



## MEMORANDUM

**DATE:** September 21, 2018

**TO:** USAID/Pakistan Mission Director, Jerry Bisson

**FROM:** Acting Regional Inspector General/Manila, Emily Gardiner /s/

**SUBJECT:** Financial Audit of the Malakand Reconstruction and Recovery Program Assistance in Pakistan Managed by the Provincial Reconstruction Rehabilitation and Settlement Authority, Government of Khyber Pakhtunkhwa, Grant No. 6, July 1, 2013, to June 30, 2014 (5-391-18-031-R)

This memorandum transmits the final audit report on the Malakand Reconstruction and Recovery Program Assistance in Pakistan managed by the Provincial Reconstruction Rehabilitation and Settlement Authority (PaRRSA), Government of Khyber Pakhtunkhwa. The audit was conducted by the Auditor General of Pakistan (Auditor General). The “Memorandum of Understanding Between the United States Agency for International Development and the Auditor General of Pakistan” requires that the audit be conducted in accordance with U.S. generally accepted government auditing standards (GAGAS) or the financial audit manual and the guidelines developed by the Auditor General.

The Auditor General stated that it performed its audit in accordance with GAGAS. It did not disclose the scope limitations that it did not fully comply with GAGAS pertaining to having a continuing professional education program and external quality control reviews. However, the mission confirmed that the Auditor General is not in full compliance with GAGAS requirements to have a continuing professional education program and external quality control reviews.<sup>1</sup> The Auditor General also stated that it performed its audit in accordance with international standards of supreme audit institutions issued by the International Organization of Supreme Audit Institutions (INTOSAI).<sup>2</sup> The Auditor General is responsible for the enclosed auditor’s report and the conclusions expressed in it. We do not express an opinion on the PaRRSA’s

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<sup>1</sup> Issues which the Auditor General should address in future audit reports to more fully comply with GAGAS 3.83-3.85, which required the auditors to institute internal quality control procedures.

<sup>2</sup> GAGAS 2.19 allows auditors to use GAGAS in conjunction with professional standards issued by other authoritative bodies.

fund accountability statement; the effectiveness of its internal control; or its compliance with grant terms and applicable laws and regulations.<sup>3</sup>

The audit objectives were to (1) express an opinion on whether the grantee's fund accountability statement for the period audited was presented fairly, in all material respects; (2) evaluate the grantee's internal controls; and (3) determine whether the grantee complied with grant terms and applicable laws and regulations. To answer the audit objectives, the Auditor General reviewed program documents and procedures; examined the fund accountability statement including revenues received from USAID and costs incurred during the period; reviewed the internal control systems; and tested compliance with grant terms and applicable laws and regulations. The audit covered program revenues and costs of \$5,167,554 and \$4,156,541, respectively from July 1, 2013, to June 30, 2014.

The Auditor General concluded that, except for the effects of the questioned cost of \$1,288,671 (PKR132,134,000),<sup>4</sup> the fund accountability statement presented fairly, in all material respects, program revenues and costs incurred under the agreements for the period audited. However, the report on the fund accountability statement did not provide a breakdown of the \$1,288,671 in questioned cost, and only stated that these costs were questioned because they were not program related, were unreasonable, or were prohibited by the terms of the agreements. Also, the fund accountability statement did not report any questioned costs.<sup>1</sup> In answer to our inquiry, the mission indicated that it neither received a breakdown of the \$1,288,671 in questioned costs from the Auditor General, nor recovered any amount of these questioned costs.

In the report on internal control, the Auditor General indicated that it identified material weaknesses in internal control. However, the report did not provide a description or summary of these material internal control weaknesses.<sup>1</sup> Further, in the report on compliance, the Auditor General indicated that it identified material instances of noncompliance. However, the report did not provide a description or summary of these material noncompliance issues.<sup>1</sup>

In its management letter, the Auditor General identified 16 issues. Based on the description of these issues, we consider all of the issues to be material instances of noncompliance;<sup>1</sup> hence we are making a recommendation for corrective action. Further, the effects of these material noncompliance issues totaling \$1,225,524<sup>5</sup> (PKR125,659,199) should have been identified as questioned costs in the fund accountability statement.<sup>1</sup> Accordingly, we are making a recommendation to the mission to determine the allowability of and recover, as appropriate,

<sup>3</sup> We reviewed the Auditor General's report for conformity with professional reporting standards. Our desk reviews are typically performed to identify any items needing clarification or issues requiring management attention. Desk reviews are limited to review of the audit report itself and excludes review of the auditor's supporting working papers; they are not designed to enable us to directly evaluate the quality of the audit performed.

<sup>4</sup> PKR stands for Pakistani Rupee. According to the mission, the exchange rate is USD 1 = PKR102.5351. In future audit reports, the Auditor General should have stated all currency amounts in the audit report, including the report findings, in U.S. dollars. The audit report must include a note to the fund accountability statement that states the exchange rate during the audit period.

<sup>5</sup> Due to the rounding difference of \$1, at the time the report was initially issued, we indicated questioned costs of \$1,225,523 instead of \$1,225,524.

these questioned costs.<sup>6</sup> The details of the material instances of noncompliance and the associated questioned costs are summarized in the table below.

**Table 1**

	Description of Findings	Ineligible Costs		Unsupported Costs		Reference-Finding No.
		PKR	USD	PKR	USD	
1.	Payments to a contractor without supporting documents			8,239,000	80,353	4.1.1 Page 26
2.	Contractor paid twice for the same item	70,000	683			4.1.2 Page 27
3.	Rate of premium applied to various contractors for payments in excess of the admissible rate	4,190,953	40,873			4.1.3 Page 27
4.	Payments to various contractors of unallowable escalation charges	23,064,000	224,938			4.1.4 Page 28
5.	Excess payments to a contractor for the supply and fabrication of steel	602,851	5,879			4.1.5 Page 30
6.	Payments to various contractors of unallowable escalation charges	32,470,523	316,677			4.1.6 Page 31
7.	Payments to a contractor of unallowable escalation charges	1,635,838	15,954			4.1.7 Page 33
8.	Payments to various contractors of unallowable security deposits	3,478,856	33,928			4.1.8 Page 34
9.	Excess payments to a contractor resulting from increasing the rates charged for certain items of work	1,852,708	18,069			4.1.9 Page 35
10.	Payments of petroleum, oil, and lubricant products; repair and maintenance; and office supplies out of the Capacity Building funds in violation of project documents	1,421,412	13,863			4.1.10 Page 36
11.	Payments of petroleum, oil, and lubricant products, and repair and maintenance in excess of the USAID approved number of vehicles	7,561,159	73,742			4.1.11 Page 38
12.	Payments related to subcontracting without the required written approval	899,716	8,775			4.2.1 Page 39

<sup>6</sup> Some questioned costs are covered by fixed amount reimbursement agreements (FARA) wherein USAID's reimbursement to PaRRSA is fixed in advance based upon cost estimates reviewed and approved by USAID, and made upon the physical completion of an activity, a subactivity, or a quantifiable element within an activity. The emphasis is upon reimbursement based on outputs rather than inputs or costs. However, the audit report did not indicate which of the findings are covered by FARA, and whether or not the questioned costs covered by FARA had been billed to and paid by USAID. Therefore, we are making a recommendation to determine allowability of all questioned costs.

Description of Findings	Ineligible Costs		Unsupported Costs		Reference-Finding No.
	PKR	USD	PKR	USD	
13. Payments to hire vehicles; repair furniture, equipment, and machinery; and purchase stationery without the required quotations, with questionable quotations (same handwriting or no specifications), made through cash instead of check, or without the required no objection certificate for repairs			1,223,183	11,929	4.2.2 Page 40
14. Payments to contractors for work not completely performed	11,634,000	113,464			4.3.1 Page 42
15. Payments made to a contractor before commencement of the work	8,615,000	84,020			4.3.2 Page 43
16. Payments for construction without supporting documents			18,700,000	182,377	4.3.3 Page 44
<b>TOTAL</b>	<b>97,497,016</b>	<b>950,865</b>	<b>28,162,183</b>	<b>274,659</b>	
<b>TOTAL QUESTIONED COSTS</b>	<b>PKR125,659,199 or \$1,225,524<sup>5</sup></b>				

In relation to the questioned costs of \$1,288,671 without details identified in the report on the fund accountability statement, we are making a procedural recommendation for the mission to determine (1) the breakdown of the \$1,288,671 in questioned costs identified in the report on the fund accountability statement, (2) the questioned costs identified in the report on the fund accountability statement that did not pertain to the questioned costs summarized in the above table, and (3) the allowability and recovery, if appropriate, of these questioned costs.

In response to our inquiry, the mission confirmed that the grantee does not have a cost-sharing contribution requirement or a USAID-authorized provisional indirect cost rate. However, the Auditor General improperly included a report on indirect cost rate on page 11 and schedule of the computation of the indirect cost rate on page 17.<sup>1</sup> Further, several findings in the above table were prior audit recommendations that had not been satisfactorily addressed; they were again reported in the current period management letter, and are covered by Recommendation 3 below.

To address the issues identified in the report and discussed in this memorandum, we recommend that USAID/Pakistan:

**Recommendation 1.** Determine the allowability of \$1,225,524<sup>5</sup> in questioned costs (\$950,865 ineligible, \$274,659 unsupported) as detailed in Table 1 on pages 3–4 of this memorandum, and recover any amount that is unallowable.

**Recommendation 2.** Determine (1) the breakdown of the \$1,288,671 in questioned costs identified in the report on the fund accountability statement, (2) the questioned costs identified in the report on the fund accountability statement that did not pertain to the questioned costs summarized in Table 1 on pages 3–4 of this memorandum, and (3) the allowability and recovery, if appropriate, of these questioned costs.

**Recommendation 3.** Verify that the Provincial Reconstruction Rehabilitation and Settlement Authority, Government of Khyber Pakhtunkhwa corrects the 16 material instances of noncompliance detailed in Table I on pages 3–4 of this memorandum.

We ask that you provide written notification of actions planned or taken to reach management decisions. We appreciate the assistance extended during the engagement.

The OIG does not routinely distribute independent public accounting reports beyond the immediate addressees because a high percentage of these reports contain information restricted from release under the Trade Secrets Act, 18 U.S.C. 1905 and Freedom of Information Act Exemption Four, 5 U.S.C. 552(b)(4) (“commercial or financial information obtained from a person that is privileged or confidential”).

Attachment: a/s