MEMORANDUM

DATE: November 29, 2018

TO: USAID/Pakistan Mission Director, Jerry Bisson

FROM: Office of Inspector General/Asia Regional Office Audit Director
Matthew Rathgeber /s/

SUBJECT: Financial Audit of Khyber Pakhtunkhwa Reconstruction Program and Capacity Building in Pakistan Managed by the Provincial Reconstruction Rehabilitation & Settlement Authority, Government of Khyber Pakhtunkhwa, Grant No. 47, July 1, 2014, to June 30, 2015 (5-391-19-005-R)

This memorandum transmits the final audit report on the Khyber Pakhtunkhwa Reconstruction Program and Capacity Building in Pakistan managed by the Provincial Reconstruction Rehabilitation & 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 international standards of supreme audit institutions issued by the International Organization of Supreme Audit Institutions (INTOSAI). 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 fund accountability statement; the effectiveness of its internal control; or its compliance with the award, laws, and regulations.[1]

[1] 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.

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 $5,240,130 and $4,685,985, respectively, from July 1, 2014, to June 30, 2015.

The Auditor General concluded that, except for the effects of the questioned costs pointed out and discussed with the management, the fund accountability statement presented fairly, in all material respects, program revenues and costs incurred under the agreement for the period audited. However, the report on the fund accountability statement and the fund accountability statement did not provide the amount of the questioned costs and its breakdown.[2] In answer to our inquiry, the mission indicated that it did not have any additional information on questioned costs and its breakdown other than what was provided in the report.

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 weaknesses.[2] 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.[2]

In its management letter, the Auditor General identified 30 issues. Based on the description of these issues, we consider all of the issues to be material instances of noncompliance;[2] hence we are making a recommendation for corrective action. Further, the effects of these material noncompliance issues totaling $5,738,008 should have been identified as questioned costs in the fund accountability statement.[2] Accordingly, we are making a recommendation to the mission to determine the allowability of and recover, as appropriate, these questioned costs.[3] The details of the material instances of noncompliance and the associated questioned costs are summarized in the following table.

[2] 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.

[3] 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. However, there was no information on whether 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.

Table 1

	Description of Findings	Ineligible Costs		Unsupported Costs		Reference-Finding No.
		PKR[a]	USD	PKR	USD	
1.	Procurement made at the rate other than the lowest bid	8,419,000	82,686			4.1.1 Page 27
2.	Award of additional work to a contractor without bid invitation[b]	-	-	-	-	4.1.2 Page 28
3.	Penalties recovered from the contractors for the delay in execution of work not credited to the government revenue account	4,012,163	39,405			4.1.3 Pages 28-29
4.	Missing dismantled materials	-	-	-	-	4.1.4 Pages 29-30
5.	Penalty was not imposed on contractors for late completion	2,007,000	19,711			4.1.5 Page 31
6.	Penalty was not imposed on contractors for late completion	977,000	9,595			4.1.6 Page 32
7.	Funds released for work not fully performed, accounted, nor inspected	12,600,000	123,749			4.1.7 Page 33
8.	Payment of repair and petroleum, oil, and lubricants for unauthorized vehicles, and for unjustified rent of vehicles	724,895	7,119			4.1.8 Pages 34-36
9.	Payment of unallowable entertainment charges and unsupported hotel accommodations	179,800	1,766	101,520	997	4.1.9 Page 36
10.	Payment to a contractor of unallowable escalation charges	34,736,444	341,159			4.2.1 Page 37
11.	Payment to a contractor of questionable arbitration award	2,839,118	27,884			4.2.2 Pages 37-38
12.	Unspent balances of deposit for completed projects not surrendered to the project authority	271,483,000	2,666,329			4.2.3 Page 39
13.	Expenditures for work not prescribed in the PC-1 Form of the project[c]	28,889,000	283,729			4.2.4 Pages 39-40
14.	Payment to contractors of unallowable escalation charges	3,185,306	31,284			4.2.5 Page 40
15.	Loss of funds for awarding of the work to another contractor at the rate higher than the contract fund balance of the defaulting contractor	4,504,000	44,235			4.2.6 Page 41
16.	Payments in excess of the amounts identified in the bill of quantities	642,964	6,315			4.2.7 Page 42
17.	Funds released without immediate requirement	21,450,608	210,674			4.2.8 Pages 42-43

	Description of Findings	Ineligible Costs		Unsupported Costs		Reference-Finding No.
		PKR[a]	USD	PKR	USD	
18.	Unspent balances of deposit for completed projects not surrendered to the project authority	48,483,000	476,169			4.2.9 Pages 43-44
19.	Payment to a contractor of unallowable escalation charges	36,031,000	353,873			4.2.10 Page 44
20.	Funds transferred from the program account to UNDP account without the supporting justification			2,190,000	21,509	4.2.11 Page 45
21.	Expenditures for work not prescribed in the PC-1 Form of the project[c]	67,157,000	659,572			4.3.1 Pages 45-46
22.	Payment to a contractor with questionable performance of work	19,123,452	187,818			4.3.2 Pages 46-47
23.	Purchases of various sports items not supported with relevant records			1,577,000	15,488	4.3.3 Page 47
24.	Expenditures related to excess use of steel which could not be justified	2,601,300	25,548			4.4.1 Page 48
25.	Expenditures for work not in accordance with the approved design	125,300	1,231			4.4.2 Pages 48-49
26.	Expenditures for work not in accordance with the approved design	2,548,000	25,025			4.4.3 Page 49
27.	Expenditures for work not in accordance with the approved design	1,481,739	14,553			4.4.4 Pages 49-50
28.	Expenditures for work without the approved design or excess payments to a contractor due to a higher billing rates	4,768,139	46,830			4.4.5 Pages 50-51
29.	Payment to a contractor for work not identified in the bill of quantities	1,272,477	12,497			4.4.6 Page 51
30.	Payment for repair work not supported with cost estimate nor recorded in measurement book			128,049	1,258	4.4.7 Pages 51-52
	TOTAL	**580,241,705**	**5,698,756**	**3,996,569**	**39,252**	
	TOTAL QUESTIONED COSTS	**PKR584,238,274 or $5,738,008**				

[a] PKR stands for Pakistani Rupee. All PKR figures have been converted at USD 1 = PKR101.819 (exchange rate per program wise detail of disbursement/releases by PaRRSA on page 14 of the audit report) for the purposes of this memo. 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.

[b] The finding was not related to disbursements in the fund accountability statement; thus, not questioned.

[c] The PC-1 Form certifies that the project proposal was prepared by a grantee based on the instructions provided by the Planning Commission.

Further, for Finding 4.1.4 (Item 4 on page 3 of Table 1), the whereabouts of the materials after the demolition should be further verified. In its response to the finding, the management stated that the materials had been delivered to the departments concerned and the results of the auction would be communicated to the auditors. Thus, we are making a procedural recommendation for the mission to determine (1) whether disposal was made for the dismantled materials; (2) the amount of sales of the dismantled materials not reported to USAID; and (3) the allowability and recovery, if appropriate, of these questioned revenues.

In response to our inquiry, the mission confirmed that the grantee does not have a cost-sharing contribution requirement and a USAID-authorized provisional indirect cost rate. However, the Auditor General improperly included a report on indirect cost rate on page 10 and a schedule of the computation of the indirect cost rate on page 15.[2] Also, some of the findings in Table 1 on pages 3–4 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 $5,738,008 in questioned costs ($5,698,756 ineligible and $39,252 unsupported) as detailed in Table 1 on pages 3–4 of this memorandum, and recover any amount that is unallowable.

Recommendation 2. Determine (1) whether disposal was made for the dismantled materials; (2) the amount of sales of the dismantled materials not reported to USAID; and (3) the allowability and recovery, if appropriate, of these questioned revenues, as detailed in Finding 4.1.4 on pages 29-30 of the audit report.

Recommendation 3. Verify that the Provincial Reconstruction Rehabilitation & Settlement Authority, Government of Khyber Pakhtunkhwa corrects the 30 material instances of noncompliance detailed in Table 1 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.

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