquake Reconstruction and Rehabilitation Authority (ERRA) to coordinate, monitor, regulate, and oversee all reconstruction and rehabilitation activities in earthquake-affected areas.

In January 2006, USAID/Pakistan and the Government of Pakistan signed a \$200 million special objective assistance agreement that formalized U.S. support for Pakistan's reconstruction program. The objective of this agreement was to strengthen the health and education sectors in the earthquake-affected areas. The largest component was a 5-year, \$120 million contract awarded to the construction firm Camp Dresser and McKee, International Inc. (contractor). The purpose of this contract was to design, build, and furnish earthquake-resistant schools and health-care facilities in Mansehra and Bagh Districts. In June 2011, USAID/Pakistan extended the contract to June 2013 and increased its ceiling to \$180 million. As of May 2012, USAID/Pakistan had obligated \$139 million and spent \$114 million for the program activities.

The contract specifies how many structures (77 total—61 schools and 16 health-care facilities) should be built and how. The contractor must meet international engineering, architectural, and seismic design standards so that the buildings may serve as safe havens for the communities in the event of future natural disasters. The contractor has to furnish the buildings: the schools with desks, chairs, chalkboards, bookshelves, cabinets, and electrical fixtures; the health-care facilities with furniture and equipment for administration offices, examination rooms, kitchens, and baths. Furthermore, the contractor should encourage community participation throughout construction to help prevent and solve problems during construction, and address issues that might affect the functioning of the facilities and their sustainability.

The Office of Inspector General (OIG) conducted this audit to determine whether USAID/Pakistan's reconstruction activities in earthquake-affected areas were being implemented effectively.

USAID/Pakistan's reconstruction activities were making progress (page 3). As of May 2012, the contractor had completed 51 of the 77 facilities (36 schools and 15 health-care facilities) and turned them over to the Government of Pakistan. ERRA officials inspected the completed buildings to verify that they met the technical specifications and issued certificates indicating transfer of ownership. The contractor turned the facilities over to the Government of Pakistan within the estimated time and budget, and the government was using most for their intended purposes. Construction was under way on 21 buildings (20 schools and a district hospital), and the contractor was bidding on sites for 5 additional structures. For the audit, OIG visited 37 schools and health facilities between April 15 and May 16, 2012.

Although USAID/Pakistan was on track to achieve the program's main goal, the audit identified three areas for improvement:

- Roof tiles needed replacement (page 5). Although the contract specifies that materials should last and be easy to maintain, the contractor used clay tiles that were not suited to the environment. Several community members said the tiles do not stand up to local weather conditions, and the audit disclosed damaged tiles on 13 completed buildings.

- A completed health-care facility was not being used (page 6). It has deteriorated considerably from disuse.
- The contractor did not submit financial audit reports to USAID/Pakistan (page 7). Four reports covering the contractor's performance from 2007 to 2010 identified problems, including questioned costs of about \$117,800 that related directly to USAID-funded activities.

To address the problems noted, the report recommends that USAID/Pakistan:

1. Implement a plan to verify that damaged roof tiles are replaced (page 5).
2. Implement a plan to utilize the newly constructed health-care facility in Neela But, Bagh (page 6).
3. Ask the contractor to submit past and future financial audit reports (including management letters) to USAID, and verify that internal control weaknesses were corrected (page 7).
4. Determine the allowability of, and collect as appropriate, questioned unsupported costs of \$117,800 (page 7).

Detailed findings follow. Our evaluation of management comments is on page 8. Appendix I presents the audit scope and methodology, and Appendix II contains the mission's written comments on the draft report in their entirety, without attachments.

AUDIT FINDINGS

Reconstruction Program Activities Were Making Progress

According to the contract, the contractor would design, build, and furnish 77 earthquake-resistant schools and health-care facilities in the earthquake-affected areas of Mansehra and Bagh Districts.

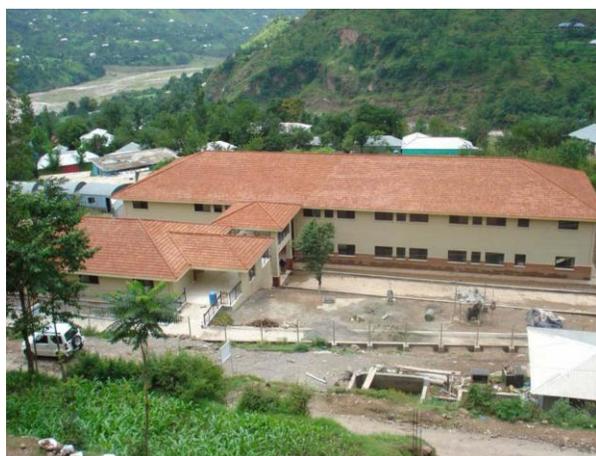
As of May 31, 2012, USAID/Pakistan had completed, furnished, and turned over 51 of 77 facilities to the Government of Pakistan. After inspecting the completed buildings to verify that they met technical specifications and were completed on time and within budget, ERRA officials issued certificates indicating transfer of ownership.

The table shows the number of facilities completed, in progress, and planned.

Status of Reconstruction Activities as of May 31, 2012 (Audited)

Status	Number of Sites
Completed	51
In progress	21
Planned	5
Total	77

To confirm reconstruction results, OIG made site visits to 37 schools and health-care facilities between April 15 and May 16, 2012, in Bagh and Mansehra Districts. OIG observed that schools were furnished with desks, chairs, chalkboards, bookshelves, cabinets, and electrical fixtures and that health-care facilities had furniture and equipment for administration offices, examination rooms, kitchens, baths, and electrical fixtures (as shown below and on page 4).



In Bagh, projects include a girls' intermediate college with 22 classrooms in Rerrah (left) and a boys' high school under construction in Pinyali (right). (Photos from Camp Dresser and McKee's progress reports dated December 2010 and April 2012)



At left, a completed health-care facility in Khawaja Ratnoi, Bagh, accommodates wheelchairs with the ramp and rails shown in the foreground; at right is a completed high school for boys in Afzalabad, Mansehra. (Photos from Camp Dresser and McKee’s progress reports dated August 2010 and December 2011)

Except for one health-care facility discussed on page 6, all the completed facilities were being used for their intended purposes and were occupied with students, patients, and staff. The contractor estimated that enrollment in affected communities has expanded by 2,000 students since 2006, with current enrollment estimated at 17,000 students. The contractor expected the enrollment rate to increase to 28,000 over the next 5 years. Community leaders and ERRA officials praised the reconstruction work and expressed gratitude for the U.S. Government’s assistance. Important aspects of implementation included paying attention to design and engineering and involving communities.

Design and Engineering. Because earthquakes occur regularly in the northeast region of Pakistan, a primary objective of the contract’s design and construction process was to dissipate earthquake energy without collapse. After incorporating community input on the designs, USAID/Pakistan approved them and coordinated with ERRA on obtaining construction permits.

To design, build, furnish, and turn over schools and health-care facilities that met international standards, the contractor conducted engineering assessments of sites to verify:

- Geotechnical data
- Slope stability
- The size of the area available for construction
- The availability of water, electricity, and sewage disposal services
- The availability of temporary facilities during construction

This advance work helped the contractor finish the facilities on time, within budget, and according to international seismic building standards.

Community Involvement. As it does elsewhere, construction in Pakistan often grinds to a halt because of problems such as disputes over land ownership, restricted access to the sites, limited access to water and electricity, and construction workers brought in from elsewhere who violate cultural norms in conservative rural areas. According to a contractor’s study, 65 percent of ERRA (government-run) construction sites in the districts of Khyber Pakhtunkhwa have had

work stoppages at some point, as have all ERRA sites in Bagh District. On a positive note, no work stoppages occurred at USAID/Pakistan’s reconstruction sites.

To counter such challenges, the USAID contractor formed a team to mobilize community leaders. Early meetings with community leaders helped establish priorities and identify issues that might affect the construction activities. Community leaders helped settle land disputes, arrange access to water, and work around electricity issues that commonly occur in construction work. The leaders provided temporary school sites, construction staging areas, and storage and advised on the design of facilities. With the help of community leaders, the contractor lost no workdays. On completion of the facilities, many of the community committees formed school management committees and parent-teacher councils to improve the quality of education. Although progress has been made, the audit identified three areas for improvement.

Roof Tiles Needed Replacement

The contractor’s work plan requires building materials to be durable and easy to maintain. Furthermore, the contract mandates a 1-year warranty period after the contractor completes construction and hands over the facility to the Government of Pakistan. During this period, the contractor is responsible for fixing problems or damage at completed buildings.

During the site visits, OIG noted damaged roof tiles (shown below) on 13 completed facilities— 10 with expired warranties and 3 still under warranty. Contractor officials thought that they had selected the best tiles, but acknowledged clay tiles were not suited to the environment. Several community members we met said the red clay roof tiles were easily damaged by weather conditions in the region, were discoloring exterior walls, and were not available locally. The damage noted during the site visits was on ten buildings whose warranty had expired. For facilities under construction, the contractor told us that better roof tiles (concrete ones) would be used. Contractor staff members also told us that damaged roof tiles at facilities where the 1-year warranty had expired would be replaced with better tiles at no cost to USAID.



These roof tiles at facilities visited in Bagh and Mansehra Districts are disintegrating from exposure. (Photos by OIG, April 17, 2012)

We reviewed the contractor’s lists of items to repair and replace at 11 sites. During our visits, we saw damaged tiles at three of these sites, which were within the warranty period. Yet the lists did not include repairs at these sites. Therefore, we make the following recommendation.

Recommendation 1. We recommend that USAID/Pakistan implement a plan to ensure damaged roof tiles are replaced.

Completed Health-Care Facility Was Not Being Used

In October 2010, USAID/Pakistan completed the health-care facility shown below and turned it over to the Government of Pakistan.



This health-care facility in Neela But, Bagh, is not in use and has deteriorated since it was turned over to the Government of Pakistan. As shown above, roof tiles are damaged. (Photo by OIG, April 16, 2012)

However, OIG observed that the two-story health-care facility was not in use and has deteriorated without maintenance. OIG noted damage to the roof tiles, a high-voltage electrical cable running across the roof of the building, a broken window, no running water or electricity, and mold on the interior walls.

According to the contractor, the Government of Pakistan was not occupying the new health-care facility because it did not want to abandon the old one. The old facility was the subject of a land dispute between the adjoining property holders, and the government thought vacating the building might escalate the dispute. As a result, residents of Neela But, Bagh, could not use the new facility, for which USAID/Pakistan spent \$864,000. USAID/Pakistan should coordinate with the contractor's social mobilization team and the Government of Pakistan to use this new facility for the benefit of the community.

Therefore, we make the following recommendation.

Recommendation 2. We recommend that USAID/Pakistan implement a plan to utilize the newly constructed health-care facility in Neela But, Bagh.

Contractor Did Not Submit Financial Audit Reports to USAID

Pakistan Companies Ordinance Part XIV of 1984 requires foreign-based companies to prepare annual financial statements. To comply with this ordinance, the contractor engaged a local accounting firm to conduct four audits from 2007 to 2010. As part of the annual audits, the accounting firm evaluated internal controls and other aspects of the contractor's operations in Pakistan.

However, the contractor did not provide the audit reports to USAID. Currently, the financial audit for 2011 is under way. The audit reports for 2007-2010:

- Included management letters that identified internal control deficiencies, such as insufficient segregation of duties in the bank reconciliation process, travel vouchers lacking travel authorization, and problems with tax withholdings.
- Made recommendations to correct deficiencies.
- Questioned approximately \$117,800 in unsupported costs related to large purchases made in cash, purchases missing approvals, incomplete receiving reports, and purchases made from vendors that were not the lowest bidders.

The contractor did not submit audit reports to USAID because the audits were not required under the contract, and the contractor saw no reason to submit them. However, USAID paid for the first audit report. Moreover, although the reports were not required, the deficiencies noted related directly to the USAID-funded program. Thus, USAID should have obtained the reports so it could have addressed any deficiencies.

The mission was not aware of the internal control weaknesses or the questioned costs identified. Although OIG gave the mission the financial audit reports from 2007 to 2010, we make the following recommendations.

Recommendation 3. We recommend that USAID/Pakistan request that the contractor submit past and future financial audit reports (including management letters) to USAID and verify that internal control weaknesses were corrected.

Recommendation 4. We recommend that USAID/Pakistan determine the allowability of, and collect as appropriate, questioned unsupported costs of \$117,800.

EVALUATION OF MANAGEMENT COMMENTS

USAID/Pakistan agreed with the four recommendations in the draft report.

On the basis of the information provided by the mission in response to the draft report, we determined that final action has been taken on Recommendation 2, and management decisions have been made on Recommendations 1 and 3. Recommendation 4 remains without a management decision.

Recommendation 1. USAID/Pakistan ensured that roofs with damaged tiles will be repaired at all sites at no cost to USAID. The mission will complete a plan to make repairs using best means, methods, and types of material by October 31, 2012. Accordingly, a management decision has been reached.

Recommendation 2. USAID/Pakistan settled the land dispute. In April 2012, the new health-care facility was in use. On July 10, 2012, the contractor's social team visited this health-care facility and confirmed that it was operational. Accordingly, final action has been taken.

Recommendation 3. USAID/Pakistan asked the contractor to submit all past and future audit reports, including management letters. The mission's Office of Acquisition and Assistance will work with the Office of Financial Management and the technical office to verify that the internal control weaknesses identified in those reports are corrected by October 2012. Accordingly, a management decision has been reached.

Recommendation 4. USAID/Pakistan's Office of Acquisition and Assistance, the Office of Financial Management, and the technical office will investigate the unsupported questioned costs and make a decision on them. A management decision on this recommendation will be reached when USAID/Pakistan determines whether the questioned costs are allowed or disallowed. Final action will occur when any disallowed amount is collected.

The Audit Performance and Compliance Division will determine final action on completion of the planned corrective actions for Recommendations 1 and 3. The mission's written comments on the draft report are included in their entirety, without attachments, as Appendix II of this report.

SCOPE AND METHODOLOGY

Scope

We 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 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 reconstruction activities in earthquake-affected areas were being implemented effectively. As of May 31, 2012, cumulative obligations and expenditures under the contract totaled approximately \$139 million and \$114 million, respectively. The audit team reviewed performance information for October 2006 through May 31, 2012, and evaluated the major activities implemented under the contract.

In planning and performing the audit, the audit team reviewed the control environment at the mission. We examined the mission's fiscal year 2011 self-assessment of management controls, which the mission is required to perform to comply with the Federal Managers' Financial Integrity Act of 1982 (as codified in 31 U.S.C. 3512), to check whether the assessment cited any relevant weaknesses. We also reviewed applicable USAID policies and procedures pertaining to USAID/Pakistan's earthquake reconstruction activities, including Automated Directives System Chapters 203 and 596.

The audit team assessed relevant internal controls used by the mission to manage the activities. These controls included maintaining regular contact with the contractor, reviewing and approving key decisions, performing site visits, and assessing reported results. The audit team also reviewed the contractor's control environment, including a review of procurement, quality control, accounting functions, and the reporting of results.

In November 2008, OIG issued a performance audit, "USAID/Pakistan's Earthquake Reconstruction Activities," Report No. 5-391-09-001-P. The audit included a review of activities performed under the contract and made four recommendations to the mission. During this audit, we reviewed the status of those recommendations and confirmed that the mission took corrective actions.

The audit team performed fieldwork at the USAID/Pakistan mission, the contractor's main office in Islamabad, the district offices in Bagh and Mansehra, and select project sites in Pakistan from March 19 through June 26, 2012.

Methodology

To answer the audit objective, we reviewed mission documentation used to manage and monitor the activities. These documents included the country operations plan, performance management plans, the contract agreement, reported results, financial reports, and site visit reports. We also interviewed mission officials; staff at the contractor's Pakistan office and U.S. headquarters; and stakeholders including, teachers, medical professionals, community

members, and government administrators. We also compared plan targets with reported results.

For this project, the audit team considered the effectiveness to mean meeting the established performance targets. The performance management plan included targets for the number of buildings delivered, community participation, timeliness of construction, accessibility for those with physical disabilities, construction in progress, and operations and maintenance plans for completed buildings. The audit team also discussed earthquake-resistant building designs.

The audit evaluated whether the indicators used to measure the effectiveness of activities were sufficiently results-oriented to permit their use in answering the audit objective. Through discussions with USAID/Pakistan officials and the contractor, the auditors gained an understanding of how (1) the indicators were defined, (2) data sources used, and (3) the flow of data from the project sites to inclusion in monthly reports.

In assessing the status of the activities carried out during the first 5 years of the contract, the auditors relied primarily on the contractor's monthly progress reports from November 2006 through April 2012, supplemented by interviews conducted with USAID/Pakistan and contractor staff about achievements and problems reflected in these reports.

To validate the results reported for the activities, the auditors checked key reported results against supporting documentation maintained by the contractor. The audit team also visited 37 project sites to observe construction in progress, inspect completed buildings, speak with community stakeholders, and verify reported results.

MANAGEMENT COMMENTS



USAID | **PAKISTAN**
FROM THE AMERICAN PEOPLE

MEMORANDUM

Date: July 16, 2012

To: Joseph Farinella
Director OIG/Pakistan

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

Subject: Management Comments on the Audit of USAID/Pakistan's Reconstruction Activities in Earthquake affected areas

Reference: Report No. G-391-12-00X-P dated June 29, 2012

In response to the referenced draft audit report, please find below Mission management comments on the recommendations included therein.

Recommendation No.1 We recommend that USAID/Pakistan implement a plan to ensure damaged roof tiles are replaced.

Management Comments:

Mission Management concurs with the recommendation. The Technical Office is working with the Contractor of the program (CDM Smith) to ensure that roofs with damaged tiles are repaired at all sites, which were noted by the OIG representatives, at no cost to USAID. Different options will be investigated for such repairs in terms of means, methods and types of materials best used to ensure that the repair is a long-term fix for this issue. Final action on this recommendation is expected to be completed by October 31, 2012.

Recommendation No. 2 We recommend that USAID/Pakistan implement a plan to utilize the newly constructed healthcare facility in Neela But, Bagh.

Management Comments:

Mission Management concurs with the recommendation. Due to a serious sectarian dispute between the adjoining property owners, the Bagh Department of Health wanted to keep some presence in the old building to hold the land and hence the move to the newly constructed building by USAID was delayed. In late April 2012, the new healthcare facility was put in full operation by moving all the main functions from the old building, except for the Expanded Program on Immunization (EPI) section. This achievement resulted from an agreement between the Azad Jammu & Kashmir Government Department of Health, and the Azad Jammu & Kashmir Rural Support Program (AJKRSP). Under this agreement, the AJKRSP has taken over the management of all Basic Health Units (BHU) in Bagh, including BHU Neela Butt. The People's Primary Health Care Initiative is to provide and manage staff and the budget includes Pak Rs. 100,000 per year for building maintenance. Members of the CDM Smith social team visited the site on July 10, 2012 and found the new BHU to be fully functioning. Site visit report is attached as Annex- A.

Accordingly, corrective action has been taken; therefore we request closure of this recommendation upon issuance of the final report.

Recommendation No. 3 We recommend that USAID/Pakistan request the contractor to submit past and future financial audit reports (including management letters) to USAID and verify that internal control weaknesses were corrected.

Management Comments:

Mission Management concurs with the recommendation. CDM Smith has been requested to submit the portions of all past and future audit reports (including the management letters) which pertain to USAID funded projects. The Office of Acquisition and Assistance (OAA) will work in collaboration with the Office of Financial Management and the Technical Office to review and verify that the internal control weaknesses identified in those reports were corrected. Final action on this recommendation is expected to be completed by October 31, 2012.

Recommendation No. 4 We recommend that USAID/Pakistan determine the allowability of and collect as appropriate questioned unsupported costs of \$117,800.

Management comments:

Mission Management concurs with the recommendation. The Office of Acquisition and Assistance (OAA) will work in collaboration with the Office of Financial Management and the Technical Office to investigate the unsupported questioned costs. OAA needs additional time to research the matter and therefore requests additional time to make a conclusive determination. The management decision will be conveyed to OIG/Pakistan under a separate memorandum on or before September 30, 2012.

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