OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/PAKISTAN'S POWER DISTRIBUTION PROGRAM

AUDIT REPORT NO. G-391-14-001-P
DECEMBER 20, 2013

ISLAMABAD, PAKISTAN

Office of Inspector General

December 20, 2013

MEMORANDUM

TO: USAID/Pakistan Mission Director, Gregory C. Gottlieb

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

SUBJECT: Audit of USAID/Pakistan's Power Distribution Program (Report No. G-391-14-001-P)

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

This report contains seven recommendations to help USAID/Pakistan strengthen its management of the Power Distribution Program. Based on the comments, management decisions have been reached on Recommendations 1, 2, 3, 5, and 7. The Audit Performance and Compliance Division will determine final action on completion of the planned corrective actions for these recommendations. Please advise this office within 30 days of actions planned or already taken to reach management decisions on Recommendations 4 and 6.

Thank you and your staff for the cooperation and assistance extended to us during this audit.

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SUMMARY OF RESULTS

For almost a decade, Pakistan has grappled with a severe power crisis. The gap between the demand for and supply of electricity has increased because of increased industrialization, rural electrification, fuel supply limitations, and decreases in hydropower. The acute power shortages result in routine load shedding—disconnecting power when demand exceeds supply—with outages ranging from 4 to 12 hours in both urban and rural areas. Load shedding is reducing the output of the industrial sector, crippling economic growth, and creating social unrest; public demonstrations and riots have regularly broken out across the country.

A lack of investment in the power sector also has contributed to the shortage of electricity. The investment shortfall stems from distribution companies charging less than the full cost of electricity supplied to consumers, the Government of Pakistan not paying the companies makeup subsidies, and companies incurring high technical (e.g., power loss due to poor quality of transmission cables) and nontechnical (e.g., theft of electricity) losses. According to USAID/Pakistan's program documents:

> Poor performance of the country's nine government-owned distribution companies results in inadequate flows of cash from the consumers through the power sector to the fuel supply companies, which starves the whole sector of needed revenues, requires massive infusions of cash from the Government or the banks, and serves as a disincentive for critically-needed investments in the sector.

To help improve the performance of these distribution companies, in September 2010 USAID/Pakistan awarded a 3-year, $60 million task order to International Resources Group[1] to implement the Power Distribution Program. This task order was amended to increase the budget to $230 million and increase the performance period to 5 years. Later the mission expanded the program's scope to include all nine[2] government-owned distribution companies,. Descriptions of the program's three components follow:

- ***Component 1.*** Conduct detailed reviews of the operations of each distribution company to identify needs for improvement, and develop action plans to address the needed improvements.
- ***Component 2.*** Focus on sustainability, governance improvement, revenue improvement, loss reduction, and capacity building and training.
- ***Component 3.*** Provide technical assistance in technology and implement intensive changes in management, governance, and organizational structure in two selected distribution companies, while continuing activities under Component 2 in the remaining companies.

[1] In July 2012, International Resources Group became part of Engility Holdings Inc.
[2] When the contract was signed in September 2010, there were eight distribution companies; however, Hyderabad Electric Supply Co. was split into two companies, and the spin-off (Sukkur Electric Power Co.) was incorporated in November 2010, bringing the total to nine.

As of July 31, 2013, USAID/Pakistan had obligated $98 million and disbursed $56 million for the program. USAID/Pakistan's Office of Energy is responsible for overseeing the Power Distribution Program.

USAID's Office of Inspector General (OIG) in Pakistan conducted this audit to determine whether the program was improving the operational and financial performance of the nine electric power distribution companies in Pakistan by reducing losses, increasing revenues, and improving service.

The program has had mixed results. The program has contributed to the distribution companies' engineering planning and operations, billing technology, and training. However, the program has had little effect on governance, organizational structure, financial management, rate control, and staffing.

Achievements

- ***Engineering planning and operations.*** The program successfully implemented engineering activities like the Load Data Improvement Project. Project staff installed automatic meter-reading devices, allowing data to be transmitted from all grid stations to a monitoring cell at each of the companies. Real-time data transmission enables optimum load management, best use of available power, reduction in unscheduled load shedding, and increased revenue. The photos below show work processes before and after project implementation.

Formerly, operators at Islamabad Electric Supply Co. called grid substations and manually recorded data on power use (left). Operators now use a daily log sheet (right). (Photos by OIG, July 2013)

Under the Load Data Improvement Project, smart meters installed at the grid substation feeder panels (left) transmit real-time data about power distributed by Lahore Electric Supply Co. The data appear on screens in the company's newly established control center (right). (Photos by OIG, June 2013)

On a pilot basis, the program installed capacitors on tube well[3] pumps in rural areas served by selected distribution companies. This reduced technical losses and power outages and helped improve voltage and supply to the farmers.

Similarly, the program has made progress in establishing geographic information systems with mapping functions. The mapping function will allow the distribution companies to analyze power allocation, identify power line losses, and monitor the quality of the power distributed. The program provided hardware and software to the companies, trained their staff, and on a pilot basis mapped selected areas for each distribution company, paving the way for the companies to map their entire networks.

- ***Billing technology.*** The program has contributed to the distribution companies' cost recovery by replacing faulty meters in areas where losses were highest. On a pilot basis, the program improved the meter-reading skills of staff in selected distribution companies. Managers of the distribution companies said this initiative led to efficient meter reading and recovery of lost and unbilled units, as well as to increased customer satisfaction.

- ***Safety training.*** The program started a lineman safety program. Selected linemen received safety training designed to meet the needs of the distribution companies in Pakistan. Staff appreciated the training, and management—which took over delivering training—expected it would minimize the accident rate.

Challenges

Conversely, the program's scope had been revised several times resulting in 13 modifications. The original program concept targeted four distribution companies, but within 6 months the scope expanded to include all nine without any immediate increase in program budget. It was not until 2 years had passed that the mission realized it needed to work with fewer distribution companies to achieve sustainable results. Therefore, the mission narrowed the focus to two distribution companies, increased the program budget for them, and limited activities at the other seven distribution companies. Because the program's scope to work with all nine distribution companies was too ambitious, unmet expectations continue to affect the program's reputation in Pakistan.

Other challenges included the following problems disclosed by the audit:

- The program made little progress in improving distribution companies' management and governance, or in establishing tariffs (rates charged to consumers) that allow full cost recovery (page 5). The distribution companies are still structured like government-owned entities, managed through political influence. In addition, inflows of cash from consumers still do not cover costs, starving the whole sector of needed revenues.

- The mission's monitoring of the program was insufficient (page 6).The mission did not oversee program activities adequately and did not assess the data reported by the contractor.

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[3] A well made by driving a tube into the earth until it reaches a layer that bears water. Water is then drawn out using an electric pump.

- The program lacked financial oversight (page 7). USAID is required to commission an annual audit of costs incurred by the contractor. The required audit of the contractor's annual incurred was 7 years behind schedule, and the mission had not done a review or audit of the contractor's purchasing system.

- The contractor inappropriately billed for weekend and overtime pay. Contrary to contract provisions, the contractor charged USAID for 29 months' worth of unallowable pay (page 8).

- The work plan lacked milestones (page 9). Work plan activities for fiscal year (FY) 2013 did not have any due dates or milestones to track their progress.

To address these problems, we recommend that USAID/Pakistan:

1. Implement a plan to continuously engage the Government of Pakistan to protect distribution companies from political influences, and to help the distribution companies operate under a more businesslike model (page 6).

2. Implement cost-effective management controls for timely monitoring and oversight of the program (page 7).

3. Implement a plan to independently review and verify data reported by the contractor (page 7).

4. Implement a plan to audit the Power Distribution Program's locally incurred costs and review the contractor's procurement system (page 8).

5. Require the International Resources Group to stop billing USAID/Pakistan for overtime pay (page 9).

6. Determine the allowability of ineligible questioned costs of $110,400—$81,225 billed for overtime and $29,175 for weekend pay—and recover from International Resources Group any amounts determined to be unallowable (page 9).

7. Implement a detailed plan to carry out Component 3 of the Power Distribution Program, with clearly defined deliverables that the mission can track and measure for timeliness and benefit (page 10).

Detailed findings appear in the following section. The scope and methodology appear in Appendix I. Our evaluation of management comments is included on page 11 of the final report, and the full text of management comments is in Appendix II.

AUDIT FINDINGS

Program Made Little Progress in Improving Governance and Cost Recovery

According to Modification 7 of the task order, program objectives include improving distribution companies' governance and management, as well as creating an environment for them to operate in a commercial manner. These objectives involve helping the distribution companies operate autonomously, without interference from the government and other political stakeholders; organize like corporations, by specialty or function; and establish tariffs that permit full cost recovery. To facilitate this process, the contractor signed agreements with the distribution companies and with the Ministry of Water and Power. These agreements call for better policies for selecting, working with, and dismissing boards of directors, as well as for reorganizing the companies by function.

Although the program has carried out some activities to address these areas, such as training boards of directors, sending staff on exchange programs, and promoting performance-based compensation, the distribution companies' governance still does not allow for autonomous operations. The companies remain subject to political intervention, and their boards of directors have not been empowered to perform oversight. In addition, the current structure of these companies does not fit the corporate model of functional hierarchy. Similarly, there has been no progress toward full-cost-recovery tariffs, though one power distribution company commissioned a cost-of-service study. The rates charged by all the distribution companies are below the cost of supplying power, and the government subsidies to compensate for these shortfalls are partial and typically paid late, worsening the debt problem that the power sector faces.

The primary reason the program has not achieved the desired results is a lack of Government of Pakistan support for changes in distribution companies' management and governance. Although the Ministry of Water and Power and the distribution companies signed agreements with the contractor, the agreements did not prevent political intervention.

Examples of political intervention follow:

- In September 2012, the Ministry appointed the chief engineer as Chief Executive Officer of the distribution company in Lahore. The appointment undermined the company's structure and the separation of duties. The CEO served as chief engineer and CEO at the same time, the two positions differing hugely in seniority. As Chief Engineer, the CEO was working under the General Manager; however, as the CEO, he supervised the General Manager.

- Similarly, the CEO of the distribution company in Peshawar changed three times within a month. Members of the Multan distribution company's board of directors were pressured by the previous government to appoint several new employees who were not qualified for their jobs; when the board members did not yield, they received threats from politicians and government officials.

Although the program made changes to recruitment policies and updated the accounting and internal audit manuals—spending approximately $1.2 million in providing corporate services to the distribution companies—the companies have not implemented these policies and manuals.

Further, because of political intervention, distribution companies continue transferring program-trained personnel without notice, reducing the effectiveness of capacity-building efforts. Similarly, turnover in some of the companies' top management positions makes program implementation difficult, as new managers have different priorities. As a result, the corporate culture at the distribution companies remains that of a government agency lacking autonomy. Correspondingly, the inability of the distribution companies to charge an appropriate tariff adds to their losses and increases their debt.

In September 2012, Component 3, with a budget of $170 million, was added to the program through Modification 9 of the contract. Under this component, the contractor was allowed to budget:

- $60 million for creating a model distribution company. The model company will undergo intensive technological and administrative reforms to prepare it for privatization. The program will select a model company through consultation, and the final approval for funding will come during the U.S. Congressional Notification process.

- $40 million for turning around a distribution company. Peshawar Electric Supply Co. has been identified as the turnaround company. Work will focus on improving the company's governance and organizational structure and maintaining stability so that it can import electricity from the Central Asian Republics.

- $70 million for the other activities, including continuing select components of the current program**.**

For Component 3 to be successful, the Government of Pakistan needs to commit to protecting the distribution companies—in particular, the proposed model and turnaround companies—from interference by public legislators and political parties. Unless there is support from the highest level of government, efforts to change organizational structure will be ineffective. Therefore, we make the following recommendation.

> ***Recommendation 1.*** *We recommend that USAID/Pakistan implement a plan to continuously engage the Government of Pakistan to protect distribution companies from political influences, and to facilitate the distribution companies to operate under a more business-like model.*

Program Monitoring Was Insufficient

According to USAID's Automated Directives System (ADS),[4] "monitoring the quality and timeliness of outputs produced by implementing partners is a major task of contracting officer's representatives and development objective teams." Further, ADS 596.3.1[5] mentions monitoring as a key management control activity that should be part of the regularly assigned duties of mission personnel. Monitoring includes "periodic reviews, reconciliations or comparisons of

[4] ADS 202.3.6, "Monitoring Quality and Timeliness of Key Outputs."
[5] ADS 596.3.1, "Establishing Internal Controls."

data." Additionally, Mission Order 200.1 requires that the program office ensure that "evaluations are planned and conducted to provide actionable, objective information to guide" managers in making decisions.

Contrary to this guidance, the mission did not have adequate management controls to oversee program activities. For instance, mission officials could not provide documentation showing they had monitored the program's progress on items and reports required under Component 2, which was to be completed in September 2013. Mission officials said they had the documentation, but it was not readily available. They were still deciding whether to approve items requested in 2011—almost 2 years ago. The items included a work plan under Component 1 and Component 2, and human resources and revenue management strategies for distribution companies.

More importantly, the mission did not carry out an independent assessment of the data reported by the contractor. For instance, the contractor reported saving 74.4 megawatts of power, valued at $47.3 million, by improving commercial procedures and installing new capacitors and smart meters; however, the mission did not independently verify these numbers. Moreover, mission officials said although they frequently met with the contractor and attended ceremonies to mark the completion of activities, they did not review any data reported by the contractor. Further, the mission documented site visit reports for only three of the nine distribution companies.

Mission officials said that staffing shortages and high turnover of the staff in the mission's Energy Office precluded doing sufficient monitoring. When the program started, the Energy Office had only four staff members, despite having one of the largest portfolios. Therefore, the mission did not plan and implement monitoring and data assessment activities.

Consequently, the mission has not verified progress on deliverables and has relied heavily on the results reported by the contractor. Given the complexity of the program, the $230 million in funding involved, and the significance of the energy crisis in Pakistan, the risk of relying solely on data reported by the contractor is high. By not having effective oversight of the program, the mission is vulnerable to inaccurate data, which could weaken the mission's decision-making process.

To mitigate this deficiency in the mission's management of control activities, we make the following recommendations.

> ***Recommendation 2.*** *We recommend that USAID/Pakistan implement cost-effective management controls to perform timely monitoring and oversight of the program.*

> ***Recommendation 3.*** *We recommend that USAID/Pakistan implement a plan to independently review and verify data reported by the contractor.*

Program Lacked Financial Oversight

According to ADS 591.3.1.2, "at least annually, USAID must assess risks associated with all U.S. for-profit organizations performing under direct contracts." Normally, the Defense Contract Audit Agency (DCAA) audits U.S. for-profit firms that have received USAID funding. However, if DCAA is unable to meet USAID's needs for a timely audit, USAID contracts with a nonfederal public accountant to perform the audit.

Also, the Federal Acquisition Regulation (FAR 31.201-3) provides: "Reasonableness of specific costs must be examined with particular care. . . . No presumption of reasonableness shall be attached to the incurrence of costs by a contractor." In addition, FAR 44.302 requires government agencies to determine whether a contracting purchase review is needed.

Audits of the contractor's annual costs incurred for work performed under government contracts were up to 7 years behind schedule; the latest financial audit of the contractor by DCAA covered FY 2006. Also, the mission has not commissioned a review or audit of the contractor's purchasing system. In addition, USAID/Pakistan has not audited local incurred costs since the program began.

According to USAID's Office of Acquisition and Assistance in Washington, annual audits for 2010 and 2011 have not been requested yet because of the funding constraints that USAID has been facing. Similarly, no review has been done of the contractor's purchasing system because the office did not have the funding to request system—e.g., accounting, billing, purchasing—reviews.

More serious than the delays are concerns about the contractor's operations. In 2011 the contractor's head office performed an internal control review of its local office in Pakistan, identifying deficiencies in critical areas such as expenditures, procurement, the human resource system, and finance. Although the contractor hired an audit firm to conduct a financial statement audit of local operations for 2011-2012, the firm's performance was not rated as satisfactory by the Institute of Chartered Accountants Pakistan, which oversees the quality of work performed by accounting firms in Pakistan, casting doubt on the quality of the audit report.

As a result of the delays in conducting these audits, USAID/Pakistan has not maintained proper accountability for the funds billed, and the $56 million spent as of July 2013 may be unreasonable, unallowable, and not properly allocated as required under the FAR. In FY 2013, the mission's Management Review Committee plans a financial review of costs incurred by the program. Therefore, we make the following recommendation.

> ***Recommendation 4.*** *We recommend that USAID/Pakistan implement a plan to audit the Power Distribution Program's locally incurred costs and review the contractor's procurement system.*

Contractor Inappropriately Billed for Weekend and Overtime Pay

The contractor's task order authorizes 40 hours of work spread over as many as 6 days per week for locally employed staff and those on short-term assignment. It does not authorize weekend or overtime pay. Further, the contractor's administration manual defines overtime as working for 8 hours in addition to the normal 40 hours. Moreover, employees' contracts specify that monthly salary is based on a normal 40-hour workweek.

Even though the task order disallows weekend and overtime pay, the company reimbursed employees for both at 100 percent of the hourly rate. The contractor charged USAID $29,175 for weekend pay and $81,225 for overtime pay. After May 2012, the contractor no longer paid employees for weekend pay because the contractor's internal audit report, issued October 2011, identified the problem. However, the contractor continues paying overtime for employees working more than 40 hours a week.

Overtime pay continued because the contractor interpreted the task order authorizing a 6-day workweek as allowing overtime pay, and the mission was not aware of the contractor's practice. These weaknesses highlight the need for the financial audit of locally incurred costs discussed previously in this report.

The contractor stopped billing weekend pay but continues to bill for overtime. As a result, as of May 2013, USAID had paid the contractor ineligible costs of $29,175 in weekend pay and $81,225 in overtime pay. Therefore, we make the following recommendations.

> ***Recommendation 5.*** *We recommend that USAID/Pakistan require International Resources Group to stop billing USAID/Pakistan for overtime pay.*
>
> ***Recommendation 6.*** *We recommend that USAID/Pakistan determine the allowability of ineligible questioned costs of $110,400—$81,225 billed for overtime and $29,175 for weekend pay—and recover from International Resources Group any amounts determined to be unallowable.*

Work Plan Lacked Milestones

According to ADS 201.3.13, "Alignment of Activities," "Activity Work Plan modifications should be required to harmonize the coordination, collaboration, and reporting responsibilities within a new project's Management Plan." Further, Mission Order 200.1 states, "As much as possible, performance data collection should be integrated with the performance management activities of implementing partners and incorporated into their work plans with appropriate funds allocated."

Contrary to this guidance, the mission did not ensure that modified work plans incorporated the detailed information necessary for coordinating activities. Because of the many modifications made to the program, the mission did not approve the contractor's 2012 work plan, and approval of 2013 work plan was delayed by 5 months at the time of this audit. Further, most activities listed in the 2013 work plan for Component 3 are scheduled to be completed toward the end of the program in mid-2015, although no intermediate deadlines are built into the work plan to track their progress. And the plan contains no information on how data on the activities will be collected and integrated with the performance management plan.

For example, according to the work plan, in June 2015 the contractor is to deliver guidelines for deregulating the electricity market in Pakistan; however, the work plan does not block out time for research, draft submission, review, or final submission of the guidelines. Another activity, related to preventing circular debt,[6] did not have any due dates or milestones for tracking its progress up to that point.

Mission officials attributed the lack of detail in the work plan to the uncertain climate in which they implement the program. Given the politically charged environment of the power sector, it is prudent to have a flexible schedule.

However, mission officials agreed that the lack of definitive items to be delivered by the contractor and target completion dates could hinder measurement of program performance. Without periodically tracking and reviewing the progress of each activity, the program may not

[6] Circular debt occurs when cash-strapped provincial and federal governments do not pay their electricity bills, leaving distribution companies unable to pay power producers.

be able to make timely adjustments if needed. To allow the mission to assess program progress effectively, we make the following recommendation.

Recommendation 7. *We recommend that USAID/Pakistan implement a detailed plan to carry out Component 3 of the Power Distribution Program, with clearly defined deliverables that the mission can track and measure for timeliness and benefit.*

EVALUATION OF MANAGEMENT COMMENTS

USAID/Pakistan agreed with all seven recommendations in the report. According to its written comments, the mission has reached management decisions on Recommendations 1, 2, 3, 5, and 7. The mission has not made management decisions on Recommendations 4 and 6.

Recommendation 1. USAID/Pakistan agreed with the recommendation. After the fieldwork for this audit was completed, the Government of Pakistan shifted its focus to privatizing four of the nine distribution companies. The mission stated that successful privatization will significantly reduce political influence and interference in the day-to-day operations of the distribution companies. Therefore, the mission has engaged the government in discussions on how the program can support it in privatizing the distribution companies. The mission is modifying the program's contract to direct the contractor to provide technical assistance in support of privatization initiatives of the Government of Pakistan. The mission expects to complete this modification of the contract by January 31, 2014. We acknowledge the mission's management decision.

Recommendation 2. USAID/Pakistan agreed with the recommendation. On July 31, 2013, the mission approved the performance management plan. Also, as discussed in the mission's response to Recommendation 7, the mission plans to work with the contractor to update the monitoring and evaluation plan by June 30, 2014, so that it clearly defines deliverables. Further, as a response to Recommendation 3, by April 30, 2014, the mission plans to conduct independent monitoring and evaluation of the program, increasing oversight. We acknowledge the mission's management decision and note the target date for final action is June 30, 2014.

Recommendation 3. USAID/Pakistan agreed with the recommendation. It stated that it would implement an independent review and verification of data reported by the contractor using the mission-wide monitoring and evaluation contract by April 30, 2014. We acknowledge the mission's management decision.

Recommendation 4. USAID/Pakistan agreed with the recommendation. It stated that an Agency-contracted audit of the program would start by March 31, 2014. The audit will cover locally incurred costs and include a review of the contractor's procurement system.

According to ADS 595.3.1.2(c), a target date for completion is required for a management decision. However, the mission did not establish a target date. Therefore, the mission has not made a management decision.

Recommendation 5. USAID/Pakistan agreed with the recommendation. However, it plans to modify the contract to allow future overtime pay to the contractor's staff. USAID/Pakistan made this decision to address the challenges involved in recruiting qualified personnel to work in Pakistan and obtaining visas for expatriate staff. The modification will give the contractor flexibility to accomplish the required tasks. The contract will be modified by January 31, 2014. We acknowledge the mission's management decision.

Recommendation 6. USAID/Pakistan agreed and stated that the contractor refunded $29,175 for weekend pay by offsetting costs in a recent claim for payment. USAID/Pakistan stated that it would review the issue to determine the allowability of the remaining balance of overtime pay—$81,225—by December 31, 2013.

According to ADS 595.3.1.2(a), a management decision related to questioned costs must include the determination on allowability of questioned costs, including the amount allowed or disallowed and a target date for collecting any disallowed amount. Since the mission has still not made a determination on the allowability of the remaining questioned costs, it has not made a management decision.

Recommendation 7. USAID/Pakistan agreed with the recommendation. It stated that it is in the process of modifying the contract to address changes in Component 3; this modification will be followed by a revision of the component's detailed work plan. Further, the mission plans to work with the contractor to update the monitoring and evaluation plan so that it clearly defines deliverables and deadlines for Component 3. The mission plans to take corrective action by June 30, 2014. We acknowledge the mission's management decision.

The Audit Performance and Compliance Division will determine final action when the mission completes planned corrective actions on Recommendations 1, 2, 3, 5, and 7. Please advise this office within 30 days of actions planned or taken to reach management decisions on Recommendations 4 and 6. The mission's written comments on the draft report are included in their entirety as Appendix II.

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 Power Distribution Program was improving operational and financial performance of the nine electric power distribution companies in Pakistan by reducing losses, increasing revenues, and improving service. As of July 31, 2013, cumulative obligations totaled approximately $98 million, and expenditures under the agreement totaled $56 million. OIG visited seven[7] distribution companies and judgmentally selected procurement and consulting activities totaling approximately $8.7 million (approximately 16 percent of expenditures) to determine whether the money was spent as intended.

The fieldwork for this audit was started on April 17, 2013, and finished on August 2, 2013. In planning and performing the audit, the audit team reviewed the control environment at the mission. We examined the mission's FY 2012 self-assessment of management controls—which the mission must perform to comply with the Federal Managers' Financial Integrity Act of 1982 (as codified in 31 U.S.C. 3512)—to determine whether it cited any relevant weaknesses. We also reviewed USAID policies and procedures pertaining to USAID/Pakistan's Power Distribution Program, including ADS Chapters 201, 202, 203, 591, and 596, as well as FAR 16, 31, and 44.

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 its procurement process, payroll functions, accounting functions, and the reporting of results.

The audit team performed fieldwork at USAID/Pakistan and the contractor's main office in Islamabad. The team also met with the management of eight distribution companies in Punjab, Khyber Pakhtunkhwa, and Sindh from June 5 through July 5, 2013. The team also met with Government of Pakistan officials as well as with officials from other donor organizations, including the World Bank and the Asian Development Bank, to gain an understanding of the role the program plays in Pakistan's energy sector.

[7] The OIG team visited only seven distribution companies because security concerns prevented visits to Sukkur Electric Power Company and Quetta Electric Supply Company. However, the team met with Sukkur Electric Power Company officials at Hyderabad Electric Supply Company's office.

Methodology

To answer the audit objective, we reviewed mission documents used to manage and monitor the activities. These documents included performance management plans, the agreement, reported results, financial reports, and site visit reports. We also interviewed mission officials; staff at the contractor's office; and others including government officials, distribution company employees, and other donors.

The audit planned for 100 percent sampling. However, security issues prevented the audit team from visiting Sukkur Electric Power Company and Quetta Electric Supply Company. Still, OIG did meet with Sukkur Electric Power Company officials at Hyderabad Electric Supply Company's office. The results from our judgmental sampling cannot, however, be projected to the distribution companies that we could not visit—Sukkur Electric Power Company and Quetta Electric Supply Company.

In assessing the status of the activities carried out under the contract, the auditors relied on the contractor's quarterly and annual progress reports from October 2010 through March 2013, supplemented by interviews conducted with officials from USAID/Pakistan, the contractor, and the Government of Pakistan about achievements and problems reflected in these reports.

To validate data for the activities, the auditors checked reported results against supporting documentation maintained by the contractor. The audit team also visited seven sites to monitor progress, speak with management and employees of the power distribution companies, and verify reported results.

MANAGEMENT COMMENTS

USAID | PAKISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

Date	**December 11, 2013**
To	**Matthew Rathgeber – Director/OIG Pakistan**
From	**Gregory Gottlieb – Mission Director USAID/Pakistan /s/**
Subject	**Audit of USAID/Pakistan's Power Distribution Program**
Reference	**Mission Response to Draft Performance Audit Report No. G-391-14-00x-P dated October xx, 2013**

The USAID/Pakistan Mission would like to thank the OIG for providing the Mission the opportunity to review and provide comments to the draft performance audit report covering the Power Distribution Program.

We thank the OIG for documenting the positive contribution that the Power Distribution Program has made in improving engineering planning and operations; improving voltage and electric supplies; increasing revenues of the companies; and in training staff. The Program reduced the demand for electricity and reduced losses of electrical power through the installation of capacitors, electricity meters, pumps, and motors. These measures helped reduce the electricity shortage that is crippling Pakistan's economic growth. The program has also helped the Government of Pakistan to improve the management of its electricity sector enterprises to speed their progress towards commercial viability and sustainability. The program brought about important improvements in the distribution companies' commercial procedures including completing a full-cost recovery tariff analysis and a cost of service study for one of the distribution companies. The program also has provided training at all levels for many of the distribution company staff. Additionally, the program reduced unscheduled load shedding in Pakistan by introducing modern technology for tracking near real-time power flows to the distribution companies' infrastructure to help the nine public-sector distribution companies increase their revenues.

We believe that the actions planned in response to the findings in this audit will improve the performance of the program and help to ensure that it continues to provide successful interventions in support of the Government of Pakistan's efforts to resolve the energy crisis.

We also believe that the findings in the audit correctly point out the limitations of USAID-funded technical assistance, equipment replacement and training. The distribution companies are state-owned-enterprises (SOEs). While the Program's activities have made improvements, the governance issues were ultimately the decision of the Government of Pakistan that owns the distribution companies. Only the Government could make the reforms needed to allow the companies to operate as commercial entities. The former GOP administration chose not to implement the reforms recommended by the Program. The newly elected GOP administration has decided to privatize four of the nine distribution companies, and USAID has offered support for that privatization. We believe that the Program, in addition to the continuous policy dialogue on the part of the international donor community, has contributed to the country's decision now to privatize many state-owned-enterprises, in addition to the four distribution companies that have been announced.

Please find our management comments below addressing the recommendations included in the referenced audit report.

<u>Recommendation No. 1</u> **We recommend that USAID/Pakistan implement a plan to continuously engage the Government of Pakistan to protect distribution companies from political influences, and to facilitate the distribution companies to operate under a more business-like model.**

<u>Management Comments:</u>
The Mission agrees with the recommendation. The newly elected GOP administration has already announced the privatization of four of the nine state-owned distribution companies. USAID management continues to engage in discussions with the Government of Pakistan on the best ways the Program can support the GOP in privatizing distribution companies. Privatization is the ultimate governance change for state-owned-enterprises. Successful privatization will remove, or significantly reduce, political influence and interference. The Power Distribution Program (PDP) contract is in the process of being modified to direct the contractor to provide technical assistance in support of the privatization initiatives of the Government of Pakistan. The modification of the contract is expected to be completed by 31 January 2014.

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

<u>Recommendation No. 2</u> **We recommend that USAID/Pakistan implement cost-effective management controls to perform timely monitoring and oversight of the program.**

<u>Management Comments:</u>
The Mission agrees with the recommendation that monitoring and oversight of the program was insufficient early on due to a shortage of staff in the USAID Energy Office. The Mission has hired the appropriate staff levels to provide the needed monitoring and oversight. In addition, the Mission has completed its strategic framework that includes rigorous performance management requirements. The new Mission Strategic Framework was approved in February 2013 and the Performance Management Plan was approved in July 2013. Together, these form a set of rigorous performance requirements.

The Mission Performance Management Unit (PMU) energy backstop provided additional support to the energy team during 2012 when the energy office was significantly understaffed. This included development of the energy results framework and indicators and performance measures for projects. The PMU participated directly with the energy team's implementing partners' monitoring and evaluation staff and reviewed their protocols, which were of high quality.

Since that time, the energy program has been fully integrated into the Mission's overall performance management requirements, which now include:

- the Mission Strategic Framework (MSF) with the energy results framework as Development Objective #1;
- implementation of the Performance Management Plan (PMP) for the MSF, including a monitoring plan, evaluation and assessments plan, and a Learning Agenda; and
- provision of quarterly MSF data entry, review, and analysis by the energy team partners, review by the contracting officer's representatives and project managers in the Energy Office, and quality assurance by the PMU.

The Mission's performance management requirements have brought the energy team into compliance with Agency policy and guidance, Mission-specific guidance, and technical standards that meet professional quality requirements. In January 2014, the energy portfolio will undergo a performance analysis of every activity which aligns each project and activity with the standards mentioned above as part of this process. Each project and activity performance framework and monitoring and evaluation plan will be reviewed by the PMU. This analysis will be completed by the end of March 2014 and the frameworks and monitoring and evaluation plans will subsequently be reviewed annually thereafter.

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

<u>Recommendation No. 3</u> We recommend that USAID/Pakistan implement a plan to independently review and verify data reported by the contractor.

<u>Management Comments:</u>

USAID management agrees with the recommendation. The energy team's plan for independent review and data verification is part of the Mission Strategic Framework's Performance Management Plan described in the response to Recommendation No. 2. Additionally, PDP's Monitoring and Evaluation Plan forms the basis for review and verification by USAID staff and third party reviewers. Each project's logical framework and Monitoring and Evaluation Plan are reviewed by the PMU for compliance with professional, Mission, and Agency standards. In addition to these steps, the PMU itself conducts a review of the Mission Strategic Framework data in the Mission's information management system, PAKINFO. This review is conducted every quarter following systematic data calls.

The energy team will implement a third party review and verification of data reported by the contractor using the Mission-wide monitoring and evaluation contract by April 30, 2014.

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

<u>Recommendation No. 4</u> We recommend that USAID/Pakistan implement a plan to audit the Power Distribution Program's local incurred costs and review contractor's procurement system.

<u>Management Comments:</u>
The Mission agrees with the recommendation. The Management Control and Review Committee (MCRC) meeting of January 30, 2013 already approved an Agency Contracted Audit (ACA) of the PDP

that will cover locally incurred costs and include a review of contractor's procurement system. The ACA will be initiated by March 31, 2014.

With respect to the finding on page 7 of the audit report, "Program Lacked Financial Oversight", it should be noted that all procurements in excess of the simplified acquisition threshold of $150,000 and all noncompetitive procurements are reviewed by the Office of Acquisition and Assistance in detail to ensure compliance with the procurement policies of USAID and of the implementer.

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

Recommendation No. 5 We recommend that USAID/Pakistan require International Resources Group to stop billing USAID/Pakistan for overtime pay.

Management Comments:
The Mission agrees with the intent of the recommendation. However, instead of requiring International Resources Group to stop billing USAID for overtime pay, USAID management plans to modify the contract with IRG to allow any future overtime pay to enable the present staff to be compensated for their work. This decision has been made to acknowledge that International Resource Group (IRG) continues to face challenges recruiting qualified personnel to work in Pakistan and obtaining visas for expatriate staff. These issues require management flexibility and existing personnel to work more than 40 hours per week to accomplish their required tasks. The contract will be modified by January 31, 2014.

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

Recommendation No. 6 We recommend that USAID/Pakistan determine the allowability of ineligible questioned costs of $110,400—$81,225 billed for overtime and $29,175 for weekend pay—and recover from International Resources Group any amounts determined to be unallowable.

Management Comments:
IRG has agreed that the $29,175 charged to USAID for weekend pay was not allowable and refunded the amount by adjusting it in their recent claim for payment.

With respect to the remaining balance of overtime pay charged to the program, OAA will be reviewing the issue and will determine allowability by December 31, 2013.

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

Recommendation No. 7 We recommend that USAID/Pakistan implement a detailed plan to carry out Component 3 of the Power Distribution Program, with clearly defined deliverables, deadlines, and impact indicators that can be tracked and measured.

Management Comments:

The Mission agrees with the recommendation. USAID and State Department leadership are in the final stages of making an agreement with the Government of Pakistan regarding the selection of a second "turn around" distribution company and the selection of distribution companies for which the program will provide technical assistance in support of their privatization as part of Component 3. USAID management is also in the process of modifying the contract with IRG to direct the contractor according to this agreement. Following these decisions and the modification of the contract, USAID will work with IRG to revise the detailed work plan for Component 3 within 45 calendar days of modifying the contract.

In addition, USAID will work with IRG to update the logical framework and Monitoring and Evaluation Plan which clearly defines deliverables and deadlines for Component 3. Once the logical framework and Monitoring and Evaluation Plan have been updated, the PMU will conduct a performance analysis per the description in the response to Recommendation No. 2. The PMU will prioritize the performance analysis of PDP for the energy team and expects to complete the analysis by June 30, 2014.

Impact indicators that can be tracked and measured have already been developed for the program along with other energy programs in the Mission Strategic Framework.

Based on above, the Mission requests OIG’s acknowledgement that a management decision has been made on this recommendation.

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