



MEMORANDUM

DATE: October 3, 2014

TO: John F. Sopko
Special Inspector General for
Afghanistan Reconstruction (SIGAR)

FROM: Larry Sampler, AA/OAPA

SUBJECT: Response to SIGAR Special Project SP-88

REF: SIGAR Special Project SP-88 - Direct Assistance: Review of Processes and Controls Used By CSTC-A, STATE and USAID dated September 12, 2014

Direct assistance to the Government of Afghanistan is a key component of our civilian assistance strategy to ensure long-term sustainability and increased capacity within the government. USAID uses rigorous oversight mechanisms to reduce risks to taxpayer funds in Afghanistan which have become a model for the agency to use in other countries. SIGAR's second review of this issue did not identify or report any waste, fraud or abuse of taxpayer resources and recognized that USAID is using 17 of 18 best practices identified in the report.

While the report is largely positive in its review of the measures in place to protect taxpayer funds, there are still some significant misrepresentations we would like to highlight.

USAID's Risk Mitigation System

In implementing direct assistance projects, USAID has put strenuous effort into ensuring appropriate and multi-tiered controls are in place before direct assistance projects go forward. We believe this report's discussion of USAID's use of conditions precedent as a risk mitigation measure does not fully reflect USAID's approach. As discussed in USAID's January 23, 2014 written response to SIGAR audit 14-32, which included SIGAR's initial

review of aspects of USAID's government-to-government risk mitigation procedures:

"In the report, SIGAR makes reference to 104 major risks. USAID believes it is important to make the distinction between the (i) actual vulnerability that was identified during the risk assessment and (ii) the potential of an adverse event occurring if the vulnerability is not addressed. For example, if the potential risk cited in a risk assessment relates to the "misappropriation of cash arising from the payment of salaries in cash," as part of the risk mitigation plan for this ministry USAID will identify actions that the ministry must take to prevent this potential event from occurring. Mitigation measures could include paying all salaries through the official banking system, conducting annual payroll audits, and reconciling and monitoring payroll each month. The Mission's Office of Financial Management, Government to Government (G2G) team performs ongoing monitoring and follow-up reviews to ensure implementation of the risk mitigation plan while simultaneously building the capacity of the ministries.

USAID addresses risks in a variety of ways. The audit report focuses on conditions precedent as if they are the only available risk mitigation measure, incorrectly assuming that vulnerabilities can only be addressed in advance by using a single corresponding condition precedent at the program level for each condition or weakness. In practice, using conditions precedent is only one of a variety of ways that the Mission mitigates risk. Therefore, the charts included in Figure 3 of the audit report provide an inaccurate representation of the potential risks involved in the actual implementation of the programs because they focus on conditions precedent as the sole means of risk mitigation. It is imperative that the entire suite of interventions, consisting of multiple levels of mitigation techniques, is considered in evaluating overall risk to U.S. funds." (Pages 8-9, USAID's January 23, 2014 Response to SIGAR Audit 14-32)

In short, we disagree again with the assertion in this draft report (p.4) that "conditions precedent" – actions USAID requires ministries to take prior the initial disbursement of funds – were USAID Mission in Afghanistan's (USAID/Afghanistan) primary method for addressing the risks it identified in its ministerial capacity assessments and internal risk reviews." As explained in USAID's January response quoted above, and as we have explained in other fora, including testimony, USAID addresses risk in direct government-to-government assistance in Afghanistan in a variety of ways. An evaluation of

the effectiveness of risk controls should reflect the entire suite of interventions utilized by USAID in Afghanistan, consisting of multiple levels of mitigation techniques and associated controls, described in other parts of this report, in evaluating overall risk to U.S. funds.

One of the primary purposes of the USAID-funded risk assessments was to identify existing public financial management risks in order to determine if we could work with a particular ministry and if so, to fashion an appropriate risk mitigation strategy. Multiple mitigation measures were identified for each risk and implementation of all mitigation measures is not always necessary to adequately address a particular risk. In addition not all weaknesses/risks identified in the assessments were relevant to specific projects being implemented as direct assistance with GIROA. There was no intent to use all of the mitigation measures identified.

USAID has continued to monitor improvements in GIROA systems. An updated risk identification chart covering the projects implemented by the four ministries identified in SIGAR's report to which USAID provides direct government-to-government assistance has been submitted to SIGAR. Safeguards differ for the fifth ministry identified in SIGAR's report, the Ministry of Public Health's Partnership Contracts for Health, as is discussed in detail in this response. USAID/Afghanistan will continue its work with the ministries to fulfill the capacity-building aspect of government-to-government assistance.

In addition to the safeguards put in place as described in the report, as an additional mitigating measure, USAID also provides extensive third-party technical assistance to ministries receiving direct assistance to address both short-term and long-term vulnerabilities, if deemed necessary. USAID tailors the work with each ministry to suit the specific development needs and to provide the appropriate risk mitigation measures for each project.

There is no way to completely eliminate risk, but we have gone to great lengths to design, implement, and refine over time a risk mitigation system that we believe provides robust protection for U.S. taxpayer funds.

Ministry of Public Health (MoPH)/Partnership Contracts for Health (PCH)

USAID disagrees with the report's assertion that, for the PCH program with the MoPH, there is increased vulnerability of USAID's funds to waste, fraud, and abuse because PCH does not use disbursement conditions (conditions precedent) or a reimbursement method of disbursement (but is rather a host

country contract mechanism). The PCH program is funded on a reimbursable basis, but through advances and liquidations in contrast to reimbursement after costs have been paid by GIRoA. USAID's invoice review process requires that MoPH submits to USAID invoices that include actual costs, which USAID then reviews and approves prior to making a liquidation. USAID also exercises other controls to mitigate risk, including reviewing and approving solicitations and contracts for substantial procurements between the Afghan government and its third party contractors.

As a key measure to address our fiduciary and stewardship responsibility and mitigate risks, USAID has implemented the PCH program utilizing the MoPH Grants and Contract Management Unit (GCMU). The GCMU is responsible for ensuring proper procedures are followed for procurement, contract and financial management, monitoring and evaluation. These activities mitigate the risk of the Ministry "concealing vital monitoring and evaluation information," as raised in the report. The GCMU staff funded by USAID provides these services specific to the PCH program activities and funds.

Other Comments

Third-Party Audits

We recognize that improvement was needed with respect to the need for more timely audits and USAID has taken measures seeking to ensure more timely completion of financial audits. Due to delays in required annual audits that were intended to be contracted by ministries, USAID modified its audit requirements and is now contracting and actively managing the required audits of the ministries. The audit requirements now are formally assessed, tracked, and included in the Mission's annual audit plan. USAID has provided training to contracted audit firms to improve the quality and timeliness of their reports. In addition, USAID is coordinating more closely with the USAID's Office of Inspector General (OIG) to facilitate the quality control reviews and timeliness of the issued reports. USAID is also relying on concurrent audits of some programs to receive timely financial and programmatic feedback from auditors during program implementation. For example, both the Agriculture Development Fund and the Basic Education and Literacy and Vocational Education Training (BELVET) programs have utilized concurrent audits that provided interim management reports.

Internal Audits of Funds

USAID, as an Agency distinct from the USAID OIG, does not perform internal audits. Nevertheless, other compensating measures are in place such as the access, stipulated in government-to-government agreements, to disbursement bank accounts and monthly reconciliations of expenditures. As mentioned, USAID also conducts reviews of invoices. Further, in programs based on cost reimbursement, USAID regularly monitors transactions and addresses emergent issues, such as reducing ineligible expenditures identified through these reviews. As one example, during the implementation of the BELVET program, USAID identified that improper taxes were withheld from contractor payments and took action to recover these unallowable costs.

Annex 1

Additional Comments

Page 6, Appendix I: Scope and Methodology

- In the second paragraph, the third USAID program is the Civilian Technical Assistance Program, not the Civil Service Technical Assistance Program.
- The Monitoring and Evaluation (M&E) plan bullet should read that it oversees the disbursement *and implementation* of direct assistance.

Page 7, Third-party audit of funds bullet

This bullet states that agencies complete audits within 4-6 month of the end of the fiscal year. However, USAID financial audit requirements stipulate completion within 9 months after the end of the fiscal year. The 4-6 months appears to be referring to World Bank and ADB audit standards, not the agencies that are subjects of this report.

Page 7, Reconciliation and reduction of ineligible expenditures bullet

USAID rules require that a bill for collection first be issued in the case of disallowed costs, and to settle the bill, if the debtor does not make payment, an offset against other payments owed to the debtor may be made.

Page 22, Ministerial capacity assessment bullet

USAID completed the Independent Administrative Reform and Civil Service Commission (IARCSC) assessment in January 2011.