



*Office of Inspector General*

March 7, 2011

**MEMORANDUM**

**TO:** USAID/Afghanistan Director, Earl W. Gast

**FROM:** OIG/Afghanistan Director, Tim Cox /s/

**SUBJECT:** Review of Cash Disbursement Practices of Selected USAID/Afghanistan Implementing Partners (Report No. F-306-11-002-S)

This memorandum transmits our final report on the subject review. Although not an audit report, this report contains one recommendation to help USAID/Afghanistan's implementing partners reduce their cash exposure risk and strengthen their cash disbursement practices. In finalizing the report, we considered management comments on the draft report and included them (without attachments) in Appendix II.

On the basis of the information provided by the mission in its response to the draft report, we determined that final action has been taken on the recommendation.

I want to thank you and your staff for the cooperation and assistance extended to us during this review.

# SUMMARY

In late 2001, following decades of conflict, the financial and banking systems of Afghanistan were devastated. Afghanistan had six licensed, state-owned commercial banks that were almost entirely based in Kabul and, to a large extent, inactive. Besides lacking connectivity and reliable information on assets and liabilities, the banks did not follow generally accepted accounting standards. Vital functions of the central bank were not defined or carried out, and Afghanistan lacked a credible, formal payment system. The lack of confidence in the banking system and uncertainties and difficulties faced by the population and the business sector led them to rely almost exclusively on the *hawala* money transfer system, an informal network of cash brokers who operate based on trust and reputation.<sup>1</sup>

When USAID reopened its Afghanistan mission in early 2002, the absence of a functional banking sector in Afghanistan caused serious challenges for USAID's implementing partners (contractors and grantees), which received billions of dollars over the course of several years to implement reconstruction and development projects. At that time, cash and *hawala* were often the only options available to move funds into and around the country, especially for cash-for-work activities in remote areas where banks did not exist.<sup>2</sup> Many Afghan vendors and suppliers did not have bank accounts and accepted only cash payments. As a consequence, USAID's implementing partners faced increased risk of fraud, loss, and personal harm when handling and transporting large sums of cash. Cash transactions are more vulnerable to misuse and diversion because they are not easily traceable.

In recent years, Afghanistan has seen some improvements and growth in the banking sector, despite the setback caused by the Kabul Bank crisis in September 2010.<sup>3</sup> At the time of this review, 17 licensed banks operated in the country. Wider availability of banking services reduces the need for cash transactions.

The Office of Inspector General/Afghanistan conducted this review to determine whether the cash disbursement practices of ten selected USAID/Afghanistan implementing partners ensure that disbursements are reasonable, allocable, and allowable under the agreements.

The review found that the cash disbursement practices of the ten selected USAID/Afghanistan implementing partners reasonably ensured that their cash expenditures were reasonable, allocable, and allowable. The Office of Inspector General/Afghanistan recommended that the mission disseminate the best practices described in this report to its implementing partners to minimize cash transactions. The mission agreed with the recommendation and issued a letter making all implementing partners aware of the best practices described in this report. The mission stated that by implementing these best practices, partners would be adequately safeguarding USAID-funded resources. In addition, technical representatives of the mission's agreement officers and contracting officers will continue to work with their respective

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<sup>1</sup> Jelena Pavlović and Joshua Charap, *Development of the Commercial Banking System in Afghanistan: Risks and Rewards*, International Monetary Fund, Washington, D.C., 2009.

<sup>2</sup> Samuel Munzele Maimbo, *The Money Exchange Dealers of Kabul: A Study of the Hawala System in Afghanistan*, World Bank, Washington, D.C., 2003.

<sup>3</sup> Kabul Bank almost collapsed after press reports and rumors of fraud caused a run on the bank.

implementing partners to ensure that they are strengthening their cash disbursement procedures.

Appendix I contains a discussion of the review's scope and methodology, as well as details on the selected partners. Our evaluation of management comments is on page 7, and full text of the management comments appears in Appendix II.

# REVIEW RESULTS

The cash disbursement practices of the selected USAID/Afghanistan implementing partners covered by this review reasonably ensured that cash expenditures were reasonable, allocable, and allowable. Of course, no controls can completely eliminate the risk of fraud, loss, and personal harm to staff associated with handling and transporting cash in a war zone.

## Costs Paid in Cash and Alternatives to Cash

According to information provided to us by the selected implementing partners, they made \$13.5 million in cash payments in 2010, representing 7 percent of the \$181.1 million in total costs they incurred in Afghanistan. For individual implementing partners, cash payments as a percentage of total costs incurred in Afghanistan ranged from 2 percent to 69 percent. Partners' total combined cash on hand was \$270,000 at the time of the review. The types of costs paid in cash included office supplies, local travel, prepaid phone cards, utilities, and maintenance. The implementing partners that had a higher percentage of costs paid in cash also used cash for programmatic activities such as small grants, cash-for-work programs, and microfinance loans, mostly in remote areas of Afghanistan where banking services were nonexistent.

Five of the ten selected implementing partners took steps to significantly reduce their cash exposure risk by proactively seeking ways to make payments through electronic funds transfer (EFT), check, or *hawala* transfers. The selected implementing partners also implemented a number of best practices for managing cash disbursements that other USAID/Afghanistan implementing partners should consider adopting. Appendix III presents the results of the review for each contractor and grantee.

## Best Practices for Managing Cash Disbursements

Title 22 of the Code of Federal Regulations, Section 226.21(b)(6), requires that USAID's contractors and grantees have effective internal controls to ensure that disbursements are reasonable, allocable, and allowable under the agreements. Implementing partners are also required to maintain financial records, supporting documents, statistical records, and all other records pertinent to the award to sufficiently substantiate charges to their awards.

During the review, the Office of Inspector General observed a number of best practices and internal control measures. These best practices, which could help other USAID/Afghanistan contractors and grantees strengthen their cash management practices and reduce risk exposure, are described below.

**Establishing and Maintaining a Cash Fund.** All of the selected implementing partners had set up formal cash funds denominated in U.S. dollars or Afghanis, the local currency in Afghanistan. We observed two types of cash funds: revolving and nonrevolving. Under a revolving fund, a fixed cash balance was established, and as the funds were spent, the cash was replenished up to the level of the fixed cash balance. Under the nonrevolving type fund, the cash balance was based on periodic expense forecasts, usually done monthly. When the

funds were spent, the cash replenishment was based on the next period's expense forecast. When they withdrew cash from the bank to replenish the funds, most of the selected implementing partners in Kabul maintained a low profile for their security. One grantee used *hawala* in Kabul to transport money from the bank to its office, thereby eliminating any risk associated with its staff traveling back from the bank with large sums of cash.

**Designating a Cashier and an Alternate.** All of the selected implementing partners formally designated a qualified cashier and an alternate to manage and disburse cash. These individuals were entrusted with the safekeeping of all cash. The following are basic functions of a cashier:

- Making payments and obtaining receipts for goods and services, such as small purchases, travel advances, etc.
- Paying local employees
- Performing cash advance functions for employees and temporary-duty visitors
- Processing payroll cash advances for expatriates
- Making other cash payments as necessary for operations under the contract/agreement

Some implementing partners provided formal training to their cashiers on cash management practices by sending them abroad, but most provided on-the-job training in Kabul. All partners regularly provided sessions on rules of ethical behavior.

**Supporting Documentation for Cash Disbursements.** We performed surprise counts of all selected implementing partners' cash funds and reviewed a judgmental sample of cash payments and supporting documents. We observed that all of the implementing partners required receipts or some form of support for each cash payment regardless of the amount. Such supporting documentation included approved cash requests, original receipts, approved vouchers, sales slips, cash register tickets, and invoices for purchases (or an equivalent receipt itemizing supplies or services purchased). Several of the selected implementing partners had exceptionally well-organized filing systems, using labeled binders that were stored in secured cabinets to file authorizations and liquidations of cash advances, payment vouchers, and supporting documentation. Most of the selected implementing partners electronically scanned their financial documentation and sent the originals to their home offices in the United States. Electronic copies were kept in Kabul for audit and reference purposes.

**Surprise Cash Counts.** All the chiefs of party or finance managers performed surprise cash counts regularly. Surprise cash counts serve as an excellent deterrent against fraud and the possibility of cashiers giving out unauthorized short-term cash loans to employees or friends.

**Supervisory Review of Cash Disbursements.** All of the selected implementing partners implemented internal control procedures that included supervisory review of cash disbursements. Some supervisors were more involved than others in reviewing cash payment vouchers. For two of the selected implementing partners, both the chief of party and the finance manager reviewed and approved each voucher before a cashier could make a cash payment. Supervisory review over cash disbursements is a standard internal control that is intended to

provide the last line of defense to ensure that such disbursements are reasonable, allocable, and allowable under the agreements.

**Performing Cost Analysis of Goods and Services.** By most accounts, corruption and fraud are widespread in Afghanistan. As a countermeasure, as part of their procurement and payment process for local goods and services, all of the selected implementing partners implemented procedures to determine fair market prices to detect inflated costs and fraudulent activity. Some of the implementing partners sent out their staff as “secret shoppers” to verify prices before making a procurement or payment. Partners also trained their financial staff to be vigilant when reviewing receipts and invoices, to look for irregularities and indicators of possible fraud such as inflated prices, forged receipts, and duplicate invoices. Several partners had terminated local vendors or subcontractors for inflating the cost of their goods and services.

**Written Policies and Procedures for Cash Operations.** All of the selected implementing partners had either written policies or procedures for their cash operations in Afghanistan, or followed corporate policies and procedures. Written policies and procedures help ensure that management directives are carried out and employees understand their roles and responsibilities.

**Proactively Searching for Ways to Reduce Cash Exposure.** Five of the ten selected implementing partners reduced their cash exposure by continuously seeking ways to minimize cash transactions. For example, they worked with local vendors and subcontractors who had bank accounts and paid them through EFT or check. Some of the implementing partners refused to issue subcontracts to Afghan companies who did not have bank accounts. Partners also required Afghan employees to have bank accounts so that their salaries could be paid through direct deposit. Finally, partners paid taxes to the Afghanistan Ministry of Finance using EFT. This has proven to be a fast and efficient mechanism for remitting and tracking tax payments sent to the Afghan Government, as well as a way to reduce the risk of fraud with tax remittances.

The importance of proactively reducing the number of cash transactions is illustrated by a 2010 OIG fraud case concerning tax payments. An employee working for a USAID/Afghanistan contractor embezzled about \$129,495 in cash and falsified receipts to make it appear that the cash payments were received by the Ministry of Finance. If the tax payments had been made through EFT, this instance of fraud would have been prevented.

We make the following recommendation to help USAID/Afghanistan’s contractors and grantees reduce their cash exposure risk.

***Recommendation 1.*** *We recommend that USAID/Afghanistan disseminate the best practices described above to its implementing partners to minimize cash transactions.*

# EVALUATION OF MANAGEMENT COMMENTS

USAID/Afghanistan agreed with the report recommendation. On the basis of the information provided by the mission in its response to the draft report, final action has been taken on the recommendation to disseminate the best practices described above to its implementing partners to minimize cash transactions to the extent possible.

On February 17, 2011, USAID/Afghanistan's Office of Acquisition and Assistance issued a letter to all its implementing partners, making them aware of the best practices described in the draft review report. In the letter, USAID strongly recommended that implementing partner organizations review the best practices described in the review report and implement applicable procedures to ensure that USAID-funded cash resources are adequately safeguarded. In addition, technical representatives of the mission's agreement and contracting officers will continue to work with their respective grantees and contractors to ensure that they are strengthening their cash disbursements procedures.

USAID/Afghanistan's written comments on the draft report are included in their entirety (without attachments) as Appendix II to this report.

# SCOPE AND METHODOLOGY

The Office of Inspector General Country Office in Afghanistan conducted this review in accordance with the evidence and documentation standards in *Government Auditing Standards*, Paragraph 7.55 and Paragraphs 7.77 through 7.84. Those standards require that we obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, in accordance with our review objective. We believe that the evidence obtained provides that reasonable basis.

Using an Office of Inspector General risk assessment of USAID/Afghanistan's U.S. contractors and grantees, we selected contractors and grantees for review as shown in the table below. The risk factors for selection included the size of the award, the type of award, the magnitude of subcontracts or subgrants, the type of activities financed by USAID, and location of program sites and activities in unsafe areas.

## Selected U.S. Implementing Partners

U.S. Implementing Partner	Program Description	Award Amount (\$)
Implementing Partner No. 1	Afghan Sustainable Water Supply and Sanitation Project	37,198,505
Implementing Partner No. 2	Afghan Civil Service Support Program	218,578,488
Implementing Partner No. 3	Afghanistan Stabilization Initiative - South	159,582,069
Implementing Partner No. 4	Afghanistan Stabilization Initiative - East	151,301,272
Implementing Partner No. 5	Expanding Access to Private Sector Health Products and Services	34,696,211
Implementing Partner No. 6	Strategic Provincial Roads - South and East	497,535,342
Implementing Partner No. 7	Afghanistan Infrastructure Rehabilitation Program	113,898,694
Implementing Partner No. 8	Rural Finance and Cooperative Development - South and East	60,470,552
Implementing Partner No. 9	Basic Education Program in Afghanistan	100,000,000
Implementing Partner No. 10	Health Services Support Project	59,016,283
<b>Total</b>		<b>1,432,277,416</b>

The ten selected U.S. contractors and grantees represented about 42 percent of USAID/Afghanistan's total active awards (\$3.4 billion) and included six of the mission's program areas: infrastructure, democracy and governance, education, health, economic growth, and stabilization in support of the U.S. Government's counterinsurgency strategy.

The review covered cash disbursements totaling about \$13.5 million and practices of the selected USAID/Afghanistan contractors and grantees in fiscal year 2010. Fieldwork was performed in the Islamic Republic of Afghanistan from November 14 through December 15, 2010, at USAID/Afghanistan and at the offices of the selected contractors and grantees.

In developing areas to examine and tests to perform, we considered standards and practices for cashiering operations from the Treasury Department's *Manual of Procedures and Instructions for Cashiers* and the State Department's *Foreign Affairs Handbook*, Volume 4, Handbook 3—Financial Management Procedures, "Cashier Operations" (4 FAH-3 H-390).

To answer the review objective, we collected evidence to facilitate a reasonable conclusion as to whether cash disbursement practices of the selected contractors and grantees ensure that disbursements are reasonable, allocable, and allowable under the agreements.

For each selected implementing partner, we evaluated internal controls over cash disbursements, performed a walk-through of the cash voucher payment process, reviewed a judgmental sample of cash vouchers and supporting documents, identified areas for improvement, and noted best practices employed. Appendix IV provides our internal control questionnaire.

We used the rating criteria below for assessing internal controls over cash disbursements of the selected implementing partners. Appendix III provides our assessment of each selected implementing partner.

#### **Excellent**

- Strong control environment that sets a positive and supportive attitude toward internal control and conscientious management of information systems, accounting, personnel functions, monitoring, and audits
- Extensive use of automated systems instead of manual processes
- Strong physical controls over cash
- Proper segregation of duties
- Accurate and timely recording of transactions and events
- Access restrictions to and accountability for resources and records
- Appropriate supporting documentation for transactions
- Current written policies and procedures
- Low cash payment limits for each transaction
- Proactive measures implemented to reduce risk exposure by continuously seeking ways to reduce cash transactions and accomplish payments through EFT, check, or *hawala*

#### **Good**

- Satisfactory control environment for information systems, accounting, personnel functions, monitoring, and audits
- Moderate use of automated systems instead of manual processes
- Essential physical controls over cash
- Proper segregation of duties
- Appropriate supporting documentation for transactions
- Written policies and procedures
- Higher cash payment limits for each transaction, but adequately controlled
- Moderate use of EFT, check, or *hawala* instead of cash

#### **Fair**

- Minimum acceptable quality for a control environment for information systems, accounting, personnel functions, monitoring, and audits
- Minimum use of automated systems instead of manual processes

- Minimum acceptable physical controls over cash
- Minimum acceptable segregation of duties (recognizing that small organizations might not be able to segregate duties to the same degree that large organizations can)
- Adequate supporting documentation for transactions
- Policies and procedures that are followed but not written
- Higher cash payment limits for each transaction and fairly controlled
- Low use of EFT, check, or *hawala* instead of cash

**Poor**

- Weak control environment that sets an unsupportive attitude toward internal control and conscientious management of information systems, accounting, personnel functions, monitoring, and audits
- No use of automated systems
- Lack of physical controls over cash
- No segregation of duties
- Inaccurate and untimely recording of transactions and events
- No access restrictions to and accountability for resources and records
- Lack of supporting documentation for transactions
- Policies and procedures not followed or written
- No cash payment limits for each transaction
- No use of EFT, check, or *hawala* instead of cash

The Office of Inspector General auditors conducted surprise cash counts for each selected implementing partner and traced the results to the cash ledger. Auditors counted a total of \$270,000 in cash for all selected implementing partners.

# MANAGEMENT COMMENTS



## MEMORANDUM

**TO:** Timothy Cox, OIG/Afghanistan Director

**FROM:** Robert Hellyer, Acting Mission Director /s/

**DATE:** February 23, 2011

**SUBJECT:** Review of Cash Disbursement Practices of Selected USAID/Afghanistan Implementing Partners (Report No. F-306-11-00X-S)

**REFERENCE:** SRamonas/EGast memo dated January 25, 2011

Thank you for providing the Mission the opportunity to review the draft report on the subject review. We are pleased to know that the cash disbursement practices of selected USAID/Afghanistan implementing partners covered by this review provide reasonable assurance that cash expenditures were reasonable, allocable, and allowable in accordance with the terms of their respective agreements.

Below is a summary of actions taken to address the following recommendation in the review report:

*We recommend that USAID/Afghanistan disseminate the best practices described above to its implementing partners to minimize cash transactions to the extent possible.*

The Mission concurs with this recommendation.

### **Actions taken:**

On February 17, 2011, USAID/Afghanistan's Office of Acquisition and Assistance issued a letter to all its implementing partners to make them aware of the best practices described in the subject draft review report. In its letter to partners, USAID strongly recommended that partner organizations review the best practices observed by the Office of Inspector General and implement applicable procedures to ensure that USAID-funded cash resources are adequately safeguarded. The signed letter and the sample acknowledgment letters are shown in Attachment A. The Mission's Agreement Officer/Contracting Officer's Technical Representatives will

continue to work with their respective grantees/contractors to ensure that implementing partners are strengthening their cash disbursements procedures.

Based on the above, the Mission deems that a management decision has been reached and final action has been taken to address the recommendation. Therefore, the Mission requests its resolution and closure.

**Attachment A:** USAID Letter to Implementing Partners dated 02/17/11 and sample acknowledgement letters.

**Summary of Review Findings for Cash Disbursements During Fiscal Year 2010**

Selected USAID/Afghanistan Contractor/Grantee	Total Costs Incurred in Afghanistan (As Reported by Partner) (\$)	Costs Paid in Cash (As Reported by Partner) (\$)	Costs Paid in Cash as a Percent of Total Costs (%)	Cash Balance During OIG Cash Count (\$)	Cash Payment Limit per Transaction (\$)	OIG Cash Controls Assessment	Implemented Policy to Reduce Cash Payments
Implementing Partner No. 1	3,306,861	183,005	6	18,826	500 petty cash	Excellent	Yes
Implementing Partner No. 2	11,775,926	1,153,068	10	24,100	500 petty cash	Excellent	Yes
Implementing Partner No. 3	29,348,513	1,354,297	5	5,455	500 petty cash 2,500 for payments to expatriate staff	Good	Yes
Implementing Partner No. 4	8,324,372	998,925	12	4,646	500 petty cash 10,000 for grants	Good	No
Implementing Partner No. 5	5,922,000	1,362,060	23	36,861	1,000 petty cash	Fair	No
Implementing Partner No. 6	77,126,389	1,390,618	2	6,654	500 petty cash	Excellent	Yes
Implementing Partner No. 7	24,546,676	2,060,001	8	76,567	1,000 petty cash	Good	No
Implementing Partner No. 8	2,309,564	1,588,312	69	8,972	500 petty cash	Fair	No
Implementing Partner No. 9	13,411,658	426,093	3	34,681	No limit	Excellent	Yes
Implementing Partner No. 10	5,074,465	3,030,446	60	53,191	100 petty cash no limit for other cash payments	Good	No
<b>Totals</b>	181,146,424	13,546,825	7	269,953			

**Internal Control Questionnaire for Cash Disbursements**

1. In fiscal year 2010 (October 1 to September 30, 2010), how much of expenses were paid in cash vs. EFT, check, or *hawala* in terms of dollars and percentage of total expenses?
2. Describe the type of expenses that are paid in cash.
3. Does the contractor/grantee have subcontractors or subgrants? If so, are they paid in cash?
4. Is there a cash/imprest fund for cash payments?
5. How much is the cash/imprest fund?
6. Is there a cash payment dollar amount limit?
7. How is the cash/imprest fund replenished and how often?
8. Is an employee designated to be responsible for cash payments?
9. Is an alternate employee designated to handle cash payments with the primary responsible employee is absent?
10. What type of training has the cashier/alternate received?
11. Is there separation of duties between the cashier and other accounting functions, such as between disbursing, recording and reconciling cash?
12. Are there written procedures or other specific guidance for cash payments?
13. Are cash and paid vouchers are kept in a protected and segregated area in a safe or vault and does the cashier strictly controls access to this?
14. Are access changes documented and authorized by key personnel?
15. What documentation is required to support each cash payment?
16. Are suitable precautions taken when transporting cash between the bank, office and other points where cash is handled? Please describe.
17. Are cash reconciliations performed? Who performs them and how often?
18. Are supervisory reviews of cash payments performed? How often?
19. Does the contractor/grantee conduct surprise cash counts? Who performs them and how often?
20. Has the contractor/grantee ever had instances of lost funds or reconciling items? Please describe.
21. Did the contractor/grantee experience any suspicious or irregular cash payments? Please describe.

22. What internal controls exist to prevent and detect fraudulent cash payments?
  - a. Purchases
  - b. Subcontractors
  - c. Subgrantees
  - d. Subprojects (cash for work, etc.)
23. Does the cashier/alternate understand what constitutes wrong or fraudulent behavior?
24. Is there a whistleblower protection policy?
25. Do employees have a way to report misconduct anonymously without fear of retaliation from the organization or the people they are informing about?