OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/PAKISTAN'S GOVERNMENT-TO-GOVERNMENT ASSISTANCE PROGRAM

AUDIT REPORT NO. G-391-14-002-P
DECEMBER 20, 2013

ISLAMABAD, PAKISTAN

Office of Inspector General

December 20, 2013

MEMORANDUM

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

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

SUBJECT: Audit of USAID/Pakistan's Government-to-Government Assistance Program (Report No. G-391-14-002-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 eight recommendations to help USAID/Pakistan strengthen its management of the Government-to-Government Assistance Program. Your comments in response to our draft report indicate you have made a management decision on Recommendation 6 only.

Please provide written notice within 30 days of any actions planned or taken to implement the Recommendations 1, 2, 3, 4, 5, 7, and 8 and target dates for completion.

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

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CONTENTS

Abbreviations

The following abbreviations appear in this report:

ADS	Automated Directives System
ASP	Assessment and Strengthening Program
FATA	Federally Administered Tribal Areas
HEC	Higher Education Commission
OAPA	Office of Afghanistan and Pakistan Affairs
OIG	Office of Inspector General
PCS	Partner Country Systems
PFMRAF	Public Financial Management Risk Analysis Framework
WAPDA	Water and Power Development Authority

SUMMARY OF RESULTS

USAID/Pakistan's Government-to-Government Assistance Program, part of the Enhanced Partnership with Pakistan Act of 2009 (Public Law 111-73), represents a large U.S. Government investment and relies on the Government of Pakistan as an implementing entity. Transfers of assistance funds are intended to meet objectives such as building Government of Pakistan institutional capacity, improving the partnership between the United States and Pakistan to achieve more effective development, increasing mutual accountability, and building capacity for Pakistan Government systems to achieve sustainability in development programs.

To date, USAID/Pakistan has disbursed $960 million in government-to-government assistance projects to the Government of Pakistan and its subnational governments. A previous audit of USAID/Pakistan's government-to-government cash transfer agreement, the Benazir Income Support Program, made clear the risk inherent in this kind of assistance. The audit noted that potential misappropriation of funds, unauthorized deposits, or diversions to the wrong accounts could occur.[1] The mission has implemented some risk mitigation measures. Projects reviewed for the current audit were designed to reduce these risks with tools like preaward assessments, fixed-amount reimbursement agreements, reassessments, and validation of training to build capacity.

USAID/Pakistan provides funds and logistical support to Government of Pakistan entities implementing a wide range of government-to-government assistance projects. Support has made possible the Higher Education Commission's (HEC's) continuing operations and university scholarships, near-term assistance provided by the Citizens' Damage Compensation Program to victims of the 2010 floods, infrastructure projects implemented by the Federally Administered Tribal Areas Secretariat (FATA/Secretariat) and the Water and Power Development Authority (roads and dams and power generation and distribution), and municipal works projects for the provincial governments in Sindh and Khyber Pakhtunkhwa. USAID/Pakistan has also provided capacity-building training to 25 Government of Pakistan entities in procurement, human resources, and financial management.

The Office of Inspector General (OIG) conducted this audit to determine whether USAID/Pakistan was managing its Government-to-Government Assistance Program to achieve the mission's development goals, such as creating improved opportunities for work and education, increasing stability in certain areas, and improving the Pakistani people's economic status. USAID/Pakistan is managing its Government-to-Government Assistance Program to achieve the mission's development goals. However, the mission could strengthen its efforts by consistently following Agency and mission guidance.

Because achievements have not been properly measured or documented, we relied on anecdotal evidence for feedback about USAID/Pakistan's government-to-government assistance projects. The mission has not conducted reassessments, updated assessments, or evaluated its government-to-government assistance projects, nor has it validated training activities designed to build capacity in government entities implementing government-to-government projects. However, staff at some of the five entities we included in the audit expressed their appreciation for capacity-building training and USAID funding of their projects.

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[1] USAID/OIG, *Audit of USAID/Pakistan's Support to the Benazir Income Support Program*, Report No. G-391-12-006-P, May 21, 2012.

For example, an official from the Water and Power Development Authority said that without funding from USAID, the authority would not have been able to continue building a dam and irrigation system in the north. Another FATA/Secretariat official said that users of the completed portions of the constructed roads reported easier access to markets for goods produced and distributed within FATA and increased vehicular traffic between Pakistan and Afghanistan. A third government official from HEC said that USAID's timely funding assistance allowed the commission to continue to operate.

While the achievements of USAID/Pakistan at the forefront of the Agency's government-to-government efforts are commendable, the audit identified four weaknesses in the mission's assistance program:

- USAID/Pakistan did not reassess Government of Pakistan implementing entities as required by USAID's Automated Directives System (ADS) Chapter 220 (page 4). Revisions to ADS 220 appeared frequently, complicating compliance, and the mission tended to follow its own orders instead.

- The mission did not follow some of its own procedures—Mission Order 200.2 and Mission Order 200.6—for project design and implementation (page 6). The orders gave conflicting guidance on requirements for design and implementation and differed from ADS 220.

- USAID/Pakistan did not validate that its training increased the capacity of the government entities that are implementing assistance projects (page 8). Mission officials attributed the omission to changing guidance.

- The PakInfo project database contains inaccurate information (page 9). PakInfo is the system the mission uses to collect and store data for its Government-to-Government Assistance Program. However, it was not functioning correctly 2 years after the mission started developing it.

We recommend that the mission:

1. Reassess Government of Pakistan implementers. If the mission is unable to do so in a timely manner, document the reasons for noncompliance and a time frame for the reassessments to occur (page 6).

2. Implement a plan with milestones and deadlines for fully complying with ADS Chapter 220 (page 6).

3. Reconcile the discrepancies between its government-to-government assistance mission orders and revise these documents to comply with ADS 220 (page 8).

4. Provide government-to-government project managers with formal designation letters before they begin serving in that capacity (page 8).

5. Implement a plan with milestones for validating capacity-building activities carried out by implementers of government-to-government projects (page 9).

6. Modify its Assessment and Strengthening Program cooperative agreement to reflect actual practices related to validating capacity-building activities (page 9).

7. Implement a plan with a timeline to validate PakInfo data, and reconcile them with data in Phoenix (page 11).

8. Implement a plan with a timeline for PakInfo to become operational (page 11).

A detailed discussion of the audit findings follows. The scope and methodology are described in Appendix I. Management comments are included in Appendix II, and our evaluation of management comments is included on page 12.

AUDIT FINDINGS

Mission Did Not Reassess Government of Pakistan Implementing Entities as Required

ADS 220 provides guidance for government-to-government assistance programs. Specifically, it highlights the goal of promoting country ownership by partner countries. This includes helping countries design and implement their own development strategies using their own internal systems—most importantly their public financial management systems. USAID's development strategy is to support long-term sustainability by partnering with countries to assess those internal systems, build capacity, and strengthen core institutions.

To ensure the best use of U.S. taxpayer funds, USAID requires missions to apply the Public Financial Management Risk Analysis Framework (PFMRAF) set out in ADS 220 and to reach agreement with government entities on both capacity building and accountability before disbursing funds. The PFMRAF assessment is designed to determine if Government of Pakistan ministries and directorates selected to disburse USAID funds have the ability to do so using their own internal systems, while identifying measures to mitigate any risks identified.

For missions that are already implementing a government-to-government assistance program, ADS 220.3.2.2, "Assessment of Partner Country Public Financial Management Systems," provides a grace or transition period for complying with ADS 220. This transition period expires when existing project funding has been fully expended.

For missions to claim transition status, ADS 220 requires reassessments or updated assessments (collectively reassessments).[2] ADS 220.3.2.2 requires missions to reassess government entities implementing government-to-government assistance projects every 3 years and when the initial commitment to the entity increases by more than 50 percent or by more than $20 million in 5 years. The reassessments are required for all government implementers (including the Government of Pakistan's Office of Economic Affairs, through which USAID funds flow) of USAID-funded projects. The reassessments are to ensure that risk mitigation measures are being followed. If material changes related to democratic governance or public financial management systems are found, the missions must take additional steps, including reviewing and revalidating the risk management plan for that particular government implementer.

If missions are unable to follow these requirements, ADS 220 contains a provision for a waiver. Missions may submit an application to waive ADS 220 procedures that may impair the missions' ability to achieve their foreign assistance objectives. One important mechanism under ADS 220 that missions are expected to use is a PFMRAF assessment. The assessment is designed to determine if partner country systems are able to support implementation of USAID-funded assistance. A Partner Country Systems Team (PCS team), made up of mission personnel such as controllers, regional legal advisors, contracting and agreement officers, democracy and government officers, program officers, and technical officers, determines which entities shall be

[2] ADS 220.3.2.2 uses both "reassessments" and "updated assessments" when describing transition period requirements.

reassessed. The reassessments are coordinated by the mission's Office of Financial Management.

However, USAID/Pakistan had not followed the provisions of ADS 220 for reassessments or applied for a waiver, although the mission had been working on its waiver submission for some time. The mission had not reassessed any Government of Pakistan entities, although some have been implementing government-to-government projects for more than 3 years, nor had it reassessed projects that received an increase in funding above the threshold established in ADS 220.

Examples include the following:

- The mission signed an activity agreement with the FATA/Secretariat in 2010 but had not conducted a reassessment. The initial commitment in 2010 was $55 million; it increased to a ceiling of $611 million as of October 2012.

- The mission extended the agreement with the FATA/Secretariat to September of 2015 for another project.

- The mission signed an activity approval document for the Water and Power Development Authority (WAPDA) in August 2010 for $26 million. The mission had not performed a reassessment of WAPDA, despite a significant increase ($150 million) for a new project.

- The mission had not performed a reassessment of HEC, even though the mission disbursed a total of $90 million to HEC in 2010 (more than 3 years ago) and plans to extend its arrangement with HEC and increase the funding by $23.1 million.

USAID/Pakistan did not follow ADS 220.3.2.2 for several reasons. First, the PCS team was not formed until 2013. Consequently, the mission could not follow ADS 220, which requires that the PCS team be involved in assessing capacity and fiduciary risk at each government implementer before any USAID funds are obligated. Mission directors may also delegate to the PCS team the mission's responsibilities for oversight, coordination, monitoring, and evaluation of risk mitigation measures. .

Second, USAID/Washington was revising ADS 220. A mission official said that since a new draft of ADS 220 was scheduled for issuance, the official had asked the mission's Office of Financial Management not to start any reassessments of government entities. USAID/Washington communicated to the mission that it would issue the new version of ADS 220 in March 2013; that date slipped to June 2013, then to September 2013. Another mission official believed that, realistically, the new version of ADS 220 would not be issued until December 2013.

Third, according to mission officials, work with USAID/Washington on a transition plan stalled. Mission officials scheduled a week of meetings at USAID/Washington with relevant senior officials to map out a plan for USAID/Pakistan to reach ADS 220 compliance. Decision makers and senior personnel attended the meetings, but only sporadically. Mission officials said that USAID/Washington's two senior officials most involved with ADS 200 (the Chief Financial Officer and General Counsel) subsequently left USAID. All of these factors made it difficult for mission officials to achieve consensus with those in Washington.

Fourth, according to some USAID/Pakistan officials, they preferred their own guidance, Mission Order 200.2, “Government to Government Assistance (Project).” Some mission officials thought that since USAID/Pakistan was the first mission to implement government-to-government assistance and has implemented more government-to-government activities than any other mission, Mission Order 200.2 was more thorough and more suited to Pakistan than ADS 220.

The government-to-government assistance program in Pakistan is large, with funding obligations of at least $1.4 billion (obligations data in PakInfo, a database that houses information on assistance to Pakistan and in Phoenix, USAID’s core financial system, did not agree, as discussed on page 11). Some $1 billion of that amount has been obligated to the five government implementing entities that we tested. For this reason, compliance with Agency regulations relating to reassessments or updated assessments of the entities is crucial.

Mission officials said that physical progress and financial accountability is reviewed when each milestone is reached and when each voucher is submitted. Officials believe these processes allow continuous assessment to identify any weakness and take immediate corrective action. While these measures are good detective controls that help in safeguarding U.S. funds, they do not substitute for risk reassessment, which is a more comprehensive preventive measure. Absent reassessments, the mission forgoes the opportunity to identify and mitigate risks introduced since inception of the program and optimize the return on its development investment, and by doing so, it increases the risk of U.S. funds mismanagement.

To mitigate some of these risks, the mission has implemented fixed-amount reimbursement agreements for many projects. These agreements allow the mission and its independent monitors to evaluate project milestones before reimbursing government entities.

> ***Recommendation 1.*** *We recommend that USAID/Pakistan reassess Government of Pakistan implementing entities according to Automated Directives System Chapter 220. If the mission is unable to conduct timely reassessments, it should document the reasons for noncompliance and specify a time frame for performance.*

> ***Recommendation 2.*** *We recommend that USAID/Pakistan implement a plan with milestones for fully complying with Automated Directives System Chapter 220.*

Mission Did Not Follow Its Procedures for Government-to-Government Assistance

ADS 527’s additional help, *Guidance on Preparing Mission Orders*, states: “Mission Orders are required when additional Mission-specific procedures are necessary to implement Automated Directives System (ADS) policy.” The guidance “ensures that Mission Orders do not create new policy . . .[or] duplicate or contradict existing policy.”

Mission Order 200.2 states that the “implementation of government-to-government projects is led by a Project Manager designated by the Supervisory program officer.”

Starting in 2009, following passage of the Enhanced Partnership with Pakistan Act in 2009 (Public Law No. 111-73), the mission was under great pressure from the Department of State and USAID to implement government-to-government assistance projects. This was before the development of any formal guidance from USAID/Washington on such projects. In the void, the mission developed and refined its own process and procedures during implementation of government-to-government assistance projects from 2009 on, culminating in the mission's issuance of Mission Orders 200.2 and 200.6 in 2012.

However, guidance in these mission orders is inconsistent. The table below illustrates several discrepancies between Mission Order 200.2 and 200.6.

Inconsistent Guidance on Design and Implementation in Mission Orders and Annexes

Document Title	Mission Order 200.2	Mission Order 200.2 Annex 4	Mission Order 200.6
Concept paper	Yes	No	Yes
Project appraisal document	Yes	No	Yes
Action memo	Yes	No	Yes
Activity agreement	Yes	Yes	Yes
Project design unit	No	No	Yes
Project design team	No	No	Yes
Preaward assessment	Yes	Yes	No
Risk mitigation framework	Yes	Yes	No
Risk analysis memo	Yes	Yes	No

Furthermore, the mission orders did not agree with ADS 220. While both sets of procedures include a risk assessment, ADS 220 includes a Democracy, Rights, and Governance review. In fact, USAID's Bureau for Democracy, Conflict and Humanitarian Assistance has even set up a specific support team to make sure there is enough focus on accountability, including legislative, media, and civil society oversight—something that is not specified in Mission Order 200.2.

Another significant difference is the requirement in ADS 220 to create a PCS team. ADS 220 requires that the PCS team assess fiduciary risk relating to the partner country's public financial management systems. The PCS team is also to consult with a team in the Office of the Chief Financial Officer in Washington about the PFMRAF and to discuss mitigation measures for risks identified through their assessments. Mission Order 200.2 does not include any reference to a PCS team (although the mission did establish a PCS team in April 2013, in its effort to begin complying with ADS 220).

The mission orders were issued more than 2½ years after the inception of the mission's government-to-government assistance program. They incorporate lessons learned and procedures that had evolved during that period, according to one mission official. However, the Office of the Chief Financial Officer in Washington (the office responsible for developing ADS 220) was developing a different framework. The office issued ADS 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," on August 16, 2011, and a revision on March 26, 2012—*before* the mission orders. Because the two sets of guidance proceeded separately, the mission did not align Mission Order 200.2 and 200.6 with ADS 220.

Formal designation of project managers is another area where guidance differs and where the mission did not follow its own guidance. While ADS 220 is silent about designating government-to-government assistance project managers, Mission Order 200.2 makes the supervisory program officer responsible for both selecting and formally designating them. Yet project managers for three of the five projects we reviewed did not receive designation letters in a timely manner. They received the letters on May 13 and 16, 2013—from 7 months to more than 3 years after beginning work on the projects. The mission did not provide copies of designation letters that officials said they had issued to the other two project managers. The acting supervisory program officer at the mission said that with a very diverse portfolio, it was difficult to keep on top of this administrative task.

The inconsistencies in documents have resulted in confusion. In addition, not issuing delegation letters in a timely manner delayed progress on government assistance projects. In at least one case, a project manager was hesitant to act and did not engage fully with his Government of Pakistan counterpart.

> ***Recommendation 3.*** *We recommend that USAID/Pakistan reconcile the discrepancies between Mission Order 200.2 and Mission Order 200.6 and update these documents to comply with Automated Directives System Chapter 220.*

> ***Recommendation 4.*** *We recommend that USAID/Pakistan implement a procedure to provide project managers with formal designation letters before they begin serving in that capacity.*

USAID/Pakistan Did Not Validate That Training Built Capacity

According to ADS 220.1, USAID's development policy ultimately must support long-term, sustained progress and make assistance unnecessary in the long term. It should do this by partnering with governments to assess and, if appropriate, use the countries' internal systems (such as public financial management systems) in USAID's assistance projects; build capacity; and strengthen core institutions. To improve the Government of Pakistan's internal systems, USAID/Pakistan launched the Assessment and Strengthening Program (ASP).[3]

The cooperative agreement between USAID/Pakistan and the ASP implementer calls for annual validations. The purpose is to ensure ongoing compliance with the standards and procedures developed under the institutional capacity-building program and to establish benchmarks to allow government implementers to reach a point where annual validations are no longer necessary. The ASP agreement included milestones for annual validations of ten government implementing entities in Year 1 (2010-2011) 20 in Year 2 (2011-2012), 30 in Year 3 (2012-2013), 30 in Year 4 (2013-2014), and 25 in Year 5 (2014-2015). Yet USAID/Pakistan, through the ASP implementer, did not validate any of its capacity-building trainings for government implementing entities.

Capacity building has spanned several sectors and many years. Three entities implementing power distribution projects (including the Tarbela Project, the Guddu Project, and the Muzaffargarh Project) began in 2010 and were scheduled to finish in December 2013. Ministry of Health personnel received training and completed a project to build the Government of Pakistan's

[3] This program was the subject of OIG's *Audit of USAID/Pakistan's Assessment and Strengthening Program*, Report No. G-391-12-009-P, September 30, 2012.

capacity in public health in March 2013. Staff of these and other government entities received training on human resource administration and management, procurement management, the gender dimensions of leadership and development, and fiscal decentralization.

The mission did not validate whether the training had improved the internal systems of these entities or increased ministry staff members' ability to implement projects. Mission officials said they are planning validations of a number of government entities. Determining whether training benefited those that have completed their projects will be difficult.

According to mission officials, the mission did not conduct any validations because of changing guidance from USAID/Washington. Two versions of ADS 220 appeared over the course of eight months, with a third revision of ADS 220 pending. Mission officials said they had put off validations and reassessments so that they could form a PCS team that met ADS 220 requirements. The team would then help determine which government implementing entities should be part of the validation process, and which should be scheduled for reassessments. The delay meant the mission did not establish the PCS team until April 2013, 3 years after ASP began. Thus, even though the mission's cooperative agreement with the ASP contractor required annual validations, the mission did not meet that requirement.

Since it conducted no validations, the mission does not know whether the program's capacity-building training activities were successful. Similarly, the mission lacks key information to identify government systems that are deficient. As a result, government entities may continue to operate inefficiently despite USAID/Pakistan's efforts to build capacity.

USAID/Pakistan is now addressing validations as required by the ASP cooperative agreement. It has chosen five government implementers for review and has begun selecting an implementing partner to validate their training.

> ***Recommendation 5.*** *We recommend that USAID/Pakistan implement a plan with milestones specifying when it will validate capacity-building activities conducted for the Government of Pakistan entities implementing government-to-government projects.*
>
> ***Recommendation 6.*** *We recommend that the mission modify its Assessment and Strengthening Program cooperative agreement to reflect actual mission practices related to validating capacity-building activities, to facilitate the mission's compliance with the agreement.*

PakInfo Database Contains Inaccurate Information

The importance of accurate data cannot be overstated. Inaccurate data can lead to uninformed and bad decision making, which in turn can affect the outcomes of government-to-government assistance projects. A pattern or practice of storing and reporting inaccurate data, even if inadvertent, can reduce users' confidence in the data.

Two systems house information on USAID/Pakistan's government-to-government projects. PakInfo, created by the mission, collects and stores information relating to activities including government-to-government assistance projects. The Program and Resource Management Office is responsible for maintaining the information in PakInfo, including the amount of funding for each project, project start and end dates, and project results data. Phoenix is the Agency's accounting system. The Office of Financial Management is responsible for maintaining Phoenix data on financial obligations and disbursements for all USAID/Pakistan's government-to-government assistance projects.

However, discrepancies exist between PakInfo and Phoenix, as well as between PakInfo and project documents.

- Some project start and end dates in PakInfo do not match those in project activity agreements. For example, the first activity agreement for the Municipality Services Program in Sindh was signed in January 2011. A second activity agreement for the program was executed in April 2012. However, PakInfo shows the start date as February 2012, not January 2011. Further, although the FATA Secretariat extended its completion date of the FATA Infrastructure Program to September 2015 from December 2014, PakInfo still shows a completion date of December 2014.

- PakInfo shows obligated funds for government-to-government assistance projects totaling about $1.8 billion, whereas Phoenix shows almost $1.4 billion.

- The obligated amounts for some projects in Phoenix exceed the obligations reflected in PakInfo. For example, although the Satpara Dam Project is $26 million (as set forth in the activity agreement), PakInfo shows total funding of $19 million.

- PakInfo groups together some projects that have different activity agreements and are managed by different offices. Doing so makes it difficult to understand the correct funding amount for each project. For example:

  - HEC's University and Technical Education Initiative includes tasks under two different activity agreements for two different projects. Financial data for both projects is combined in PakInfo under HEC.

  - Also, the Municipality Services Program has two projects—one in Sindh Province managed by USAID's Karachi office, and another in Khyber Pakhtunkhwa Province managed by the FATA/Khyber Pakhtunkhwa office in Islamabad. PakInfo groups these two projects together as one and shows total funding of $116.8 million; Phoenix shows funding for the Sindh project is $66 million and for the other project is $84.7 million—totaling $150.7 million, not $116.8 million. In addition, the Sindh project was not reflected at all on the Phoenix obligations report that auditors received from the Office of Financial Management.

- Mission officials stated further that PakInfo combines projects into sectors (often managed by different technical offices), making the data even more difficult to comprehend.

Asked why these discrepancies exist, mission officials said PakInfo is still under development. Washington's Office of Afghanistan and Pakistan Affairs is working on PakInfo development and periodically sends technical experts to Pakistan for this purpose. The system therefore is not used as an authoritative source of data. One official said PakInfo does not interface well with Phoenix.

During the course of this audit, in response to requests for information, program office staff provided information from PakInfo which differed from that contained in Phoenix. This incident raised the concern that the program office is reporting inaccurate data to other offices in the mission. Mission officials were confident, however, that any information from the PakInfo database was reviewed numerous times by technical offices and the program office before being reported to USAID/Washington or other offices in the mission. Because PakInfo, although still under development, is used for some decision making at the mission (the PCS team uses it to decide which government entities to select for validations or reassessment/updated assessments), inaccurate information could delay the process and lead to errors in decision making.

PakInfo was not operational more than 2 years after development began. Before any USAID/Pakistan offices use information from PakInfo in official reports, it must be validated and corrected as needed. For these reasons, we make the following recommendations.

Recommendation 7. *We recommend that USAID/Pakistan, in coordination with the Office of Afghanistan and Pakistan Affairs, implement a plan with a timeline to validate information in PakInfo and reconcile information contained in PakInfo with information contained in Phoenix.*

Recommendation 8. *We recommend that USAID/Pakistan, in coordination with the Office of Afghanistan and Pakistan Affairs, implement a plan with a timeline for PakInfo to become operational.*

EVALUATION OF MANAGEMENT COMMENTS

USAID/Pakistan agreed with Recommendations 1, 2, 3, 5, and 6 but disagreed with Recommendations 4, 7, and 8. The mission made a management decision only on Recommendation 6. Our evaluation of the management comments follows.

Recommendation 1. The mission agreed with the recommendation but did not reach a management decision on it. USAID/Pakistan stated that it had started reassessing Government of Pakistan implementing entities in accordance with ADS 220. However, it did not provide detailed information on its corrective action plan as required by ADS 595.3.1.2.c. A management decision can be reached when the mission provides a complete, detailed corrective action plan including target dates for completing all actions necessary to reassess Government of Pakistan implementing entities.

Recommendation 2. The mission agreed but did not reach a management decision on this recommendation. The mission stated that it had applied for a waiver of ADS 220 requirements. However, the mission did not provide detailed information about its corrective action plan as required by ADS 595.3.1.2.c. A management decision can be reached when the mission provides a complete detailed corrective action plan including target date for completion of all actions necessary to bring the mission into compliance with ADS 220.

Recommendation 3. The mission agreed but did not reach a management decision on this recommendation. The mission stated that it took a leadership role in implementing risk management methods at USAID/Pakistan before ADS 220 was issued and had provided valuable input into shaping ADS 220. However, the mission did not describe how and when it would reconcile the discrepancies between Mission Order 200.2 and Mission Order 200.6 and update these documents to comply with ADS 220*.* A management decision on this recommendation can be reached when USAID/Pakistan provides a detailed corrective action plan including target dates for completion of all action necessary to reconcile the mission orders with ADS 220.

Recommendation 4. The mission disagreed with this recommendation because it believes that project managers have already been issued formal designation letters. However, the mission did not provide evidence that the designation letters were issued on a timely basis. Although, the mission did not agree with this recommendation, it stated that it would issue designation letters at the time of the award to all project managers. Thus, it is unclear with what management disagrees. A management decision can be reached when the mission provides a complete, detailed corrective action plan to provide designation letters to project managers before they assume their roles.

Recommendation 5. The mission agreed with this recommendation. It stated that it has validated many activities and is in the process of validating more than 40 entities, including government agencies throughout Pakistan. However, the mission did not include target dates for completing all actions. A management decision can be reached when the mission provides a complete corrective action plan, including milestones and target dates, for validating training to the entities implementing government-to-government projects.

Recommendation 6. The mission agreed with this recommendation. USAID/Pakistan stated that would modify the cooperative agreement by the end of November 2013 to require validations at the completion of capacity-building activities. We acknowledge the mission's management decision on this recommendation**.**

Recommendations 7 and 8. The mission disagreed with these recommendations but agreed with the principle of validating information in PakInfo. USAID/Pakistan believes that the two recommendations should be removed from the report or should be addressed to the Office of Afghanistan and Pakistan Affairs (OAPA). The following points describe the mission's position.

- The mission believes that the audit evaluation of PakInfo is outside the scope of the audit of government-to-government assistance because PakInfo is a management tool for the mission's portfolio as a whole. However, the mission used PakInfo as a monitoring database to manage its portfolio, including government-to-government programs. Thus, OIG considered PakInfo a significant source of evidence, as described in the audit objective, to determine whether USAID/Pakistan was managing its program to achieve the mission's development goals.

  OIG considers monitoring an integral part of program management. Further, in response to audit requests for information, the mission provided data generated using PakInfo. For these reasons, OIG assessed PakInfo data reliability and communicated deficiencies noted, in compliance with generally accepted government auditing standards. The fact that PakInfo is not used exclusively for managing government-to-government assistance does not place it outside this audit's scope.

- The mission stated there was no indication that data in PakInfo led to any uninformed decision making. The mission also stated that PakInfo is one among many management information tools. It does not replace Phoenix, nor should it be compared to or elevated to the same level as the core financial system.

  OIG maintains that USAID/Pakistan should implement a plan to validate information in PakInfo and reconcile it with information in Phoenix because inaccurate data increases the mission's risk of making erroneous decisions. Further, discrepancies between databases require unnecessary reconciliation, creating inefficiencies. As mentioned in our finding, mission officials stated that after 2 years, they continue to have to correct and verify reports generated from PakInfo before using the information for external reporting.

- The mission requested that OIG redirect Recommendations 7 and 8 to OAPA if they are not removed from the audit report. USAID/Pakistan stated that it supports the development of management tools, but PakInfo's development and management team reports directly to OAPA.

  OIG determined that the errors noted during the audit testing are input errors. Project data are keyed into PakInfo by the mission's staff; therefore, the mission is responsible for preventing, detecting, and correcting the data entry errors. While OIG acknowledges that addressing Recommendations 7 and 8 will require working with OAPA, the primary responsibility for correcting these weaknesses lies with USAID/Pakistan.

The mission did not make management decisions on Recommendations 7 and 8. Management decisions can be reached when the mission provides (1) a corrective action plan to validate information in PakInfo and reconcile it to that in Phoenix and (2) a corrective action plan to make PakInfo operational.

SCOPE AND METHODOLOGY

Scope

We conducted this performance audit in accordance with generally accepted government auditing standards.[4] 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 was managing its Government-to-Government Assistance Program to achieve the mission's development objectives.

The audit covered activities implemented from October 1, 2009, to March 30, 2013, and onward, as relevant. The Government-to-Government Assistance Program at USAID/Pakistan officially started after the passage of the Enhanced Partnership with Pakistan Act of 2009. The program was originally intended to span 5 years, from fiscal year 2010 to fiscal year 2014, with an expectation that it would continue from fiscal year 2015 to fiscal year 2019. We conducted audit fieldwork from June 11 to July 17, 2013.

As of May 31, 2013, USAID had obligated approximately $1.38 billion and disbursed $900 million for government-to-government assistance projects. OIG visited five Government of Pakistan implementing entities (which managed projects representing obligations totaling nearly $960 million, or 69 percent of funds obligated for government-to-government assistance) to determine if USAID/Pakistan was managing these projects in a manner that would meet the mission's development goals.

We reviewed applicable laws and regulations as well as USAID policies and procedures pertaining to the program, including ADS 103, 200, 201, 220, and 350. We also reviewed Mission Orders 200.2 (and Annexes 2, 4, and 11) and Mission Order 200.6. The audit relied on the following sources of evidence: fixed-amount reimbursement agreements, cash transfer (budget support or emergency supplemental funding) agreements; activity agreements; preaward assessments; risk mitigation frameworks; risk analysis memorandums; activity approval memorandums; progress reports; monitoring and evaluation plans and reports; PakInfo data; and interviews with officials from USAID/Pakistan and Government of Pakistan implementing entities.

Implementing entities included the Government of Pakistan's Economic Affairs Division, HEC, the Cabinet Directorate, the FATA Secretariat, WAPDA, and the Government of Sindh. We reviewed and analyzed documentation maintained at the mission and at the government implementers' offices in Islamabad, FATA, and Sindh Province. Audit fieldwork was conducted from June 11 to July 17, 2013. We conducted fieldwork at the USAID/Pakistan mission and at the government implementers' offices in Islamabad including the FATA/Secretariat's offices and (by telephone) Sindh.

[4] *Government Auditing Standards*, July 2011 revision.

In planning and performing the audit, the audit team tested compliance with ADS 220 and the relevant mission orders. The team reviewed project design and implementation documents and activities, formal designations of project managers, mission assessments and reassessments, validations of capacity-building activities for Government of Pakistan implementers, and internal and external monitoring and evaluation programs.

We reviewed the mission's internal control procedures, which included:

- Guidelines for creating risk mitigation frameworks
- Guidelines for creating risk analysis memorandums
- Guidelines for conducting preaward assessments of Government of Pakistan implementers
- Guidelines for obtaining approval to move ahead with projects
- Guidelines for government-to-government project management and implementation
- Guidelines for funding mechanisms to reduce fiduciary risks for USAID funds
- Guidelines for monitoring and evaluation
- Guidelines for validating the effectiveness of capacity-building activities conducted at Government of Pakistan implementers.
- Guidelines for reassessing Government of Pakistan implementers after a certain period of time or upon a significant increase in funding.

Methodology

To answer the audit objective, the audit team interviewed USAID/Pakistan mission officials, including officials and project managers from the Program and Resource Management Office, the Mission Director's Office, the Office of Financial Management, and individual technical offices including the FATA/Khyber Pakhtunkhwa Office, the Sindh Regional Office (Karachi), the Communications Office, the Office of Energy, and the Office of Education.

We also interviewed officials from the Government of Pakistan's Economic Affairs Division, HEC, the FATA Secretariat, the Water and Power Development Authority, the Government of Sindh, and the Cabinet Directorate. The audit team also reviewed mission and Government of Pakistan documentation used to design, implement, manage, monitor, assess, and validate government-to-government assistance projects. To validate components of the projects, we also reviewed PakInfo data.

The audit team judgmentally selected five government-to-government assistance projects. In identifying government-to-government assistance projects and government implementers to review, the audit team selected recipients from different provinces, with different types of activities, operating under different funding mechanisms. In conducting our reviews of documents provided by the mission, we deemed any activity approval documents to meet the requirements of project appraisal documents (mentioned in ADS 220) and Mission Order 200.6.

The results from our judgmental sampling cannot, however, be projected to all government-to-government assistance projects or implementers.

Additionally, through interviews, documentation reviews and data analysis, the audit team obtained an understanding of (1) USAID/Pakistan's Government-to-Government Assistance Program goals, (2) the mission's way of managing and monitoring the design and implementation of the program, (3) the quality of the data reported, and (4) the mission's compliance with ADS 220 and relevant mission orders.

USAID | PAKISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

Date	**November 13, 2013**
To	**Matthew Rathgeber- Director/OIG Pakistan**
From	**Greg Gottlieb – Mission Director, USAID/Pakistan /s/**
Subject	**Management Comments on Draft Audit of USAID/Pakistan's Government to Government Assistance Program**
Reference	**Draft Audit Report No. G-391-14-00X-P dated October XX, 2013**

The purpose of this memo is to provide the Mission's comments on the above-captioned draft audit report which concludes that USAID/Pakistan is managing its government-to-government (G2G) assistance program to achieve the Mission's development goals. The Mission appreciates both the affirmation of its sound management and the feedback contained in the report to further strengthen procedures, and will work to address the points contained therein. The Mission is proud of the pioneering risk mitigation methodologies that it has created and the success of our G2G programs to date. The Mission's successes and best practices have been incorporated into the Agency's policies and procedures, and the Mission will continue to inform the Agency as we gain more experience in G2G programming.

Introduction

The Mission respectfully requests that the final report highlight the OIG audit objective and principal conclusion in a manner at least commensurate with the presentation of its other findings (Pg. 1, Para 4). Through the G2G mode of implementation, the Mission jointly with the Government of Pakistan has significantly advanced its development goals in addition to U.S. foreign policy objectives. These G2G achievements form a foundation for a more peaceful, prosperous democratic Pakistan. In particular, we believe that our G2G programs have contributed to stability and increased economic opportunities in the Swat Valley following the Taliban invasion and epic floods, as well as in North and South Waziristan. To illustrate, hundreds of kilometers of roads have been built, over 1,000 megawatts of power have been created, and irrigation systems are being built or rehabilitated for over 600,000 acres of land. In addition, over 10,000 university scholarships have been granted and over 600 schools have been built. Improving social and economic circumstances in these regions leads to more productive communities, facilitates improved governance and reduces conflict in regions where terrorism and the absence of the rule of law would otherwise more aggressively take hold.

The Mission would like to present some historical context, and explain the facts and circumstances leading to the current status of compliance with ADS 220. The Mission's contemporary G2G program predates ADS 220 by at least two years. The G2G program grew at a rapid pace concurrent with the institution of the 2009 Kerry-Lugar-Berman Act which authorized funding to Pakistan through FY 2014. The Mission responded and utilized a variety of existing guidance and risk control tools, and began to implement its G2G program in compliance with the laws and Agency policies in force at the time. The result of the Mission's pioneering efforts was a rigorous methodology of risk mitigation designed to address accountability and management control over G2G activities. The knowledge and experience gained by the Mission through its varied and continuing working relationships with Pakistan government partners over the years informed not only the Mission's, but also the Agency's Government to Government (G2G) program practice and policy over the years. The CFO's office in Washington regularly called upon USAID/Pakistan to inform and guide the development of ADS 220, a fact not widely known. Our experiences in G2G programming will continue to refine ADS 220.

Significantly, the Mission has a long track record of conducting detailed assessments and risk analyses of partner country entities. The Mission would like to insert a key point contained in the Audit of USAID/Pakistan's Management of Preaward Assessments, Audit Report No. G-391-11-004-P, dated May 6, 2011. On page one of that report, it concludes that USAID/Pakistan's preaward process did provide a reasonable basis for identifying significant financial management vulnerabilities. The Mission respectfully suggests that the final version of this audit report reference Audit Report No. G-391-11-004-P and note its relevant conclusion.

The Mission would like to note that necessary procedures have been in place to successfully protect taxpayer funds used in connection with the G2G programs. Agency guidance in this area also continues to evolve, and the Mission is regularly updating internal procedures to comply with such guidance As the Agency updated its guidance, USAID/Pakistan recognized and continues to agree that compliance with the Agency's policies and best practices remains a priority.

The Mission believes it has made great strides in measuring and documenting its achievements, contrary to page one of the draft report. The majority of the Mission's current G2G assistance is in the form of fixed amount reimbursement agreements, whereby the Government of Pakistan is reimbursed in fixed amounts for certain pre-determined milestones. The budgeting process for these agreements is rigorous, during which the milestone payments are properly assessed and validated. Reimbursements are contingent upon validation by third-party monitors to verify that the physical progress was made according to agreed-upon standards. In that way, achievement of milestones is constantly measured and documented. Activity managers and Certifying Officers are routinely scrutinizing disbursements and linked programmatic achievements, an internal oversight process essential to administrative approval and payment certification. Apart from the fixed amount reimbursement process, the Mission performs additional third-party evaluations, pre- and post-disbursement verifications, depending on the activity, to ensure that the results are properly met. For instance, when the Mission disbursed $190 million for flood victims, the eligibility of each household was independently verified before disbursement was made. The Mission is also regularly conducting independent audits of its G2G activities which are approved by the Auditor General of Pakistan.

The comments below track the recommendations made in the draft report and cite relevant page numbers.

<u>Recommendation No. 1:</u> **We recommend that USAID/Pakistan reassess Government of Pakistan implementing entities according to Automated Directives System Chapter 220. If the mission is unable to conduct timely reassessments, it should document the reasons for noncompliance and specify a time frame for performance.**

The Mission concurs with this recommendation. The Mission has already been complying with ADS 220 in terms of the Stage 2 assessments.

The Mission is in the process of conducting reassessments of various government ministries as their re-assessments become due. For example, the assessment of the FATA/Secretariat was done in March 2010. The Mission is currently working on conducting a reassessment of the government entity to ensure compliance with the ADS 220. Additionally, the Pakistan Water and Power Development Authority (WAPDA) pre-award assessment was completed in February 2010 and the Mission has solicited applications from Certified Public Accountant (CPA) firms to conduct the reassessment. The Mission completed a Control Environment and Risk Analysis (effectively an internal control review) of the Higher Education Commission (HEC) which served as the risk mitigation measure for the HEC. The Mission also relied on a compliance audit conducted by the Auditor General of Pakistan (AGP) as a risk mitigation measure to ensure that relevant controls were in place to safeguard the assistance funding that was being distributed to the Pakistani entity.

All of these GOP institutions are active participants in USAID-funded G2G programs. In all cases, physical progress is verified to determine if benchmarks and objectives have been achieved. Vouchers are reviewed by our USAID financial staff to ensure that funds are appropriately safeguarded.

Page five indicates that the Mission has not yet applied for a waiver of ADS 220. Please note that on August 29, 2013, a waiver for ADS 220 was submitted to OAPA after clearances from General Counsel (GC) and the Chief Financial Office (CFO) in USAID/Washington to request that the provisions of that Chapter not be applied for USAID/Pakistan funds through FY14. The Mission expects to receive approval to waive ADS 220 and will use this transition time period to achieve full compliance with the guidance.

Page six contains the statement "Without reassessments, weaknesses may not be detected until project implementation, putting tens or hundreds of millions of dollars of US taxpayer dollars at risk of mismanagement." The Mission respectfully requests that this statement be modified or removed given that physical progress and financial accountability is reviewed when each milestone is reached and when each voucher is submitted. These processes provide a continuous assessment and reassessment to identify any weakness and take immediate corrective action.

Recommendation 2: We recommend that USAID/Pakistan implement a plan with milestones for fully complying with Automated Directives System Chapter 220.

The Mission concurs with this recommendation. The Mission anticipates that a waiver will be granted for the provisions of ADS 220. If granted, the waiver will have a direct impact on the sequence of the transition plan to bring the Mission into full compliance.

Regarding the parenthetical remark on page six regarding "the two databases", the Mission advises the use of a clear delineation between the Agency's official Phoenix accounting database and the PakInfo management tool.

Recommendation 3: We recommend that USAID/Pakistan reconcile the discrepancies between Mission Order 200.2 and Mission Order 200.6 and update these documents to comply with Automated Directives System Chapter 220.

The Mission concurs with this recommendation.

These Mission Orders, issued in 2012, functioned as valuable guidance that captured earlier best practices during the period preceding the release of ADS 220. Taking a leadership role, the Mission invested heavily in ensuring that adequate risk mitigation approaches and tools were in place well *before* the Agency generated its updated guidance. The Mission also issued detailed interim guidance on conducting risk assessments in July 2011, an early example of the Mission's vanguard work. Page nine of the draft report states that Washington "was developing an entirely different framework." Please note that while there are clear differences in these parallel tools, there are actually more similarities, and for a good reason: the CFO office in Washington was regularly consulting the Mission on its risk management process to glean lessons learned. The CFO incorporated USAID/Pakistan's risk management accomplishments in order to build the foundation and framework that largely determined the policy content of ADS 220.

The Mission would also like to take this opportunity to propose changes to the tabulation of non-compliance (Table 1). Following the OIG Audit of USAID/Pakistan's management of Preaward Assessments in May, 2011, the Mission developed guidance for Risk Mitigation Frameworks (RMF) and Risk Analysis Memos (RMM). Therefore, there was no Mission requirement or practice for development of RMMs or RMFs for all the activities listed, which were all completed before the referenced audit. As far as the Citizens Damage Compensation Program (CDCP) is concerned, the Mission used its preaward assessment for a program entitled GOP's Cash Support for the Internally Displaced Persons Program, as it used the same mechanism as the CDCP with the same implementing entities.

<u>Recommendation 4:</u> We recommend that USAID/Pakistan implement a procedure to provide project managers with formal designation letters before they begin serving in that capacity.

The Mission does not concur with this recommendation. The project managers have already been issued formal designation letters and a procedure exists as outlined in MO 200.2 (Annex 11) to have designation letters routinely issued. Therefore, the Mission requests that this recommendation be closed prior to the issuance of the final report. Going forward, all project managers will be issued designation letters at the time of the award.

Please note that the discussion regarding the designation of project managers is driven by stricter Mission policy (MO 200.2), not ADS 220. Since Mission guidance imposes stricter requirements beyond ADS 220 on this point, the Mission believes it has flexibility in how to implement a requirement that was created by the Mission.

<u>Recommendation 5:</u> We recommend that USAID/Pakistan implement a plan with milestones specifying when it will validate capacity-building activities conducted for the Government of Pakistan entities implementing government-to-government projects.

The Mission concurs with this recommendation.

The Mission has conducted validations for non-G2G activities and the Mission is now conducting validations of capacity building for G2G activities as well. The Mission is in the process of conducting validations of over 40 entities including government entities in KP and Sindh and various other locations.

On page 11, the report states that "the Mission is unable to determine which government systems are deficient". The Mission respectfully requests that this statement be removed in the final report because it is inaccurate. Please note that pre-award assessments have been performed on a consistent basis, and the Mission would like to again draw your attention to the general conclusions of the Audit of USAID/Pakistan's Management of Preaward Assessments. In addition, to further illustrate and support the Mission's commitment to risk management, we point out that the Mission is also conducting financial audits that involve internal control reviews.

Recommendation 6: We recommend that the mission modify its Assessment and Strengthening Program cooperative agreement to reflect actual mission practices related to validations of capacity-building activities, to facilitate the mission's compliance with the agreement.

The Mission concurs with this recommendation.

The Mission has been validating capacity building at the end (rather than annual) of activities as a matter of practice. Cooperative Agreement #391-A-00-11-01203 and 391-A-00-11-01201 currently requires *annual* validations. The Mission intends to modify the Cooperative Agreement prior to the end of November 2013 so that the validation requirements coincide with actual practice, which would be at the end of activities.

Recommendation 7: **We recommend that USAID/Pakistan implement a plan with a timeline to validate information in PakInfo and reconcile information contained in PakInfo with information contained in Phoenix.**

While we agree with the principle of having validated information in PakInfo, we believe this recommendation is outside of the scope of the audit per comments under Recommendation 8.

Recommendation 8: We recommend that USAID/Pakistan implement a plan with a timeline for PakInfo to become operational.

Mission believes that these two recommendations (seven and eight) should be removed from the report for the following reasons:

- PakInfo is not exclusively a G2G management tool. It is intended to be a tool to monitor the entire Mission portfolio, not dedicated to G2G aspects. Since the audit intended to focus on whether USAID/Pakistan is managing the G2G program in a way that will achieve development goals, the Mission questions whether an evaluation of this tool is within the scope of the G2G program audit.
- There is no indication that data in PakInfo led to any uninformed or bad decision making. PakInfo is one of several management information tools and does not replace Phoenix, the core accounting system.
- The PakInfo tool is continuously being improved. As such, some reconciliation issues and discrepancies can reasonably be expected as additional features are developed and existing features are refined.
- The PakInfo database should not be compared to the Phoenix database, or elevated to a level of significance on par with Phoenix. Phoenix is the official accounting record for the Mission and the Agency, and is audited annually. While PakInfo draws upon Phoenix for some data, PakInfo remains a tool to help the Mission use the Phoenix data.

In the event that Recommendations 7 and 8 are not removed from the report, the Mission requests that any such recommendations be directed to the OAPA office in Washington. USAID/Pakistan is indeed working diligently in support of the effort to create and improve tools for more effective program management. However, the staff developing and managing PakInfo do not report to USAID/Pakistan. Rather, PakInfo software developers report to the OAPA Office in USAID/Washington, which provides day-to-day supervision.

Mission would like to again express its appreciation for the guidance and feedback provided by the Inspector General through this audit report. The G2G program indeed represents a large and successful portion of the Mission's portfolio. The Mission's effective risk and performance management has indeed been a key to implementation success.

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