MEMORANDUM

DATE: January 28, 2019

TO: USAID/Pakistan Mission Director, Jerry Bisson

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

SUBJECT: Financial Audit of the Municipal Services Delivery Program in Pakistan Managed by the Local Government & Rural Development Department, Government of Khyber Pakhtunkhwa, Grant No. 51, July 1, 2015, to June 30, 2016 (5-391-19-009-R)

This memorandum transmits the final audit report on the Municipal Services Delivery Program in Pakistan managed by the Local Government & Rural Development Department (LG & RDD), 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 LG & RDD's fund accountability statement; the effectiveness of its internal control; or its compliance with the grant terms and applicable laws and regulations.[1]

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[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 system; and tested compliance with grant terms and applicable laws and regulations. The audit covered program revenues and costs of $7,343,456 and $7,343,456, respectively, from July 1, 2015, to June 30, 2016.

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, both 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 questioned costs were identified with the findings in the management letter and that it did not receive from the Auditor General information on the amount of the questioned costs and its breakdown.

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 13 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 $12,762,403 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.

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[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 LG & RDD 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.	Expenditures related to a contract awarded based on fake audited financial statements[b]	199,539,876	1,905,825			4.2.1 Pages 42-44
2.	Contract payment despite expired performance securities	100,567,829	960,533			4.2.2 Pages 44-45
3.	Questionable contract awards[c, d]	-	-	-	-	4.2.2, 4.2.3 Pages 44-46
4.	Expenditures related to a contract with questionable contract performance and penalties not imposed for the contractor's delay[b]	148,937,000	1,422,512			4.2.4 Pages 46-47
5.	Payment of salaries and allowances to project officials hired without conducting the required verification of educational documents	38,795,789	370,542			4.3.1 Pages 47-48
6.	Advances to contractor without the required bank guarantees	32,348,000	308,959			4.3.2 Page 48
7.	Payment to various contractors without the required approval of competent authority[b]	798,495,236	7,626,507			4.3.3 Pages 48-49
8.	Improper maintenance of records[d]	-	-	-	-	4.3.4 Page 49
9.	Payment to project employees above the admissible pay rates per policy	11,520,789	110,036			4.3.5 Pages 49-50
10.	Payment related to rented cars without supporting vehicle logbook			1,655,184	15,809	4.3.6 Pages 50-51
11.	Payment to promoters without justification	2,800,000	26,743			4.3.7 Page 51
12.	Payment of entertainment charges without adequate supporting documents			1,563,936	14,937	4.3.8 Pages 51-52
13.	Required rehabilitation funds for disabled persons not deducted from contracts awarded[d]	-	-	-	-	4.3.9 Page 52
	TOTAL	**1,333,004,519**	**12,731,657**	**3,219,120**	**30,746**	
	TOTAL QUESTIONED COSTS	**PRK1,336,223,639 or $12,762,403**				

[a] PKR stands for Pakistani Rupee. All PKR figures have been converted at USD 1 = PKR104.70 (OIG-computed average exchange rate based on State Bank of Pakistan's published rates) for the purpose of this memo. In future audit reports, the Auditor General should state 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 statements that states the exchange rate during the audit period.

[b] The Auditor General reported questioned costs up to the audit period—February 2017. Among other things, this explains why the reported questioned costs are greater than the audited program cost.

[c] This pertained to 19 contracts awarded without obtaining the required bank guarantees, audited financial statements, and third party insurance and 4 contracts awarded based on questionable technical evaluation including award to a contractor with lacking bid requirement, particularly financial statement.

[d] Issues that were not expenditure-related; thus, without questioned cost reported.

Further, in its management letter, the Auditor General identified internal control weaknesses on procurement and contract management, financial management, and monitoring and evaluation of the project associated with the issues identified in Table 1. Thus, we are making a recommendation for corrective action included in Recommendation 2 below.

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. The Auditor General reported Government of Khyber Pakhtunkhwa's actual cost share amount on page 3 of the report. However, the mission clarified in response to our inquiry that the contribution is voluntary and not required in the agreement. Also, some of the findings[4] in Table 1 on page 3 were prior audit recommendations that had not been satisfactorily addressed; these were again reported in the current period management letter and are covered by Recommendation 2 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 $12,762,403 in questioned costs ($12,731,657 ineligible and $30,746 unsupported) as detailed in Table 1 on page 3 of this memorandum, and recover any amount that is unallowable.

Recommendation 2. Verify that the Local Government & Rural Development Department, Government of Khyber Pakhtunkhwa corrects the 13 material instances of noncompliance detailed in Table 1 on page 3 of this memorandum and the associated internal control weaknesses identified in the management letter and discussed on page 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

[4] Findings 3, 7, 9, and 12 in Table 1 on page 3 of this memorandum