QAVI ENGINEERS (PRIVATE) LIMITED
Pre-award Assessment Report

September 15, 2012

ASP-RSPN

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Naveed Zafar Ashfaq Jaffery & Co.

Pre Award Assessment Report on

Qavi Engineers (Private) Limited

September 2012

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Accounts Executive	AE	Inventory Control Procedure	ICP
Assessment Strengthening Program	ASP	Manager Accounts	MA
Board of Director	BOD	Managing Director	MD
Chief Executive Director	CEO	Pakistani Rupee	PKR
Executive Director	ED	Presumption Tax Regime	PTR
Financial Management System	FMS	Purchase Request Form	PRF
Fixed Asset Register	FAR	Qavi Engineers (Private) Limited	QEL
General Manager	GM	Rural Support Program Network	RSPN
General Manager Procurement	GMP	Security Exchange Commission of Pakistan	SECP
Human Resource	HR	Senior Manager Accounts	SMA
Indefinite Quantity Contract	IQC	Standard Operational Polices	SOPS
Information Technology	IT	Store Department	SD
Infrastructure Management Services	IMS	Store Issue Request	SIR
International Accounting Standard	IAS	Store Register	ST
International Finance Reporting Standard	IFRS	United State Agency for International Development	USAID
Inventory	IR	United State Consulate	USC

ASSESSMENT REPORT

Mr. Ejaz Rahim
Chief of Party
ASP-RSPN
House# 70, Street 25, F-10/1
Islamabad.

Pre-award Assessment Report of Qavi Engineers (Private) Limited

We have made a review and evaluation of the managerial capacity and internal control systems of the Qavi Engineers (Private) Limited using those criteria established by ASP-RSPN per the USAID standards. Our review included tests of compliance with Qavi Engineers (Private) Limited 's stated procedures to the extent that such testing was deemed necessary and feasible. Our review is not an audit of financial statements prepared by Qavi Engineers (Private) Limited.

The management of the Qavi Engineers (Private) Limited is responsible for establishing and maintaining systems of internal controls and financial management. In fulfilling this responsibility, estimates and judgments by management are required to assess expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in accordance with generally accepted accounting principles. We understand that the objective of those financial management and internal control procedures comprehended in USAID's criteria is to provide similar assurance.

Based on this knowledge and the review and evaluation conducted by our firm, we believe the Qavi Engineers (Private) Limited current policies and procedures are sufficient for USAID/Pakistan's purposes, assuming satisfactory compliance, except for the conditions described in on page 5 which we believe would be material weaknesses. The level of risk identified as a result of our assessment is considered to be **high**. In addition to these weaknesses, other conditions that we believe would not be in conformity with the criteria referred to above be described in Appendix III.

Further, with the exception of the conditions referred to in the preceding paragraph, nothing came to our attention that would cause us to believe that the Qavi Engineers (Private) Limited does not have the managerial, technical, administrative and financial capabilities to carry out the proposed USAID funded activities.

Naveed Zafar Ashfaq Jaffery & Co.

Place: Islamabad

Dated: September 15, 2012

Naveed Zafar Ashfaq Jaffery & Co.
Chartered Accountants

Engagement Partner
Shah Naveed Saeed

Executive Summary

a. Introduction to organization

Qavi Engineers originally established as a partnership firm in 1979 to provide all kind of construction services. In 1982, the firm converted its legal status to a limited liability company – M/s Qavi Engineers (Private) Limited (QEL) by incorporating it with the SECP (formerly Corporate Law Authority) as a private limited company – a closely held family business having six shareholders and four directors, but managed by professionally qualified and experienced CEO/Director and other managerial staff. The Company has also incorporated a subsidiary company in Afghanistan namely M/s Qavi Engineering Limited. The operational offices of the Company are located in Lahore, Islamabad and Karachi and have also established offices in Dubai and Kabul. The Company has undertaken 121 projects including two projects in Afghanistan since its inception totaling Rs 6.19 billion.

b. Introduction to assignment

The objective of this Pre-Award Assessment is to provide reasonable assurance to USAID/Pakistan that QEL has an acceptable organizational and management structure, accounting, financial management systems, financial capability, property control system, procurement policies, including systems of internal controls, quality assurance capabilities as well as Company's suitability to provide comprehensive program management services, including design and specifications, construction contracting, and construction supervision for infrastructure projects throughout Pakistan.

c. Summary of risk assessment findings

Appex-II Page Ref.	Functional Area	Observations	Risk Level	Risk Mitigation Measures
1	Governance and management structure	Ineffective risk management	High	Formulation of Disaster Recovery and Whistleblower Policy
3	Governance and management structure	No Policies and Procedures Manual	High	Development of a comprehensive Policies and Procedures Manual and its approval from BOD.
6	Financial management and accounting system	Lack of Independent Internal Audit Function	High	Establishment of an internal audit department and hiring of qualified staff reporting directly to the BOD.
7	Financial management and accounting system	Preparation and Review of Budgets	High	Quarterly meeting by the higher management to see variations between actual and budgeted plan and to realign its budgetary plans.
8	Financial management and accounting system	Labor costs, social charges, and overhead charges applied by QEL	High	Such costs must be linked to actual costs incurred. The percentage applied by QEL in computing the FDR's appear to be at the higher side, when applied to actual labor cost.
9	Financial management and accounting system	Company is using unregistered software	High	Use of licensed software

10	Financial management and accounting system	Annual financial statements are not prepared in accordance with IAS-11 and are not audited on timely basis.	High	QEL's annual financial statements must be prepared in accordance with Construction Accounting Standards IAS-11.
14	Human resource function	Attendance record does not reflect time in and time out of the labor	High	Appropriate daily attendance record showing time in and time out should be maintained.
16	Sustainability	Lack of strategic and sustainable planning system	High	Formulation and implementation 'Sustainability Plan'

d. Summary of management response

Appex-II Page Ref.	Issue Identified	Management Comments
2	Ineffective risk management	*Disaster Recovery Plan and Whistle Blower Policy will be formulated and shared with employees within 10 Days of USAID Directive.*
2	No conflict of interest policy	*QEL's work culture and ethics do not allow any senior manager to enter into any agreement with a third party where a personal vested interest exists. However, a formal written Conflict of interest policy will be implemented within 10 Days of USAID Directive.*
3	No Policies and Procedures Manual	*Policies and Procedures Manual will be prepared within 45 Days of USAID directive. Further, we shall require support of ASP-RSPN in development of our policies and procedures.*
4	Company has not obtained insured policies for its offices, cash in hand and fidelity insurance.	*As we are currently working in a rented facility, insurance of just the furniture and computers etc. is not cost effective. However, all our project machinery, vehicles and assets are insured which forms the bulk of our assets. Additionally, it is pertinent to mention that QEL offices are secured by CCTV camera and a security system comprising of motion sensors, magnetic contactors and alarms. Head Office insurance will be made available within 05 Days after USAID directive.*
5	Project performance is not updated in the project management software	*We have made a policy of updating the software on regular basis.*
6	insufficient firefighting equipment	*Additional Firefighting Equipment will be installed at sites.*
7	Lack of Independent Internal Audit Function	*All activities including expenses and payments are approved and monitored at the director level for compliance and cost control. However, Internal Audit Function will be created in accordance with USAID RFP.*
8	Preparation and Review of Budgets	*Consolidated budgets on quarterly basis will be compiled in discussed in the meeting of the directors.*
9	Labor costs, social charges, and overhead charges applied by QEL	*Summary of Labor Costs, Social Charges and Overhead Charges has been provided.*
10	Company is using unregistered software	QEL will arrange Registered Software upon Award of USAID's Project.
11	Annual financial statements are not prepared in accordance with IAS-11 and are not audited on	*QEL will prepare its Financial Statements for the year 2011-12 in accordance with IAS -11 and has informed our Chartered Accountants for the same.*

	timely basis.	
12	Physical verification of fixed assets and stores	*Management of QEL has made a policy of stock taking in the presence of accounting department staff.*
13	Lack of segregation of duties	*Company has separated the stores and procurement departments and has made a policy that the physical stock taking will be made in the presence of the accounting department staff.*
14	Proper HR files are not maintained	*QEL continues to make its hiring process transparent and merit based. Relevant records for recent hiring are available.*
15	Attendance record does not reflect time in and time out of the labor	*Although we are maintaining the attendance registers for our management staff we shall also make efforts for keeping the similar records for labors.*
16	Lack of strategic and sustainable planning system	*We agree to prepare the strategic and sustainability plan for our organization but we need the support of ASP-RSPN in this regard.*

e. **Summary of mapping activity:** QEL capacity to fully address all control weaknesses and other issues including preparation of FMS Manuals and accounting policies including preparation of annual financial statements are limited and may requires donor intervention in mitigating the risks to a low level.

f. **Recommendations** – See Risk Mitigation Measures depicted in Risk Matrix given above.

Risk Assessment

a. **Risk assessment matrix - ATTACHED as Appendix I**

Risk analysis: Based on the assessment of the internal controls, gap identifications of the current accounting and reporting system of the Qavi Engineers (Private) Limited we conclude that the risk rating of the Company is **High** which may be reduced to a low level subject to appropriate mitigating factors adopted by the management.

b. **Risk mitigation framework.** The overall pre-award assessment risk is rated **High** that may come down to **Low** after necessary mitigation measures have been taken by the management as depicted in the Risk Matrix given above.

Introduction to Organization

a. Legal entity

Qavi Engineers (Private) Limited was established as a partnership firm in 1979 and later on it was incorporated with the SECP (formerly known as Corporate Law Authority) as a private limited company under the repealed Companies Act 1913 (now Companies Ordinance 1984) in 1982. Company has also a wholly owned subsidiary incorporated in Afghanistan with the name of Qavi Engineering Limited and the Company is also registered with Pakistan Engineering Council. Registered office of the Company is located in Lahore and its operational head office is located in Islamabad.

b. Brief profile

Qavi Engineers is a medium sized entity and is a closely held company. Company is providing all kind of construction related services and major projects undertaken by the Company include Lahore Expo Centre at Johar Town, Lahore, Research Facility at Heavy Industries, and Taxila, US Consulate at Herat, Afghanistan and Physical Security up gradation of US Consulate Peshawar, Pakistan.

c. Management and Organizational structure

The Company is basically a family owned business and all of the directors are blood relations. Currently the Company has the following directors on its board:-

1. Mr. Arshad Dad (Managing Director)
2. Mr. Jahanzeb Arshad Dad (Exec. Director)
3. Mrs. Zareen Dad (Director)
4. Mrs. Nazneen Malik (Director)

Organizational structure of the Company depicts it is closely held family business, but also engaged professional qualified and experienced staff to manage its operations. Organogram of the Company is attached as **Appendix-IV**.

d. Budget

i. Last three years budget

The Company is preparing its budgets at two different levels: head office and the project levels; predicting expenditures as line items under various head of accounts. Head office budget is prepared on annual basis whereas; respective project budget is prepared at the time of bidding based on the amounts bid for the services/activities to be performed. There is no practice for preparing annually consolidated budgets – an important tool for managing performance and strategic planning. Furthermore, there is no practice for preparing budgets for working capital and capital expenditures for the acquisition of fixed assets – an important exercise for forecasting fund flow requirements.

Year	2010/2011	2011/2012	2012/2013
Projects budget – Direct costs	*Not available*		
Head office - Indirect	43,000,000	48,000,000	45,000,000

ii. Main expenditure

Expenditures of the Company can be classified as (a) project cost (b) operating expenses. Project costs comprise of all direct costs of the company including direct material, direct labor, site expenditure, fuel and power and other direct costs. All costs other than direct costs like head office salaries, director remuneration, utilities, legal and professional costs, audit and other admin costs are classified as operating expenses.

Analysis of the actual direct and indirect expenditures for the year ended June 30, 2011, based on the audited financial statements, shows that: total direct costs of Rs 378.903 million incurred on the 7 running projects, comprises of – Material 36%; Labor costs 53%; and other related project costs 11%. Whereas, indirect costs totaling Rs 51.357 million comprises of payroll costs 33%; vehicle running 6%; business development expenditure 34%; donations 14%; financial charges 2%; and other costs 11%.

Introduction to Assignment

a. Brief introduction

In response to the advertisement dated April 30, 2012 published in local newspapers, USAID/Pakistan received ‘expressions of interest’ from Pakistani construction companies for the proposed Infrastructure Management Services (IMS) Indefinite Quantity Contract (IQC), short listed companies, including QEL were explained proposed IQC. It was determined by the USAID/Pakistan that selected Companies have the technical capacity and experience for delivering the required program management services specified for the proposed IMS IQC.

In this connection, Qavi Engineers (Private) Limited Pre-Award Survey has been awarded through ASP-RSPN (CPO) to Naveed Zafar Ashfaq Jaffery & Co., Chartered Accountants through task order dated August 03, 2012.

b. Objectives of pre-award assessment

The objective of the Pre-Award Assessment is to provide reasonable assurance to USAID/Pakistan that M/s Qavi Engineers (Private) Limited has an acceptable organizational and management structure, accounting, financial management systems, financial capability, property control system, procurement policies, and other attributes: (i) can meet project goals and objectives; (ii) can adequately safeguard, monitor and efficiently utilize resources; (iii) can obtain, maintain, and fairly disclose reliable data and information; (iv) has the institutional framework for sustainability and; and (v) can comply with applicable laws and regulations.

Furthermore:

1. To check current and possibility of future compliance with the USG rules and regulations.
2. To evaluate M/s.Qavi Engineers (Private) Limited’s capacity for receiving future higher level of funding based on a comprehensive absorptive capacity analysis.
3. To ensure that management leadership, organizational strengths, quality of staff, and quality of processes and procedures have the potential to support the management of a USAID-funded award.
4. Perform walk through and test on sample basis of financial, management and procurement systems of the Company.

c. Methodology

The assignment has been conducted by a team of professionals having relevant experience and knowledge of USAID’s requirements of Pre-Award Assessment.

Following procedures were adopted in conducting this assignment:

- Participated in the entrance meeting, and made presentation about the assignment objectives, scope of work and information/documentation requirements.
- While conducting fieldwork we conducted interviews with the relevant officials to understand the Company’s legal status, management structure, systems and procedures including financial reporting, budgetary control and accountability systems –internal and external audits.

- Conducted review of Internal control systems, policies, procedures, related to financial management systems, procurement, and human resource including accounting policies for reporting financial statements, financial position and financial reports, comparison of actual outlays with budgeted amounts, including assets management system.
- Performed walk through tests of transactions.
- Conducted analysis for: absorptive capacity; technical and quality assurance capabilities, and sustainability
- Use of check lists to documents all areas given under scope of work including internal control assessment.
- Evaluated capability to determine indirect costing and adequate charge-out of indirect expenses as per USAID requirements.
- Conducted site visit of an ongoing project located in Lahore.

d. Scope of work

Scope of work of this pre-award assessment covers the areas and their risk analysis; Gaps identification and risk mitigation measures related to: (a) Governance and management structure; (b) Financial management and accounting system; (c) Procurement system; (d) Human resource function; (e) Absorptive capacity; (f) Quality assurance; and (g) Organization sustainability

Assessment Areas

A. Governance and management structure

1. Legal entity

Qavi Engineers (Private) Limited was established as a partnership firm in 1979 and later on it was registered as a private limited Company under the repealed Companies Act 1913 (now Companies Ordinance 1984) on November 22, 1982. Company also has a wholly owned subsidiary incorporated in Afghanistan with the name of Qavi Engineering Limited and the Company is also registered with Pakistan Engineering Council. Registered office of the Company is in Lahore and its operational Head Office is in Islamabad.

Company is a family owned business and is providing all kind of construction related services and major projects undertaken by the Company include Lahore Expo Centre at Johar Town, Lahore, Research Facility at Heavy Industries, Taxila, US Consulate at Herat, Afghanistan and Physical Security up gradation for US Consulate Peshawar, Pakistan.

2. Decision making and regulatory framework

Qavi Engineers (Private) Limited is a closely held company and all decision making is done by the Company's Managing Director who is an electrical engineer with more than 35 years of practical experience. Composition of Board of Directors of the Company is as follows:

Sr.No.	Name of Director	Nationality	Designation
1.	Mr.Arshad Dad	Pakistani	Managing Director
2.	Mr.Jahanzeb Arshad Dad	Pakistani	Executive Director
3.	Miss Zareen Dad	Pakistani	Director
4.	Mrs. Nazneen Malik	Pakistani	Director

Shareholders of the Company and their shareholdings are as follows:

S.No.	Name of Member	Nationality	Shareholding %	No. of Shares
1.	Mr.Arshad Dad	Pakistani	48.45	969,000
2.	Mr.Jahanzeb Arshad Dad	Pakistani	31.75	635,000
3.	Miss Zareen Dad	Pakistani	5.99	100,000
4.	Mrs.Nazneen Malik	Pakistani	2.80	56,000
5.	Mr.Shahid Dad	Pakistani	6.00	120,000
6.	Mr.Zahid Dad	Pakistani	6.00	120,000
Total			**100.00**	**2,000,000**

3. Accountability

As QEL is a closely held company, all of the matters are being closely monitored by the Managing Director of the Company i.e. a transaction only takes place after the approval of the Managing Director in line with the budgetary provisions. BOD has not established separate internal audit department to ensure effective compliance of approved control policies and procedures. External audits are also being performed by a firm of Chartered Accountants; the auditors have an unqualified opinion on the financial statements for the last three years.

4. Organization structure of QEL

Company is virtually governed by its Managing Director/ Chairman of the BOD. The Company's operational activities are structured under various departments namely: (i) Technical department responsible for project contracting/ management, quality assurance and business development; (ii) Accounts department is responsible for recording accounting transactions, payroll preparation, banking, budgeting and reporting financial information and compliance with statutory provisions of income tax and company laws; (iii) Procurement and stores department is responsible for the supply chain management, warehousing and organizing physical verification of stores and fixed assets; and (iv) Admin and HR department is mostly responsible for the office/project maintenance, security, logistic support, custodian of HR files, etc. The Company has employed suitably qualified and experience departmental heads to ensure effective management and controls.

Organogram is attached as **Appendix-IV**.

5. Segregation of authorities and duties

Company is a medium sized entity and all operations are being closely monitored by the Managing Director of the Company. Further the Company is divided into various departments for management control and operational purposes.

B. Financial management and accounting system

1. Financial management system

A financial management system and processes of the Company are generally based on the practices adopted over the time. We noted that the Company has not developed its financial management system manual (in written format) for providing guidelines for internal controls policies and procedures, adopting of appropriate accounting policies in accordance with generally accepted accounting principles, execution and recoding of transactions after approval, appropriate classification of transactions in a chart of accounts, bank reconciliation, adequate safeguards over access to and use of assets, physical verification and maintenance of fixed assets register, insurance coverage, budget preparation and monitoring, performance reporting, and other related areas including appropriate segregation of duties and authorizations, management supervision and independent checks on performance and proper valuation of recorded amounts. However, a well developed chart of accounts based on numeric codification is used for classifying nature of transactions and in the appropriate head of account. Further, Standard Operating Polices (SOPs) for travel has been developed and implemented. The bank accounts are jointly operated by authorized by employees up to a limit of Rs 500,000 whereas; Managing Director and Executive Director can singly operate the bank accounts without any limit.

Currently the Company is using in-house developed accounting software for recording its day to day transactions and to produce various reports for decision making purposes. The software is developed locally by an IT specialist who also provides consultancy services for trouble-shooting and system management. The accounting software is capable of maintaining records on accrual basis.

2. Financial analysis

Financial performance of the Company shows that its growth rate over the period is satisfactory and sustainable. Ratio analysis of the Company's audited financial statements for the two years ended June 30, 2011 and 2010 show that its: (i) Current Ratio: 2011- 8.90; 2010- 3.09; (ii) Quick Acid Ratio: 2011 - 8.77; 2010 3.08; (iii) Total Assets to Net Worth: 2011 – 1.11, 2010 – 1.35; (iv) Debt to Equity: No long term borrowing – under exposed; (v) Dividend paid-out ratio: No dividend paid during last three years; and (vi) Earnings per share: 2011 - Rs 196.75; 2010 - Rs 36.33.

3. Budgeting system and functions

Qavi Engineers (Private) Limited prepares its budgets at two different levels, head office and project level. Head Office budget is prepared annually and is reviewed after the completion of the year to identify variations, if any, Company has not defined a date or month for preparation and review of its Budgets; however the project budget is prepared at the time of bidding classified under each line item linked to the chart of accounts. QEL financial management system does not provide on periodic basis comparison of actual outlays with budgeted amounts for each funding source. However, project budgets for each source of funding are compared with the actual outlays on completion of the respective project to assess performance net income. Monthly technical progress report is generated by the project management to meet contractual requirements and for billing purposes.

4. Accounting and reporting system

Accounts department consist of one Senior Manager Accounts, one Manager Accounts and two Accounts Executives. Senior Manager Accounts is an accounting literate and have relevant experience of more than ten years. He reports to the Executive Director and to the Managing Director, and responsible for the proper functioning of the accounts department and timely submission of annual financial statements, preparation of financial data – daily cash position for the review by the Managing Director including annual comparison of indirect cost (head office expenses) with the budgeted amounts.

Company has developed an in-house accounting software for recording of day to day transactions and the accounting software can generate various reports including trial balance, general ledger, profit and loss statement, balance sheet, project expenses report and voucher reports. The accounting system and software is incompatible to meet the specific accounting and reporting requirements for a construction industry. There is a system for allocating direct costs to a contract through routine posting of books of accounts, but there is no practice to generate interim (at least monthly) report of such costs.

Company has not established an Internal Audit Department. The Company's books of accounts and its annual financial statements are audited by a firm of Chartered Accountants. We noted that the auditors' have given an unqualified opinion on the last three years annual financial statements of the Company. Further, we were informed that the auditors have not submitted their management letters on the books of accounts audited by them as they have not noted any material weaknesses in the system.

The Company has a policy of physical verification of fixed assets and stores and this task is being performed by the Stores Department as and when requested by the senior management. Annual physical counting of the Company's assets is conducted by the Stores Department which is also attended by the external auditors.

5. Cash and Bank

Review of the Company's financial position entails that it has sufficient financial resources for managing its projects, as also evident from the fact that it has not acquired funds from banks for meeting its financial needs. As a matter of practice, separate bank account is maintained for each source of funding/each project. Online banking system is used for the transfer of funds from head office to the project site. Thus, there is a minimum time elapsing between the receipts of funds by QEL and their subsequent disbursement.

Signing authority for cheques is as follows:

Managing Director authorized by BOD with no limits
Executive Director authorized by BOD with no limits
Manager Accounts and General Manager Procurement jointly operate the bank accounts up to limit of Rs. 500,000 per transaction.

C. Procurement system

1. Procurement policies and procedures

Procurements department is headed by GM Procurement, who is supported by two procurement officers. GM Procurement is a commerce graduate and has more than 30 years experience with QEL. There is <u>no</u> procurement manual, but summarized SOP (two pages) provides guidelines for conducting purchases. The procurement, as per practices, is initiated on the basis of a request on a pre-printed format by the user department/person which in turn is reviewed by the respective project manager and after assessing the need, request is sent to GM projects/ head of technical department. The Managing Director formally approve purchase request on the advice of GM projects. The GM procurement invites quotations, on the basis of approved purchase request, from the known suppliers – usually no advertisement for RFP is issued. The procurement officers prepare comparative statement of prices and product quality quoted by the vendors. This statement is approved both by the MD and GM procurement before placing an order.

2. Contract management

Usually the Company has a practice to obtain quotations from vendors for supply at a specific location and time of delivery is agreed upon. Normally, there is no practice to enter into a formal written contract/agreement with the vendors. In some cases, we noted that an advance, as a token money, is given just to 'commit' the vendor for the supply of essential materials to the project as and when required.

3. Inventory management

Store supervisors are responsible for maintaining the records of the inventory. Company is currently not using any software for maintenance of store records rather it is using Excel Sheet and manual registers for this purpose. Documents being used for management or store are Gate Pass, Store Purchase Request, and Store

Issue Request. A gate pass is generated when an item is moved to or from one store/project to the other or from head office and Store Issue Report is generated when the item is issued from store. The Procurement processes is centralized at the Company's head office except for emergency situations when procurement is made by the project store after obtaining necessary approval and instructions on telephone from the head office.

4. Property Management Standards and System

All stores and assets at the projects sites are centrally controlling by the company from Head Office, Company is using asset management software for this purpose. Further manual records are also maintained at project sites. Store supervisor at the project is responsible for maintaining the records of inventory and fixed assets located at the respective project. Following documents are maintained by Store supervisors: Store Issue Request (SIR); Gate Pass (used as Goods Receipt Note); Purchase Request Form; Store Register; Temporary Issue of Inventory Register; and Fixed Assets Register. All movements of Company's property are with the authorization from the Project Manager. Warehouses located at the projects are adequately manned by the security personal and physical counting of project inventory is conducted by warehouse personal and observed by the external auditors.

D. Human resource function

1. Human resource policies and procedures

QEL has a written HR Standard Operating Procedures (SOPs) that deals with Recruitment, Ethical Requirements of Employees, Confidentiality Requirements, Employee Benefits, Performance Evaluation, Pay and Allowances and other general HR policies like working hours, probation, notice period, leave policy, etc. These SOPs requires further review and improvements to align with industry practices.

2. Recruitment

All new hiring are made only after the receipt of request from the concerned department head and after approval of the Managing Director. All hiring / recruitments are made through publishing an advertisement in the newspapers and on the Company website. Recruitment is usually made by a team of three persons including Managing Director, Head of Department and Executive Director. Candidates are selected on merit basis.

3. Trainings

Although we have been given to understand that in-house trainings are arranged for professional development of the staff but we have not been provided with any documentation like training materials or agreement with any training organization. Further the Company has no written policies for training of its employees.

4. Pay and incentives

Payments to employees are made as per terms of the contracts. Further annual increments in the salary are made on the basis of performance, leave encashment is provided for ten days, bonus is given to employees on performance basis; usually Company pays bonus in two to three years subject to viability of the Company.

5. Job descriptions and segregation of duties

Although job descriptions are developed on broader terms these are not fixed and may be amended as per decision of management and the requirements of the Company. No proper segregations are maintained between various functions.

6. Travel Policy

Adequate travel policies and procedures exists both for local and international travel. Travel expenditure of employees is properly authorized, approved and accompanied by appropriate supporting documents. Travel advance is adjusted within reasonable period of time. There are adequate controls over the use of company vehicles including proper maintenance of log-books and control over unauthorized/ personal use of vehicles.

E. Absorptive capacity

QEL Absorptive Capacity[1] is based on the empirical study using the experience gained during the 'Pre-Award Assessment' and learning of various factors which impacts the 'Absorptive Capacity' of an entity involving: knowledge management, organizational structures, human resources, external interactions, supplier integration, client/donor integration and intra-organizational fit. The study also takes into consideration: realized absorption capacity, based on historical costs analysis, and potential absorption capacity without structural changes in the present set up.

Following are the objectives of Absorptive Capacity:

- Review of the staffing of the entity to assess the adequacy to support the proposed award;
- Analysis of: procurement system; personnel; and financial and reporting system;
- Number of projects managed;
- Effective utilization of different level of funding;
- Historical spending pattern;
- Specific improvements required for enhancing QEL capacity to manage more funds; and
- Information Technology

1. Review of the staffing of the entity to assess the adequacy to support the proposed award.

It is essential that the staff of Finance & Accounts section of QEL including procurement and HR personnel should be given extensive training so as to understand the reporting requirements and effectively manage USAID funds.

[1] By definition Absorptive Capacity is: "a set of organizational routines and processes by which firms acquire, assimilate, transforms and exploit knowledge to produce a dynamic organizational capability.

2. Analysis of procurement system; personnel; and financial and reporting system

The procurement system requires review and perhaps engaging more technically qualified persons, in case, QEL receives USAID funding. The present capacity of the procurement section which is currently managed by four persons and head of department has dual charge of Procurement, Stores and fixed asset management, with head of these units requires enhancement in capacity. Currently they are not able to comply with QEL's Inventory Management procedures.

Finance and accounts section of QEL is not competent enough to comply with International Accounting and Reporting Standards for its reporting requirement purposes and has some capacity issues in their current roles.

Furthermore Finance Manager and Manager Procurement are over-occupied in their current roles. Therefore, these key personnel will have to either relinquish a significant portion of their existing responsibilities to be able to work on additional project(s) or the company would have to consider hiring more professional staff to work on proposed USAID funded projects.

3. Number of Projects Managed

QEL has completed more than 100 projects with an approx cost of Rs. 6 billion since 1979 to 2012, whereas four projects are currently in progress. The Company has also working experience with US Government.

4. Effective utilization of different level of funding

QEL does not have any previous experience of funding from Government or any other institution.

5. Historical spending pattern

Types of Expenditures	**2010-2011**	**2009-2010**	**2008-2009**
	Rupees		
Project expenses	378,903,687	760,682,472	668,775,098
Administrative & general expenses	50,357,596	27,091,797	22,158,942
Financial expenses	990,795	428,037	535,797
	430,252,078	788,202,306	691,469,837

Source : Audited accounts of QEL

6. Specific improvements required for enhancing QEL capacity to manage funds

QEL's capacity to manage funds is directly linked with strengthening of its human capital, development of sound financial management and accounting systems.

7. Information Technology

Accounting software system does not fully meet the needs of accounting and other related disclosure requirement as per IAS and IFRS applicable to construction industry.

8. Burn rate analysis

During our review of the Qavi Engineers (Private) Limited we have analyzed the burn rate of the company on the basis of expenses of the Company available from the last three years audited financial statements; average burn rate of the Company is from PKR 37 million to PKR 55 million per month.

9. History of receiving and spending grants

QEL has not received any grant in the past but it has working experience with US Government. QEL has constructed US Consulate in Herat, Afghanistan and has undertaken a project of security up gradation for US Consulate, Peshawar, Pakistan.

F. Quality Assurance

1. Planning, development and monitoring structures, procedures

Qavi Engineers has established a Technical Department to monitor the progress of all of its projects, Technical Department is headed by the Managing Director of the Company and two General Manager Projects assist him. General Manager (North) is looking after the projects in the Capital Territory and the Northern Regions of Pakistan while General Manager (Central) is responsible for the projects in the Punjab. Further each of the project has one project manager, one project coordinator, one project manager admin and a proper team of their assistants is formed to ensure the quality, planning and monitoring. All General Managers and Project Managers are well qualified and experienced. Furthermore, construction work of QEL is also technically supervised by the clients' engineers, normally engineering consulting firm, who oversees progress and quality of work done in compliance with contractual requirements. Nothing came to our knowledge that QEL bills have been stopped by the engineers on account of quality assurance.

2. Projects completion period delays with justification

Qavi Engineers has a good reputation in timely completion of the projects; it has also received Certificates of Appreciation from US Consulate, Heart, Afghanistan and US Consulate, Peshawar, Pakistan. No delays in the projects came to our knowledge.

G. Sustainability

There are many ways to interpret the term sustainability, but whether it means environmental performance, corporate citizenship, long term business prospective or all three, it is a growing priority for businesses of all sizes. Successful sustainability performance translates to successful business performance. Furthermore, BOD and management of any entity is responsible for setting sustainable business plan comprising of: (a) strategic planning; (b) execution and alignment; and (c) performance and reporting.

Further, the finance department plays a critical role in formulating and implementing a sustainability strategy and data gathering processes that enable an organization to show how well it is improving its performance around specific goals. It often defines the metrics and monitors progress. It always creates the vital link between investment in the strategy and the commercial benefit that accrues. As such it is often the guardian of the sustainability strategy, but it can also be the originator of it.

We noted that no formal efforts are in place to confirm strategic planning processes have been evolved by the Company in line with the above broader lines. However, during our review we noted that Qavi Engineers (Private) Limited completed more than 100 projects mainly related to buildings construction, and the upgrading of industrial buildings since its inception at a cost of more than Rs.6 billion. At present, only four projects are currently ongoing costing Rs.1,020.63 million billion located in Rawalpindi, Multan, and Lahore.

The analysis of Company's audited financial statements for the two years ended June 30, 2011 and 2010 indicates that its: (i) current ratios: 2011 8.90;, 2010 3.09; (ii) Quick Acid Test: 2011 8.77, 2010 3.088 ; (iii) Debt to Equity: **No long term borrowing – under exposed**; (iv) Dividend paid-out ratio: **No dividend paid during last three years**; and Earnings per share: 2011 Rs 196.75; 2010 Rs 36.33.

The Economic Survey of Pakistan for 2011/2012, published by the Ministry of Finance, Government of Pakistan, indicates that the Construction Sector has shown a growth of 6.5 percent as compared to negative growth of 7.1 percent in 2010/2011; shows potential for construction companies growth.

H. Compliance with USAID Related Requirements

1. Organization's current, and possibly future, compliance with USG rules and regulations

QEL's current staff has no knowledge of USG rules and regulations and will not be able to comply with the rules unless adequate trained. Management will be required to hire qualified and experienced staff for handling of USAID funded projects.

2. Management and leadership skills to manage USAID Funded Awards

The Company is successful in its operation's in Pakistan due to strong management and leadership skills of the top management that shows their dedication and commitment to its growth. Company has successfully completed more than 100 projects generating revenue of more than Rs. 6 billion since its inception.

3. Organizational Capacity to Manage USAID Advance Funding Mechanism

USAID Funding Mechanism requires certain procedures to be applied by the awardees like accounting and reporting in USD and comparisons of actual and budgeted outlays. QEL staff will require necessary training for USAID reporting.

Management Response

a. Itemized comments

Appex-II Page Ref.	Issue Identified	Management Comments
1	Ineffective risk management	*Disaster Recovery Plan and Whistle Blower Policy will be formulated and shared with employees within 10 Days of USAID Directive.*
2	No conflict of interest policy	*QEL's work culture and ethics do not allow any senior manager to enter into any agreement with a third party where a personal vested interest exists. Although, a formal policy declaration form is not required from senior employees, our strong company culture is a deterrent against such activities. It is our opinion that shared company values are more effective than declaration forms. Additionally, all third party agreements whether subcontractor or vendor, are approved by the directors. QEL's work culture also encourages all employees to "act out" against suspicious activities. This adds to the moral pressure imposed by company culture. We don't agree with the risk rating assigned. All major procurement and contracting deals are made in the presence of and with the active involvement of the directors. Aided by years of historical procurement and contracting data, risk of material embezzlement does not exist.* *However, a Conflict of interest policy will be implemented within 10 Days of USAID Directive.*
3	No Policies and Procedures Manual	*Policies and Procedures Manual will be prepared within 45 Days of USAID directive. Further, we shall require support of ASP-RSPN in development of our policies and procedures.*
4	Company has not obtained insured policies for its offices, cash in hand and fidelity insurance.	*As we are currently working in a rented facility, insurance of just the furniture and computers etc. is not cost effective. However, all our project machinery, vehicles and assets are insured which forms the bulk of our assets. Recently purchased vehicles at HO are also insured. Nonetheless, QEL is willing to implement this suggestion. Additionally, it is pertinent to mention that QEL offices are secured by CCTV camera and a security system comprising of motion sensors, magnetic contactors and alarms.* *Head Office insurance will be made available within 05 Days after USAID directive.*
5	Project performance is not updated in the project management software	*We have made a policy of updating the software on regular basis.*
6	insufficient firefighting equipment	*Additional Firefighting Equipment will be installed at sites.*
7	Lack of Independent Internal Audit Function	*Being a private organization, QEL cannot afford inefficient or lax cost controls. For this reason, all activities including expenses and payments are approved and monitored at the director level for compliance and cost control. As an example, cash books, bank books, store requisition and sub-contractor agreement etc. are all approved by either from MD or ED.* *However, Internal Audit Function will be created in accordance with USAID RFP.*

8	Preparation and Review of Budgets	*We disagree with the cause as mentioned. Material and Labor Expense Reconciliation with Budgeted Amounts is made at each or every alternate IPC. These two expense heads make over 80% of the total project expense. Also, Profit and Loss Statements for individual projects are generated as and when required. Records of these reports and reviews are available for multiple projects. Additionally, strict utilization of funds policy is adhered to where cash from one project is tracked and monitored.* *Further, the consolidated budgets on quarterly basis will be compiled.*
9	Labor costs, social charges, and overhead charges applied by QEL	*Summary Labor Costs, Social Charges and Overhead Charges has been provided.*
10	Company is using unregistered software	*We agree with your suggestion. However, risk rating assigned needs to be lowered.* <u>QEL will arrange Registered Software upon Award of USAID's Project</u>.
11	Annual financial statements are not prepared in accordance with IAS-11 and are not audited on timely basis.	*While focusing on construction / design management services, we do not claim to be financial accounting experts. However, we have employed "A" rated accounting firms for audit purposes and apart from normal adjustments; none of the accredited firms have raised this issue. Please note that presently we are being audited by M/s Riaz Ahmad & Co. Chartered Accountants, whereas previously QEL was audited by Ilyas Saeed & Co. Chartered Accountants, who in their audited report clearly stated the following:* *a) "In our opinion, proper books of accounts have been kept by the company as required by the Companies Ordinance 1984".* *b) "The balance sheet and income and expenditure statement have been drawn up in conformity with the Companies Ordinance, 1984. And are in agreement with the books of account and are further in accordance with accounting policies consistently applied".* *c) "In our opinion and to the best of our information and according to the explanation given to us, the financial statements conform with approved accounting standards as applicable in Pakistan, and give the information required by the Companies Ordinance, 1984".* *QEL, however, is willing to implement these suggestions after further discussions. Preliminary round for implementation of these suggestions has already been held with or auditors. The preparation of financial statements is progressively improving in terms of duration. It is our target to complete financial closure by October 2012. We have already intimated our auditors of our preparedness.* *<u>QEL will prepare its Financial Statements for the year 2011-12 in accordance with IAS -11 and has informed our Chartered Accountants for the same.</u>*
12	Physical verification of fixed assets and stores	*The annual stock taking (Stores Inventory Count) is not done by the existing store team. We have hired the service of M/S RIAZ AHMED CO.(Chartered Accountants) for this purpose. All machinery items are coded*

		with a dedicated machinery card as well as an Individual Asset Card in the software. The codes are prominently displayed on the machinery and all relevant details including date of purchase, vendor, model, specification, capacity, repair history and movement record are entered into the machinery card. Only our office assets limited to furniture and computers is not coded. Please note that these assets make up less than 1% of our total assets by value. Additionally, these assets are housed in a secured environment. *Management of QEL has made a policy of stock taking in the presence of accounting department staff.*
13	Lack of segregation of duties	*Company has separated the stores and procurement departments and has made a policy that the physical stock taking will be made in the presence of the accounting department staff.*
14	Proper HR files are not maintained	*QEL continues to make its hiring process transparent and merit based. Six advertisements in national Newspapers and four ads in leading web based job portals have been placed since 2008. Copies of these ads are available. Your attention is drawn towards hiring of procurement assistant and senior accounts manager. Their selection was based on objective written tests and computer skill tests. Their interview scores are recorded along with scores of other shortlisted candidates. Complete information is recorded in their respective personal files. Risk rating is not agreed with.*
15	Attendance record does not reflect time in and time out of the labor	*The attendance record of labors is maintained by a Time Keeper. As most of the labor are illiterate and cannot sign, so we maintain Muster Roll sheet along with the labor cards. Over time sheet is signed by the concerned Site Incharge on daily basis which is transferred on Labor card / Muster roll sheet on the next day by the time keeper. This record was presented to the Audit Team during the visit (copies are available). Additionally, surprise visits are made by the Time Keeper and Admin officer for labor tally. A round of the labor camp is particularly made after lunch break to make sure that no one is present without authorization. Labor is fined for up to three days of wages due if they are caught missing from the designated work area.* *Although we are maintaining the attendance registers for our management staff we shall also make efforts for keeping the similar records for labors.*
16	Lack of strategic and sustainable planning system	*It is part of QEL's "Sustainability Efforts" that today QEL has built up over 5 million USD of strategic reserve and has moved outside Pakistan by working in Afghanistan while actively bidding for projects in Libya, Kosovo, Tajikistan, Ethiopia and Sudan. To mitigate risks from financing costs, QEL does not have any short or long term debts for the past 5 years as evidenced by our balance sheets. High risk rating assigned in this regards is not understood.* *We agree to prepare the strategic and sustainability plan for our organization but we need the support of ASP-RSPN in this regard.*

b. **Agreements**

Following time - line action plan has been provided by the management of QEL:

Sr. No.	Mitigating Measure	Timeline
1.	Development of Disaster Recovery Plan and Whistle Blower Policy	Within 10 Days of USAID Directive
2.	Development of conflict of interest policy	within 10 Days of USAID Directive
3.	Preparation of Policies and Procedures Manual	Within 45 Days of USAID directive (Support of ASP-RSPN will be required).
4.	Insurance of operational offices of the company	within 05 Days after USAID directive
5.	Updating of project management software data	Already prepared a policy for regular updating of the data.
6.	Insufficient firefighting equipment	Instructions have been forwarded to the procurement department for increasing of firefighting equipment.
7.	Formation of Internal Audit Department	Will be created in accordance with USAID RFP
8.	Preparation and Review of Budgets in the quarterly meetings	Instructions have already been given to the relevant staff
9.	Obtaining the license for the unregistered software	Upon Award of USAID's Project
10.	Preparation of annual financial statements in accordance with IAS-11	Will be done in the current year audit i.e. for the year ended June 30, 2012
11.	Physical verification of fixed assets and stores	Made a policy and Instructions have been circulated that the next stock taking will be made in the presence of accounting staff.
12.	Lack of segregation of duties	Company has separated the stores and procurement departments and has made a policy that the physical stock taking will be made in the presence of the accounting department staff.
13.	Maintenance of time in and time out of the labors	
14.	Preparation of strategic and sustainable planning system	We need the support of ASP-RSPN in this matter.

Mapping Exercise

i. Organization's capacity to take steps to mitigate risks

QEL capacity to fully address all control weaknesses and other issues including preparation of FMS Manuals and accounting policies is limited and may require consultancy services or donor interventions in mitigating the risks to a low level.

ii. Existing Donor interventions to mitigate risks: Not Applicable

a. Current interventions
b. Planned interventions
c. USAID capacity building measures

Overall Risk Ranking

S. No.	Overall Risk Ranking	Risk Ranking		
		Low	Medium	High
	Overall Objectives			
1.	Organizational and Management Structure			✓
2.	Accounting and financial management system			✓
3.	System of internal controls			✓
4.	Quality assurance capabilities	✓		
5.	Existing policies, procedures and practices			✓
6.	Organization's current, and possibly future, compliance with USG rules and regulations		✓	
7.	Management and leadership skills to manage USAID Funded Award		✓	
8.	Organizational capacity to manage USAID Advance Funding Mechanism		✓	
	Financial Management			
9.	Evaluation of Financial Statements & Financial Position			✓
10.	Financial Management – Operations	✓		
11.	Grants	***NOT APPLICABLE***		
	Management Capacity			
12.	Internal Control Structure			✓
13.	Branch Operations	✓		
14.	Evaluation of Information Systems (IS/IT) Environment & Review of Financial Information Systems	✓		
15.	Cash and Bank	✓		
16.	Payroll Processing			✓
17.	Personnel Policies and Procedures		✓	
18.	Travel Policy	✓		
19.	Procurement		✓	
20.	Property Management Standards and Systems	✓		

Risks Identified During Assessment

A. Governance and management structure

1. Ineffective risk management

Risk: High

Condition

The Company does not have a Disaster Recovery Plan in place. Moreover, the Company does not have any Whistleblower Policy for its employees.

Disaster Recovery Plan is the process, policies and procedures related to preparing for recovery or continuation of technology infrastructure critical to an organization after a natural or human-induced disaster. While Business Continuity involves planning for keeping all aspects of a business functioning in the midst of disruptive events, disaster recovery focuses on the IT or technology systems that support business functions.

Whistle blowing encourages and enables employees to raise serious concerns within the Company rather than overlooking a problem or 'blowing the whistle' outside. Employees are often the first to realize that there is something seriously wrong, however, they may not express their concerns as they feel threaten by their colleagues and superiors.

Criteria

Generally accepted policies related to information system security and effective risk management requires that an entity must have appropriate policies and procedures for dealing with disasters and thus minimizing disruption of business activities.

Cause

Lack of knowledge and human resource constraints.

Effect

In case of crash of software or any other form of disaster all the workings of the company may be stopped entailing in business losses. Further, in the absence of a formal Whistleblower Policy, suspicious activities within the organization remain unreported.

Recommendation

The management should formulate and implement Disaster Recovery Plan and Whistleblower Policy. These policies should be shared with employees for compliance.

Management's Comments

Disaster Recovery Plan and Whistle Blower Policy will be formulated and shared with employees <u>within 10 Days of USAID Directive</u>.

2. No conflict of interest policy

Risk: Medium

Condition

We noted that the Company has not developed conflict of interest policy which requires annual disclosure by all senior and middle management employees that they have no direct or indirect interest or benefit in the contracts/agreements entered into by the Company with any third party.

Criteria

Existence of conflict of interest policy ensures transparency in executing contracts with a third party, and disclosing appropriately related party transactions in accordance with established accounting practices.

Cause

Lack of knowledge about such policies and procedures.

Effect

In the absence of no conflict of interest policy there is a risk that the Company may enter into a transaction that may not be beneficial or may be prejudicial to interests of the Company as the official having an interest in the transaction may impact on the decision making process.

Recommendation

Company should develop a conflict of interest policy containing detailed procedures and to ensure that the person having any direct or indirect interest in any transaction should not be involved in the decision making process for that particular transaction.

Management's Comments

QEL's work culture and ethics do not allow any senior manager to enter into any agreement with a third party where a personal vested interest exists. Although, a formal policy declaration form is not required from senior employees, our strong company culture is a deterrent against such activities. It is our opinion that shared company values are more effective than declaration forms. Additionally, all third party agreements whether subcontractor or vendor, are approved by the directors. QEL's work culture also encourages all employees to "act out" against suspicious activities. This adds to the moral pressure imposed by company *culture. We don't agree with the risk rating assigned. All major procurement and contracting deals are made in the presence of and with the active involvement of the directors. Aided by years of historical procurement and contracting data, risk of material embezzlement does not exist.*

However, a Conflict of interest policy will be implemented within 10 Days of USAID Directive.

3. Policies and Procedures Manual

Risk Level: High

Condition

We noted that although the Company has developed various practices over the period of time but it does not have a comprehensive Policies and Procedures Manual documenting all approved policies in the shape of a manual. We have further noted that the existing SOPs are also not formally approved by the BOD.

Criteria

Standard policies and procedures are important aspects in providing clarity/guidance in day to day activities in effective monitoring and financial reporting processes. Further whole of the budgeting and pricing process depends on the quality of financial reporting process of an organization if these are properly documented reviewed and updated on periodic basis.

Cause

Lack of guidance to develop organization's specific Financial Management, Procurement and HR Manuals.

Effect

In the absence of policies and procedures Manuals, operational and reporting processes cannot be streamlined.

Recommendation

We recommend that the Company must develop comprehensive policies and procedures manuals and implement them accordingly. These manuals should be reviewed and updated at least annually.

Management's Comments

Policies and Procedures Manual will be prepared within 45 Days of USAID directive. Further, we shall require support of ASP-RSPN in development of our policies and procedures.

4. Insurance

Risk: Medium

Condition

The Company has not obtained insurance coverage for its operational office premises, although projects are insured.

Criteria

The Company's uninsured assets are subject to risk.

Cause

Lack of guidance in conducting cost - benefit analysis.

Effect

Assets not insured are subject to risk of theft, fire and any natural disaster. In the absence of fidelity insurance the Company is subject to risk of loss due to acts of employee (s).

Recommendation

We recommend that the Company may obtain necessary insurance coverage for all of its assets including fidelity insurance.

Management Response

As we are currently working in a rented facility, insurance of just the furniture and computers etc. is not cost effective. However, all our project machinery, vehicles and assets are insured which forms the bulk of our assets. Recently purchased vehicles at HO are also insured. Nonetheless, QEL is willing to implement this suggestion. Additionally, it is pertinent to mention that QEL offices are secured by CCTV camera and a security system comprising of motion sensors, magnetic contactors and alarms.

Head Office insurance will be made available within 05 Days after USAID directive.

5. **Project management**

Risk: Medium

The team visited one of the on-going project namely, 'Sustainable Development Walled-City Lahore'. The objective of this visit was to assess: project management and processes' effectiveness including physical progress data gathering and quality assurance; warehousing system –controls over receipts and issues of materials; time-keeping and labor control; payroll preparation and wages distribution; project accounting; fund flow mechanism; and reporting system. The team took two work days at the project site.

The project having a contract value of Rs 703.313 million, its commencement date was April 17, 2012 and expected date of completion is April 16, 2013. The contractor's client is Government of Punjab. The internal control weaknesses noted during our visit with possible recommendations for improvements are depicted below:

Condition

The project management is using project management 'Primavera software' for project management. The software allows the user to track the progress of the project and possible delays on the basis of the planned and actual results. However, we noticed that overall activity wise plan of the project has been fed in the computer, but actual results are not updated in the software for tracking work in progress.

Criteria

Project Management reports, generated on timely basis, are useful for effective planning and monitoring.

Cause

Lack of training in using the software.

Effect

In the absence of proper utilization of its resources the Company cannot track its projects to ensure the minimum possible delays. Further, investment in acquiring the software will be wastage of funds.

Recommendation

We recommend that the management should use project management software for monitoring actual progress with the planned, which enable them to identify possible delays on timely basis.

Management's Comments

We have made a policy of updating the software on regular basis.

6. Firefighting equipment

Risk: Medium

Condition

We observed that the firefighting equipments are not sufficient i.e. only two fire extinguishers were installed at the project site to meet any eventuality/ disaster. We further noted that no instructions were found on the office boards showing possible measures which may be taken during emergency situations.

Criteria

Effective risk management practices require that the management keep the Company and its employees updated for coping the emergency situations.

Cause

Lack of foresightedness on part of the project management.

Effect

There is a risk that the Company might not be able to respond timely to the emergency situations.

Recommendation

Company should enhance its firefighting capacity and should ensure that all of its employees are aware of the necessary activities in the emergency situations. Further, effective disaster management will also reduce insurance premium.

Management's Comments

Additional Firefighting Equipment will be installed at sites.

B. Financial management and accounting system

1. Lack of an Internal Audit Function

Risk: High

Condition

There is no independent internal audit department of the Company.

Criteria

Suitable control environment mandates monitoring of internal control, which is done through periodic internal audits. Internal audit department ensures that control procedures are properly being followed, there is proper segregation of duties, each employee works under its area of jurisdiction etc.

Cause

Lack of human resources and management knowledge about internal controls.

Effect

Control weakness

Recommendation

As a matter of good corporate practices, we recommend that the Company should establish an internal audit department and engage suitably qualified internal auditors to ensure effective monitoring of internal control system including cost controls at the projects.

Management's Comments

Being a private organization, QEL cannot afford inefficient or lax cost controls. For this reason, all activities including expenses and payments are approved and monitored at the director level for compliance and cost control. As an example, cash books, bank books, store requisition and sub-contractor agreement etc. are all approved by either from MD or ED.

However, Internal Audit Function <u>will be created in accordance with USAID RFP</u>.

2. Preparation and Review of Budgets

Risk: High

Condition

We noted that budget comparisons of direct costs (project costs) with actual outlays are not reviewed on timely basis. Head Office budgets are prepared and reviewed at annual basis however project budgets are reviewed at the time of completion of the project.

Criteria
Comparison of actual outlays with budget should be reviewed.

Cause

Human constrains and lack of knowledge about the importance of budgetary controls reviews.

Effect

In the absence of a mechanism of timely review there is a risk that the management will not be able to timely recognize a possible loss and will not be able to revisit its strategy for a particular project.

Recommendation

It is strongly recommended that the management should meet at least once in each quarter for in-depth review of its budgets against the actual outlays to identify any gaps and realigned its budgetary plans accordingly.

Management's Comments

We disagree with the cause as mentioned. Material and Labor Expense Reconciliation with Budgeted Amounts is made at each or every alternate IPC. These two expense heads make over 80% of the total project expense. Also, Profit and Loss Statements for individual projects are generated as and when required. Records of these reports and reviews are available for multiple projects. Additionally, strict utilization of funds policy is adhered to where cash from one project is tracked and monitored.

Further, the consolidated budgets on quarterly basis will be compiled.

3. Review of Labor costs, Social charges, and Overhead charges applied by QEL

Risk Level: High

Condition

Under the IMS IQC, program management services provided directly by QEL shall be paid for on a Time and Materials basis using the Fixed Daily Rates (FDR) proposed in the IQC. We have reviewed: (i) Social charges applied at 30% of the Labor Costs; (ii) Overheads are 75% of the sum of labor costs and Social charges; and (iii) Fee at 10% of the total computed costs. Management has provided us with the basis of social and overhead cost submitted to USAID/Pakistan. The social charges comprise of: annual bonus (20.8%); paid leaves (8.3%); and employees assistance (2%) whereas, overheads cost is computed as a ratio of head office payroll to head office general and administrative expenditure (excluding certain line item costs related: legal and professional charges; vehicles maintenance and running; business development; zakat and donation; and miscellaneous expenses. Application of such percentages to the direct labor cost as reflected in the audited financial statements (Note 16) for the year ended June 30, 2011, exceeds the actual general and admin costs.

Criteria

Under FDR contracting, actual costs incurred by the contractor plus contractors profit margin are billed. Depending upon the terms and conditions of the contract agreement, normally, these costs are also subject to independent audits by the donor's auditors.

Cause

'Fixed Daily Rates' methodology has been defined by USAID.

Effect

Amount billed in excess of actual costs may be recovered by the donor.

Management Comments

Summary Labor Costs, Social Charges and Overhead Charges has been provided.

4. Use of registered software

Risk: High

Condition

While reviewing the IT environment of the Company, we noticed that Company is using various office and engineering software but most of the software are unlicensed.

Criteria

The software vendors require every user to buy their licensed product.

Cause

The availability of software at cheap prices induces management to use licensed software.

Effect

The Company is exposed to penalties by the software companies. Also unlicensed software is prone to errors and viruses which may corrupt important data.

Recommendation

We recommend that the Company should use licensed software.

Management's Comments

We agree with your suggestion. However, risk rating assigned needs to be lowered. QEL will arrange Registered Software upon Award of USAID's Project.

5. Timely, reliable and accurate financial statements

Risk: High

Condition

Timely preparation of financial statement is very much important for decision making process but we have noted that the audits of the Company for the last three years financial statements i.e. for the year ended June 30, 2009, June 30, 2010 and June 30, 2011 were completed in March 12, 2010, March 17, 2011 and December 19, 2011 respectively. Pakistan Company Law requires that the annual general meeting of the members of an organization must be held within four months after the close of accounting year (June 30th).

We have further noted that management of the company is recording the revenue on the basis of progress billing; this is a non-compliance of the requirements of International Financial Reporting Standards. Para 22 of the "IAS-11 Construction Contracts".

Accounting and reporting of revenues from construction activities, as a matter of practice adopted by the Pakistani Construction Companies, differs and often conflicting approach in determining income from those prescribed under IAS 11. The accounting approach adopted is based on withholding of tax from payments by the clients against billing by the contractors. This tax withholding is termed as 'Presumptive Tax Regime' (PTR) and is final tax liability, although contractors are required to file annual income tax return including audited annual financial statements and other related information. This system of measuring income for income tax purposes have led contractors to adopted tax based accounting system.

Both US GAAP and IASs guidelines requires that long-term construction contractors are required to use the percentage-of-completion method for computing long-term contract revenue for accounting purposes, rather than the measuring revenues on the basis of billing. The use of the percentage-of-completion method may result in an income materially different from the tax accounting method under PTR.

The financial accounting and reporting does not take into account all known factors regarding contract performance. Thus, financial reports do not serve: (i) as the basis for management planning and control, and (ii) with information on the current contract and financial status.

Therefore, the reported income as reflected in its annual audited financial statements by QEL is in conflict with accounting income which may have been reflected had the Company adopted Construction Accounting methods in accordance with generally accepted accounting principles.

Criteria

Timely and accurate financial statements are important for decision making process.

Cause

Lack of knowledge of accounting and financial reporting standards and compliance with the Company law.

Effect

Company's annual financial statements do not reflect true and fair views of its revenues and financial position.

Recommendation

We recommend that the management should make efforts to gets its audited financial statements within the statutory time frame. Further, efforts must be made to prepare financial statements in compliance with the generally accepted accounting principles.

Management's Comments

- *While focusing on construction / design management services, we do not claim to be financial accounting experts. However, we have employed "A" rated accounting firms for audit purposes and apart from normal adjustments; none of the accredited firms have raised this issue. Please note that presently we are being audited by M/s Riaz Ahmad & Co. Chartered Accountants, whereas previously QEL was audited by Ilyas Saeed & Co. Chartered Accountants, who in their audited report clearly stated the following:*

  a) "In our opinion, proper books of accounts have been kept by the company as required by the Companies Ordinance 1984".

  b) "The balance sheet and income and expenditure statement have been drawn up in conformity with the Companies Ordinance, 1984. And are in agreement with the books of account and are further in accordance with accounting policies consistently applied".

  c) "In our opinion and to the best of our information and according to the explanation given to us, the financial statements conform with approved accounting standards as applicable in Pakistan, and give the information required by the Companies Ordinance, 1984".

  QEL, however, is willing to implement these suggestions after further discussions. Preliminary round for implementation of these suggestions has already been held with or auditors. The preparation of financial statements is progressively improving in terms of duration. It is our target to complete financial closure by October 2012. We have already intimated our auditors of our preparedness.

- *QEL will prepare its Financial Statements for the year 2011-12 in accordance with IAS -11 and has informed our Chartered Accountants for the same.*

C. Procurement system

1. Physical verification of fixed assets and stores

Risk: Medium

Condition

We noted that the stores and fixed assets of the Company are being physically verified by the stores department. We have further noted that physical verification is limited to the projects only i.e. assets at the offices of the Company are not being verified. We have further noted that the fixed assets being used at the offices of the Company are not tagged and physically verified.

Criteria

Physical verification is one of the basic principles for safeguarding Company's assets.

Cause

Human constraints.

Effect

Segregation of duties not properly defined – serious internal control weakness, as the assets and store items are being verified by the persons of stores department who are also the custodian of such assets. There is a risk that any control weaknesses variance between recorded and actual may not be reported. Further in the absence of a fixed assets register and tagging codes on the fixed assets located at the operational offices including head office be subject to misuse and misappropriation.

Recommendation

It is recommended physical verification of fixed assets and stores be conducted by accounting department. We further recommend that the Company should adequate fixed assets register and fixed assets at operational offices and head office must be tagged and physically verified.

Management's Comments

The annual stock taking (Stores Inventory Count) is not done by the existing store team. We have hired the service of M/S RIAZ AHMED CO.(Chartered Accountants) for this purpose. All machinery items are coded with a dedicated machinery card as well as an Individual Asset Card in the software. The codes are prominently displayed on the machinery and all relevant details including date of purchase, vendor, model, specification, capacity, repair history and movement record are entered into the machinery card. Only our office assets limited to furniture and computers is not coded. Please note that these assets make up less than 1% of our total assets by value. Additionally, these assets are housed in a secured environment.

Management of QEL has made a policy of stock taking in the presence of accounting department staff.

D. Human resource function

1. Lack of segregation of duties

Risk Level: Medium

Condition

Due to limited number of staff at Company's head office, the Procurement and Store departments are being headed by the same person. Furthermore, annual physical verification of stores and fixed assets are being conducted by the stores department without participation of the accounting department persons.

Criteria

A suitable control criterion should be referred for incorporating necessary segregation of duties in operations of the Company.

Cause

The Company has a limited human resource base to perform its day-to-day functions.

Effect

Non maintenance of appropriate segregation of duties may result in improper controls over the assets of the Company.

Recommendation

We recommend that more staff be hires maintain the segregation of duties and internal audit function may be developed.

Management's Comments

Company has separated the stores and procurement departments and has made a policy that the physical stock taking will be made in the presence of the accounting department staff.

2. Proper files of HR are not maintained

Risk: Medium

Condition

We have noted that HR records don't contain vacancy advertisement, interview checklist, selection criteria of the employee, interviewer comments etc in the personal files of the employees.

Cause

Company has not hired a suitably qualified person, having qualification and experience in the field of Human Resource, for heading the HR Department.

Effect

HR files are incomplete and may indicate that the selection criteria were not followed and necessary verification of educational and experience certificates was not performed.

Recommendation

We recommend that all relevant records should be placed in the files for a transparent selection of employees and record keeping.

Management's Comments

QEL continues to make its hiring process transparent and merit based. Six advertisements in national Newspapers and four ads in leading web based job portals have been placed since 2008. Copies of these ads are available. Your attention is drawn towards hiring of procurement assistant and senior accounts manager. Their selection was based on objective written tests and computer skill tests. Their interview scores are recorded along with scores of other shortlisted candidates. Complete information is recorded in their respective personal files. Risk rating is not agreed with.

3. Attendance records

Risk: High

Condition

We noted that daily attendance on 'Labor Card' does not contain time in and time out columns, which mainly shows the attendance, consequently, overtime hours of the labor cannot be verified in a transparent way.

Criteria

Effective human resource management techniques require that appropriate daily records showing daily hours worked by labors/officers are maintained and reviewed by an authorized person(s).

Cause

Human resource constraints.

Effect

There is a risk that the salaries or overtime may be misstated with the collusion of the labor and staff.

Recommendation

We recommend that either a register or attendance software should be used for time keeping of each of the labor. We further recommend that the time should be noted on the labor cards of the employees and the cards and the registers be compared at the time of finalization of payment of labors for better control over the labor cost. Further reason of overtime of the labor should also be obtained in writing from the relevant supervising staff.

Management's Comments

The attendance record of labors is maintained by a Time Keeper. As most of the labor are illiterate and cannot sign, so we maintain Muster Roll sheet along with the labor cards. Over time sheet is signed by the concerned Site Incharge on daily basis which is transferred on Labor card / Muster roll sheet on the next day by the time keeper. This record was presented to the Audit Team during the visit (copies are available). Additionally, surprise visits are made by the Time Keeper and Admin officer for labor tally. A round of the labor camp is particularly made after lunch break to make sure that no one is present without authorization. Labor is fined for up to three days of wages due if they are caught missing from the designated work area.

Although we are maintaining the attendance registers for our management staff we shall also make efforts for keeping the similar records for labors.

E. Absorptive capacity

Nothing to Report

F. Quality Assurance

Nothing to Report

G. Sustainability

1. No strategic and sustainable planning system

Risk Level: High

Condition

There is no formal strategic and sustainable planning system.

Criteria

Good corporate governance requires that formal strategic and sustainable policies must be followed.

Effect

The Company future growth and sustainability is inconsistence.

Recommendation

The Company must formulate and implement 'Sustainability Plan' as indicated above.

Management Response

It is part of QEL's "Sustainability Efforts" that today QEL has built up over 5 million USD of strategic reserve and has moved outside Pakistan by working in Afghanistan while actively bidding for projects in Libya, Kosovo, Tajikistan, Ethiopia and Sudan. To mitigate risks from financing costs, QEL does not have any short or long term debts for the past 5 years as evidenced by our balance sheets. High risk rating assigned in this regards is not understood.

We agree to prepare the strategic and sustainability plan for our organization but we need the support of ASP-RSPN in this regard.

Other Risk Conditions

Sr. Nr.	Functional Area	Observations	Risk Level	Risk Mitigation Measures
1.	Governance and management structure	No conflict of interest policy	Medium	Development of conflict of interest policy.
2.	Governance and management structure	Company has not obtained insured policies for its offices, cash in hand and fidelity insurance.	Medium	Obtaining insurance coverage for offices of the Company, Cash-in-hand and fidelity insurance.
3.	Governance and management structure	Project performance is not updated in the project management software	Medium	Updating the progress in the project management software for tracking the progress of the project and timely identification possible delays.
4.	Governance and management structure	insufficient firefighting equipment	Medium	Enhancement of firefighting capacity and creation of awareness among the employees
5.	Procurement system	Physical verification of fixed assets and stores	Medium	Conducting of physical verification by accounting department and keeping the copy of fixed assets registers at the operational offices.
6.	Human resource function	Lack of segregation of duties	Medium	Company has separated the stores and procurement departments and has made a policy that the physical stock taking will be made in the presence of the accounting department staff.
7.	Human resource function	Proper HR files are not maintained	Medium	Relevant records should be a part of the personal files.

Organogram


Managing Director
Director Technical
Executive Director
Director Administration
GM Projects North
GM Projects Central
GM Procurement & Stores
Senior Manager Accounts
Manager Administration
Manager HR
Project Manager
Project Manager
Assistant Manager Procurement
Assistant Manager Stores
Manager Accounts
Admin Officer
HR Officer
Project Staff
Project Staff
Procurement Officer
Store Officer
Assistant Manager Accounts