PD-AAG-360 (1) 3910432

*3910432	PAKISTAN	*
*	FAUJI-AGRICO FERTILIZER PROJECT	*
*	FY77 TO FY82	*

PROJECT SUMMARY DESCRIPTION

LOAN TO THE GOVERNMENT OF PAKISTAN (GOP) WILL ASSIST FAUJI-AGRICO FERTILIZER LIMITED, A NEW COMPANY CO-OWNED BY FAUJI FOUNDATION IN PAKISTAN AND AGRICO CHEMICAL COMPANY OF TULSA, OK, TO DESIGN AND CONSTRUCT A MODERN FERTILIZER PLANT IN PAKISTAN AND THEREBY INCREASE PAKISTAN'S DOMESTIC PRODUCTION OF FERTILIZER.

NEW FACILITY,TO BE BUILT IN THE PUNJAB PROVINCE, APPROXIMATELY 375 MILES FROM KARACHI, WILL INCLUDE A 1,725 TON PER DAY (TPD) UREA PLANT WITH AN INTERMEDIATE AMMONIA PRODUCTION PLANT OF 1,000 TPD, ALONG WITH ALL NECESSARY ANCILLARY FACILITIES. ON THE BASIS OF 315 DAYS PER YEAR ON-STREAM TIME, THE PLANT WILL HAVE ANNUAL CAPACITIES OF APPROXIMATELY 543,000 TONS OF UREA OF 244,000 NUTRIENT TONS OF NITROGEN, WITH INTERMEDIATE PRODUCTION CAPACITY OF 315,000 TONS OF AMMONIA. THE RAW MATERIAL FOR THE PLANT WILL BE NATURAL GAS TO BE BROUGHT TO THE PLANT SITE VIA A 50 MILE PIPELINE THAT WILL BE CONSTRUCTED AS PART OF THE TOTAL PROJECT. ALSO INCLUDED IN THE TOTAL PROJECT ARE A POWER GENERATING CAPACITY, AN EMERGENCY DIESEL GENERATOR, A COOLING WATER SYSTEM, A WATER TREATMENT SYSTEM, AND A STEAM GENERATION SYSTEM.

RECRUITMENT OF QUALIFIED PROJECT PERSONNEL WILL BE BY THE FAUJI FOUNDATION. AGRICO COMPANY WILL DESIGN AND SUPERVISE A TRAINING PROGRAM FOR KEY PERSONNEL IN SPECIFIC PROJECT REQUIREMENTS AND WILL ALSO NOMINATE, FROM ITS OWN PERSONNEL, INDIVIDUALS TO FILL THE POSITIONS OF DEPUTY MANAGING DIRECTOR, DIRECTOR OF OPERATIONS, AND DEPUTY DIRECTORS OF FINANCE, ADMINISTRATION AND MARKETING.

ADDITIONAL DONORS IN THE PROJECT ARE IBRD AND THE KREDITANSTALT FUER WIEDERAUFBAU OF THE FEDERAL REPUBLIC OF GERMANY.

LOAN FUNDS OF $40 MILLION, WHICH WILL PROVIDE 16.5% OF TOTAL PROJECT ESTIMATED COST OF $246.7 MILLION, WILL BE USED TO FINANCE ONLY FOREIGN EXCHANGE COSTS OF GOODS AND SERVICES.

DESCRIPTORS

AGR CONSTRUCT	AGRO CHEMICALS	NITROGEN	AGR TECH TRNG
UREA	AMMONIA	FERTILIZE INDUS	FERTILIZER

SUB-PROJECT NUMBER: 00 BATCH NUMBER: 97

PD-AAG-360 (2)

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6

39104320 01801

UNITED STATES GOVERNMENT

Memorandum

TO : Mr. Bryant George, Director (Acting)
USAID/Islamabad, Pakistan

DATE: Nov. 25, 1980

FROM : E. H. Gustman
Area Auditor General/NE

SUBJECT: Memorandum Audit Report No. 5-391-81-5
AID Loan No. 391-T-164 to the Government of Pakistan for the Fauji Fertilizer Project

INTRODUCTION AND SCOPE

On April 1, 1977 the Agency for International Development (AID) entered into loan agreement No. 391-T-164 with the Government of Pakistan (GOP) to provide up to $40 million dollars to assist in financing the foreign exchange costs of goods and services for the construction of an Ammonia/Urea Fertilizer Plant. The loan agreement provided that the entire proceeds of the loan would be transferred to the Fauji Fertilizer Company Limited (FFC), a corporation organized and existing under the laws of Pakistan to carry out the construction program and operate the fertilizer plant. The loan was made on soft terms and is repayable over a forty year period in 61 equal semi-annual installments starting about 10 years after the first loan disbursement is made. Interest will be charged at the rate of two percent per annum during the first ten years and at the rate of three percent per annum thereafter.

Initial cost estimates for the project indicated a total cost of approximately $272 million dollars but, due to a 10 month construction delay and contractual difficulties, estimated costs have since increased to about $333 million and construction is now expected to be completed about December 31, 1981. The revised total cost will include a requirement for about $192 million in foreign exchange and $141 million in local currency. Due to the cost escalation a financing shortfall of approximately $26.4 million presently exists.

Equity financing for the project will total about $82 million and has been or will be provided by various Pakistani organizations and one foreign corporation. Other financing, in addition to this AID loan, has been or will be provided by a group of international lenders including the International Development Association (IDA), an agency of the Federal Republic of Germany, an Italian Government credit, the Government of the Kingdom of Denmark and a consortium of commercial banks in Pakistan.

The major objectives of the project are to establish a modern, efficient, reliable Ammonia and Urea Fertilizer Plant including a 33 mile pipeline, a bagging plant, roads, utility systems and a housing colony. The construction site is located about 375 miles northeast of Karachi and was selected due to its close proximity to the natural gas energy supply needed for the basic production process. When completed the plant is planned to have a production capacity of 1,000 metric tons of Ammonia per stream day or an annual capacity of 330,000 metric tons. This is expected to be converted into 1,725 metric tons of prilled urea per stream day or 569,250 metric tons a year. AID financing for the project will be used for procurement of equipment and materials valued at about $38 million and for approximately $2 million of advisory services.

The purpose of our audit was to review implementation progress and determine if the loan proceeds were being utilized in compliance with AID policy and procedures and to identify problem areas requiring management attention. Our examination included a review of commodity procurement activities and a general review of project progress in relation to the utilization of AID financed goods and services. The review covered loan and project activities from April 1, 1977 to September 30, 1980, but included a financial cut-off date of July 31, 1980 at which time $39.1 million of AID funds had been committed and a total of $22.5 million had been disbursed.

We examined pertinent records and reports maintained by USAID/Pakistan and the FFC. In addition, we visited the offices of the FFC in Islamabad and Karachi, the Eastern Federal Union Insurance Company Limited of Pakistan, the Karachi Port facilities and performed a field inspection at the project site. Our examination was carried out in accordance with generally accepted auditing standards and included such tests of the books and records considered necessary under the circumstances. This report was reviewed by USAID/Pakistan officials prior to finalization.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

A. STATUS OF PROJECT IMPLEMENTATION

Implementation progress of the Fauji Fertilizer Project is considered satisfactory by project personnel. As of August 25, 1980, construction of the Plant was approximately one and one-half months behind planned schedule but all facilities are still expected to be completed by the revised December 31, 1981 target date. The estimated status of construction based on statistics maintained by the prime contractor and monitored by FFC's advisory consultants showed the following work completion (a) Overall construction - 32 percent; (b) Civil Work - 48 percent; (c) Mechanical Works - 9.5 percent; and (d) Engineering - 92 percent.

Our test checks of project activities and documentation did not disclose any major problems but we did note a four month delay in the delivery of $4.3 million of AID financed compressors and some delay in procurement of certain spare parts. In our discussions of these items with FFC we found that they had taken action to expedite procurement and had requested AID/W assistance to monitor the manufacture and delivery of the compressors. Nevertheless, any further delays in the delivery of these items could adversely affect project completion therefore we suggest the USAID maintain a close follow-up.

Due to construction delays, project costs have escalated and it is anticipated that the project will require approximately $26.4 million additional loan financing. The shortfall now consists of $19.6 million in local currency and $6.8 in foreign exchange. In their efforts to obtain additional financing, FFC has held discussions with the Kuwait Development Bank for a $6 million loan which should be decided upon in November 1980. FFC also reported that an additional $6.8 million loan in foreign currency may be available from the Federal Republic of Germany. With GOP guarantees, they anticipate financing the additional local currency requirements from commercial resources in Pakistan.

FFC also plans to obtain about $4 million from the sale of project financed equipment and materials which are no longer needed. At the time of our review, information, was not available to determine what AID financed commodities were included in the proposed sale but the USAID has informed us that FFC is planning to request their approval prior to the sale. Accordingly, we suggest the sale activity be closely monitored to ensure that the sales proceeds of any AID financed commodities are handled in accordance with requirements of the loan agreement.

B. MONITORING OF PROJECT ACTIVITIES

There is a definite need for more active USAID monitoring of project activities to ensure compliance with loan agreement requirements. For example, we found that the USAID was not informed by FFC of the receipt or utilization of loan financed commodities valued at $20.8 million. USAID had not maintained an organized follow-up and thus, was not aware of commodity utilization, damages or losses, the adequacy of FFC's insurance coverage, or whether loan agreement terms relating to shipping via U.S. Flag vessels had been adhered to.

In our review of FFC records, we found that adequate procurement and shipping information is readily available in Pakistan. For example, at our request FFC provided us with current status reports on the arrival at project site of commodities and of shipments enroute to Pakistan. We were also informed by FFC representatives that these reports could be made available to the Mission on a periodic basis upon request. During our field trips to the project site we reviewed the accuracy of FFC's reports through a comparison with computorized inventory records and on a test check basis, examined selected equipment and material located at the construction site.

In general, we found that the information made available was adequate for monitoring purposes but we also noted problems relating to insurance coverage, claims processing and shipping procedures that require resolution. Furthermore, with an approximate $12.2 million of commodities still to be delivered to the Fauji Fertilizer Project, it is important that the USAID move quickly to resolve these issues and thus prevent more serious future problems.

On October 30, 1980, the USAID informed us that FFC was requested to issue a monthly project analysis report consisting of detailed inventories, fixed costs and construction status. In coordination with AID/W, the prime contractor's representative in New York will also be requested to supply a monthly computor printout of inventory and shipping status which can be crossreferenced with inventory controls maintained at the project site. The USAID has also agreed to increase project monitoring of AID financed commodity inventories, including utilization, and will require FFC to submit a periodic report regarding receipt, storage and utilization of AID financed materials and equipment.

Unfiled Insurance Claims

FFC has not finalized insurance claims for diversions, damages, losses and shortages that occurred during transportation of AID financed equipment and materials to the construction site. Their records disclosed that the insurance company was notified by telex and letters of 39 cases of damages, shortlandings and missing shipments valued at approximately $432, 195 plus freight costs but, of that amount, FFC finalized only five claims totalling $8, 541 or 2 percent of the total value of the estimated losses.

At the moment, it is critically important that this performance be improved because we were informed by the insurance company that claims resulting from shipments to the construction site must be finalized and submitted within one year from the date of unloading from the ocean or air carriers. As of late September 1980, the insurance company had not received 34 of the finalized claims supported by the following documents: survey reports, certificate of insurance, shipping invoice from suppliers, bills of lading and claim bills.

In addition, we also noted that FFC's insurance coverage relating to on-site losses was not adequate. Their present coverage requires a joint survey report of on-site losses but subjects each such loss to a $25,000 deduction whereas AID regulations require, including all risk insurance, coverage for the full value of all goods financed.

During October 1980, the USAID and FFC reached agreement that more management attention towards insurance claim processing is warranted. FFC has agreed to file regular claims with supporting documents within one-year of the off-loading of the materials and equipment. The USAID has also informed FFC in writing that an additional letter will be forwarded in the near future and will specify the detailed actions required of FFC to bring their insurance coverage in line with the requirements of the loan agreement and AID regulations.

Recommendation No. 1

The Director, USAID/Pakistan should require that FFC develop adequate insurance claim processing procedures and ensure that claims are filed for all existing losses and that insurance coverage levels meet the requirements of the loan agreement and AID regulations.

Compliance Reporting on use of U.S. Flag Carriers

FFC has not complied with Loan Agreement requirements relating to utilization of U.S. Flag carriers and reporting to AID on shipments of loan financed commodities. As of July 31, 1980, AID/W determined that FFC was not complying with 50/50 shipping requirements and that only about 87 tons of the approximate 633 tons shipped to Pakistan were carried on U.S. Flag vessels. Section 7.04(a) of the Loan Agreement (and Project Implementation Letter No. 5) specifically requires that at least 50 percent of the gross tonage of all commodities be shipped on privately owned U.S. commercial vessels.

Accordingly, the Mission was requested to submit a cumulative shipping statement through June 30, 1980, to enable an evaluation of compliance with cargo preference requirements contained in the loan agreement. Thus far, the USAID has taken no action except to refer the matter back to ASIA/PD, AID/W. In discussing this matter with FFC representatives, we were also informed that they were unaware of how to apply Section 7.04(a) and did not know of the reporting requirement or the reporting format required by AID. As a result, unless AID/W authorizes source waivers, practically all of the remaining $12.2 million of loan procured commodities must be shipped on U.S. Flag vessels.

Recommendation No. 2

The Director, USAID/Pakistan should require FFC to comply with loan agreement terms relating to shipping requirements and reporting or obtain appropriate waivers of those requirements.

LIST OF REPORT RECIPIENTS

USAID/Pakistan	
Director	5
AID/W	
Deputy Administrator (DA/AID)	1
Bureau For Asia	
Assistant Administrator (AA/ASIA)	5
Office of Pakistan, Nepal and Sri Lanka Affairs (ASIA/PNS)	1
Audit Liaison Officer	1
Bureau For Development Support	
Assistant Administrator (AA/DS)	1
Office of Development Information and Utilization (DS/DIU)	4
Bureau For Program and Policy Coordination	
Office of Evaluation (PPC/E)	1
Office of Legislative Affairs (AA/LEG)	1
Office of General Counsel (GC)	1
Office of Financial Management (FM)	1
IDCA Legislative and Public Affairs Office	1
Office of Auditor General	
Auditor General (AG)	1
Communications and Records Office (AG/EMS/C&R)	12
Policy, Plans and Programs (AG/PPP)	1
Inspection and Investigation Staff (AG/IIS)	1
Area Auditor General	
Area Auditor General/Washington	1
Area Auditor General/Africa (East)	1
Area Auditor General/East Asia	1
Area Auditor General/Egypt	1
Area Auditor General/Latin America	1
OTHER	
General Accounting Office (GAO/W)	1
New Delhi Residency	1