



*Office of Inspector General*

October 30, 2014

**MEMORANDUM**

**TO:** USAID/Afghanistan Mission Director, William Hammink

**FROM:** OIG/Afghanistan Country Office Director, Robert W. Mason /s/

**SUBJECT:** Review of USAID/Afghanistan's Financial Management Controls for Government-to-Government Assistance (Report No. F-306-15-001-S)

This memorandum transmits our final report on the subject review. In finalizing the report, we considered your comments on the draft review and have included them in Appendix II, without attachments.

The report contains nine recommendations to strengthen USAID/Afghanistan's financial management controls for government-to-government assistance. We acknowledge management decisions on all nine and final action on Recommendations 1, 3, 6, and 9. Please provide the Audit Performance and Compliance Division in the Office of the Chief Financial Officer with the necessary documentation to achieve final action on Recommendations 2, 4, 5, 7, and 8.

Thank you and your staff for the cooperation and courtesies extended to us during this review.

# SUMMARY

In response to the goal of international donors to give more aid directly to the Afghan Government, USAID's development portfolio includes "on-budget assistance" (OBA). OBA can go directly to Afghan Government entities (referred to in this review as "government-to-government") or as contributions to trust funds created by several donors and run by international organizations. In theory, OBA gives the Afghan Government more experience in managing areas such as budgeting, procurement and oversight, and thus helps build their capacity.

USAID/Afghanistan committed a total of \$3.2 billion to OBA projects that were active between October 1, 2011, and January 31, 2014. Of that amount, \$997 million was committed to government-to-government assistance, the portion this review focused on. Recent oversight work has criticized USAID/Afghanistan's use of this type of assistance because financial risk assessments funded by the mission indicated that Afghan systems were not reliable.<sup>1</sup>

USAID officials contended that government-to-government assistance supports U.S. national security objectives, and that mitigation measures, or controls, were put into place to mitigate the problems described in the risk assessments. In a congressional hearing held in March 2014, the Agency's assistant to the Administrator and director of the Office of Afghanistan and Pakistan Affairs said:

USAID is intensely conscious of the trust that has been placed with us to safeguard taxpayer funds while implementing development programs in support of U.S. national security interests. The Agency . . . has applied best practices to design and implement rigorous risk mitigation measures for direct assistance. It also continues to work internally and with its auditors to refine oversight policies and procedures.

The objective of this review was to determine whether financial management controls associated with USAID/Afghanistan's government-to-government assistance were designed and operating effectively. The review focused on projects implemented between October 1, 2011, and January 31, 2014. As of January 31, 2014, USAID/Afghanistan had 11 ongoing projects in its government-to-government assistance portfolio and 2 that ended during that period. (Appendix III has more information on the projects reviewed.)

We concluded that the mission has improved its implementation of financial management controls for government-to-government assistance over time, as Agency guidance changed and mission officials gained more experience with government-to-government projects. By the end of the review period, USAID/Afghanistan had eight controls designed to help ensure that obligated funds were disbursed as planned and that disbursed funds were used as intended.<sup>2</sup>

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<sup>1</sup> *Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries' Ability to Manage Donor Funds, but Concerns Remain*, SIGAR Audit 14-32, issued by the Special Inspector General for Afghanistan Reconstruction (SIGAR) in January 2014.

<sup>2</sup> Appendix IV has additional details on the controls in place, including improvements the mission made to them during the period reviewed.

However, there was the opportunity for taxpayer funds to be misused during this time because only one of the controls had been operating consistently since October 1, 2011.

For example, USAID/Afghanistan awarded the District Delivery Program to the Independent Directorate of Local Governance as a cash advance project in August 2010. The mission did not yet have a reliable control structure in place, but officials there said they were under pressure to begin implementation. By the time OIG issued a financial audit of this project,<sup>3</sup> it had incurred more than \$700,000 in questioned costs that ultimately were sustained.<sup>4</sup>

Meanwhile, it is worth noting that officials said they preferred not to disburse previously committed funds when they could not monitor them properly, and the mission had disbursed only \$255 million of the \$997 million (26 percent) committed to government-to-government assistance for projects active during the period under review.

In addition, the mission had not addressed the following problems.

- Officials did not ensure that audit requirements were met (page 4). Between October 1, 2011, and January 31, 2014, USAID/Afghanistan disbursed more than \$90 million to government-to-government projects that had not yet been audited as required by USAID's guidance.
- The mission's involvement in Afghan procurements was not always adequate (page 6).
- Some mission employees did not understand their responsibilities (page 7). Five of 11 officials charged with monitoring government-to-government projects were unclear on their roles, and so were members of the on-budget committee, because the mission's documented policies and procedures did not include accurate descriptions of all the controls, and the officials had not been trained.
- The mission did not explain expectations clearly in project documents (page 8).
- Accounting transactions were recorded late (page 10). In 3 of 11 transactions reviewed, the mission allowed at least 1 month to pass from the date an implementation letter was signed to when funds were properly subcommitted and subobligated in the system.

To address the identified weaknesses, we recommend that USAID/Afghanistan:

1. Implement procedures to evaluate whether the Afghan Government has met its commitments, including audit requirements, before the Agency disburses funds to government-to-government projects (page 5).

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<sup>3</sup> *Financial Audit of USAID Resources Managed by the Independent Directorate of Local Governance under the District Delivery Program, Implementation Letter No. 306-IL-10-04-01 for the Period April 01, 2010 to March 20, 2012*, No. F-306-13-017-N, September 30, 2013.

<sup>4</sup> The mission later reported to OIG that a bill of collection was issued to the Independent Directorate of Local Governance on September 30, 2014, to recover the sustained questioned costs resulting from the financial audit of the program.

2. Modify the audit requirements within its government-to-government project documents to describe the Agency-contracted audit process, and communicate to these recipients that additional funding may not be disbursed until audits are completed (page 5).
3. Issue a notice to relevant staff to remind them that OIG's country office should be notified each time the mission awards an audit of a government-to-government project (page 6).
4. Implement procedures that require procurement officials to be included in the team responsible for individual government-to-government projects, as applicable (page 7).
5. Update its OBA mission order to reflect its current practices (page 8).
6. Schedule and document periodic training courses for officials designated to monitor OBA (page 8).
7. Develop or update templates for its government-to-government implementation letters to include more clearly defined expectations,<sup>5</sup> based on the revised Automated Directives System (ADS) 220 and lessons learned (page 10).
8. Implement a procedure to confirm that Afghan Government officials responsible for implementing government-to-government projects understand the expectations described within project documents (page 10).
9. Perform an evaluation of its newly implemented process to verify that government-to-government transactions are recorded correctly and promptly, make necessary adjustments, and document the final results (page 11).

In addition to the weaknesses described above, the review found another matter. USAID established separate project implementation and management units run by nongovernmental organizations that receive funding from the Agency (page 12). Establishing these units seems to run counter to the goal of strengthening the Afghan Government and raises questions about the cost effectiveness of implementing projects using government-to-government assistance.

Detailed findings appear in the following section, and the scope and methodology appear in Appendix I. Management comments are included in their entirety in Appendix II, and our evaluation of them begins on page 14.

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<sup>5</sup> An implementation letter is used for approving and managing government-to-government assistance projects.

# REVIEW RESULTS

## Officials Did Not Ensure That Audit Requirements Were Met

ADS 591.3.2.1 states that host governments that spend \$300,000 or more of USAID funds during their fiscal year must have an annual audit completed in accordance with OIG’s *Guidelines for Financial Audits Contracted by Foreign Recipients*.

USAID/Afghanistan used this audit process as one of the risk mitigation measures in place to justify the use of partner-country systems despite the fiduciary risks identified in the financial management risk assessments. In fact, in April 2014 the Agency’s assistant to the Administrator and director of the Office of Afghanistan and Pakistan Affairs told the House Oversight and Government Reform Subcommittee on National Security, “For direct assistance, USAID utilizes multiple levels of protection to mitigate risks to taxpayer funds. These measures may include, but are not limited to . . . an annual audit by a USAID OIG-approved firm.”

We selected and reviewed project documents and noted that audit requirements were included. However, USAID officials fell short in ensuring that they and the Afghan Government adhered to those requirements. As shown in the table below, audits were not awarded annually and were not completed on time.<sup>6</sup>

**Table 1. Project Audits, as of July 2014**

Project	Audit Period	Report Issue Date
Partnership Contracts for Health Services Program	7/20/08 – 9/22/10	10/3/11
	9/23/10 – 10/20/13	Not Issued
District Delivery Program	4/1/10 – 3/20/12	9/30/13
Agriculture Development Fund	7/18/10 – 12/31/13	Not Issued
Cash Transfer Assistance to Support Civilian Technical Assistance Program	10/1/10 – 3/20/12	4/30/13
	3/21/12 – 3/20/13	Not Issued
Regional Airports Project	1/9/11 – 7/31/12	8/31/13
Cash Transfer Program Assistance for Civil Service Reform	10/31/11 – 2/28/13	Not Issued
Basic Education, Literacy, and Technical-Vocational Education and Training Project - Textbook Procurement Activity	11/16/11 – 12/20/13	Not Issued

This happened because mission officials were not tracking whether ongoing commitments outlined in project documents—including audit requirements—were fulfilled. They attributed this to three factors, discussed below.

First, most of the mission’s 13 government-to-government projects included language in project documents that required the implementing ministry or agency to contract for its own financial audit. Officials said that at the time they believed that giving this responsibility to the Afghan Government was part of the mission’s capacity-building efforts. However, they soon realized that the implementing ministries were not equipped to shepherd the audit process. They

<sup>6</sup> OIG *Guidelines* require that audit firms submit their reports within 9 months from the audit period’s end.

recognized this when, for example, the Ministry of Public Health quoted audit timelines of 1.5 years. USAID/Afghanistan therefore decided to award its own contracts to independent audit firms under the Agency-contracted audit process, but doing so took time.

Second, according to ADS 590.3.4.1, OIG should approve the statement of work for Agency-contracted audits, monitor the audit itself, and review the draft and final audit reports. While the mission's statement of work for Agency-contracted audits included steps in which OIG needed to be involved, the mission did not ensure that this happened in four of the seven projects reviewed.

For example, the statement of work for the audit of the civil service reform project, signed in September 2013, required that OIG/Afghanistan be notified of the audit's entrance conference. However, OIG's first involvement with the audit occurred when the Office of Financial Management forwarded the draft audit report to it in March 2014. This meant that OIG officials had to perform additional procedures before they could approve the draft report (e.g., obtaining and reviewing minutes from meetings they were not invited to), which extended the audit finalization date.

Third, the independent audit firms the mission contracted to conduct these audits have had difficulty finishing them within the deadlines. Some of this is attributable to the Afghan entities' reluctance to be audited, which can be addressed through improved communication of USAID's expectations (discussed in the finding on page 8). However, the limited number of audit firms working in Afghanistan and their lack of experience in performing audits of USAID-funded activities also contributed.

USAID/Afghanistan intended the audit process to mitigate fiduciary risks identified during the financial management risk assessments. These audits help the mission find misused funds and weaknesses in internal control or compliance. Using audits to make decisions about future disbursements is particularly important because funds have proven difficult to recover once disbursed. While the mission reported that it was provided interim feedback from audit firms, during the review period the mission disbursed more than \$90 million to projects with overdue audits.

As of June 2014, all of the required audits were in process, and mission officials provided support that they now have a system to track the status of government-to-government audits. They were also updating their internal policies and procedures. However, to strengthen the design and operation of these controls, we make the following recommendations.

***Recommendation 1.*** We recommend that USAID/Afghanistan implement procedures to evaluate whether the Afghan Government has met its commitments, including audit requirements, before the Agency disburses funds to government-to-government projects.

***Recommendation 2.*** We recommend that USAID/Afghanistan modify the audit requirements within its government-to-government project documents to describe the Agency-contracted audit process, and communicate to these recipients that additional funding may not be disbursed until audits are completed.

**Recommendation 3.** *We recommend that USAID/Afghanistan issue a notice to relevant staff to remind them that the Office of Inspector General's country office should be notified each time the mission awards an audit of a government-to-government project.*

## **Mission's Involvement in Afghan Procurements Was Not Always Adequate**

As discussed in the previous finding, the USAID assistant to the Administrator and director of the Office of Afghanistan and Pakistan Affairs told a congressional committee in April 2014 that the Agency "utilizes multiple levels of protection to mitigate risks to taxpayer funds." These may include, he added, "substantial involvement and oversight by USAID staff in procurement processes." USAID/Afghanistan officials clarified that this applies when procurement actions are deemed "significant."

Three of seven projects we reviewed required USAID staff to be involved in procurement, either through the milestones/benchmarks or other conditions of the implementation letter. However, USAID/Afghanistan's involvement in procurement actions was not always adequate to mitigate risks to taxpayer funds. The mission had designed this control so that the substantial procurement involvement came from the respective technical offices that oversaw particular subjects (e.g., engineering). However, while these officials were able to effectively oversee technical evaluation meetings, for example, they were not required to have procurement experience, and were therefore not qualified to give procurement advice to Afghan entities.

We recognize that the mission director approves procurements on the recommendation of the on-budget committee, or with the concurrence of officials from the Office of Financial Management. While this may improve the effectiveness of the control somewhat, there are still two problems. First, the director of the Office of Acquisition and Assistance is the only person from that office who belongs to the on-budget committee. Because of this person's multiple responsibilities, he/she cannot review in detail every procurement action brought before the committee (though he/she forwards some documents to other procurement staff for review). Second, officials from the Office of Financial Management do not have procurement experience.

As a result, the mission's control over procurement practices was not as effective in mitigating the risks to taxpayer funds as it could have been. In one example, officials from the Office of Economic Growth and Infrastructure recommended that USAID/Afghanistan approve a \$3.5 million increase to a construction contract under the Kajaki Unit 2 Project; it was approved. However, this modification included several questionable items. For example, the chief of party's salary was covered for several months after the project ended; employees were given more recuperation breaks for the extension period than they had received for the original period of performance; and fees increased without explanation.

Following this particular example, mission officials realized that they needed to have procurement officials involved in procurement actions for the project. A team including procurement and legal officials was established, and its members must agree on procurement actions before they make a recommendation to the on-budget committee and subsequently to the mission director. (A similar team structure is defined in ADS 220, updated in July 2014). However, this change has not yet been written into mission guidance. Accordingly, we make the following recommendation.

**Recommendation 4.** We recommend that USAID/Afghanistan implement procedures that require procurement officials to be included in the team responsible for individual government-to-government projects, as applicable.

## Some Mission Staff Did Not Understand Their Responsibilities

According to the U.S. Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government*, "Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives . . . They help ensure that actions are taken to address risks." An organization uses these activities to communicate its objectives and designate who is responsible for achieving them.

However, 2 of the 11 on-budget monitors—those tasked with facilitating communications between the two governments—said that their responsibilities were unclear. Although three monitors said their responsibilities were clear, additional comments from them and other mission officials implied that these three had overstepped the roles outlined in their on-budget monitor designation letters. This indicates that either the monitors' responsibilities truly were unclear or that they did not understand or agree with how their responsibilities fed into the mission's control structure. There have also been complaints from mission staff that members of the on-budget committee were not sure what they were responsible for, leading to confusion and delays in clearing documents.

Responsibilities for government-to-government projects were unclear because (1) USAID/Afghanistan's documented policies and procedures did not reflect what the mission actually did to address risk, and (2) while the mission has biweekly government-to-government meetings, the staff had not been trained on the mission's processes. In fact, none of the on-budget monitors we asked had received any training regarding their role in implementing government-to-government assistance.

USAID/Afghanistan first committed itself to OBA in 2010 and began to institutionalize government-to-government processes in a mission order dated August 2012. However, the mission continued to make improvements to its OBA processes after this date (as described in Appendix IV), which by the time of our review had resulted in outdated, inaccurate, or incomplete policies and procedures. Examples included the following.

- Mission Order 220.02 states that approval of use of partner-country systems documents (AUPCSs)<sup>7</sup> will cover a specific OBA project. However, the mission chose to have some AUPCSs cover multiple projects implemented by the same entity. For example, a separate AUPCS had not been prepared for the Kajaki Unit 2 Project, implemented by Da Afghanistan Breshna Sherkat (the Afghan Government's utility agency). Implementation letters for the project stated that the mission would use the same conditions as the Power Transmission Expansion and Connectivity Project, which is conducted by the same entity.

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<sup>7</sup> The mission director approves AUPCSs when any mitigation measures in them are deemed sufficient to address the risks identified in the public financial management assessment.



- The mission order does not say who at the implementing ministry/agency is authorized to sign project implementation letters, nor does it say that the Ministry of Finance must sign the letters, though this is done in practice.
- Contrary to the order, the implementing entity is not always given a copy of USAID’s on-budget monitor designation letter.
- The mission’s OBA policies and procedures do not mention the Office of Financial Management’s monthly review of project bank accounts—one of the mission’s controls for the financial management of government-to-government assistance.

At a November 2013 meeting that mission officials with OBA responsibilities attended, the group discussed updating existing mission policies and procedures, training and a checklist for on-budget monitors, and ensuring that the mission has a systematic approach to monitoring OBA projects and measuring results. During fieldwork, we noted that revisions to mission guidance were in process, but pending the update of ADS 220.<sup>8</sup> We also learned of a 2-day pilot government-to-government training course that the mission offered in July 2014.

However, to ensure that these activities continue, we make the following recommendations.

**Recommendation 5.** *We recommend that USAID/Afghanistan update its on-budget assistance mission order to reflect its current practices.*

**Recommendation 6.** *We recommend that USAID/Afghanistan schedule and document periodic training courses for officials designated to monitor on-budget assistance.*

## **Mission Did Not Explain Expectations Clearly in Project Documents**

Mission Order 220.02 requires that expectations concerning “project objectives, results, resources, and timelines” be documented clearly to avoid misunderstandings between USAID and the implementing Afghan entity. However, we found numerous examples of when they were not.

- The on-budget monitor for the Afghanistan Workforce Development Project said the project’s implementation letters should have done a better job of explaining the fund disbursement process—who should submit requests and how they should do it. He also said the Ministry of Education does not have a good understanding of the special covenants it has agreed to.
- The implementation letters signed by the ministry and USAID for the workforce project did not outline the roles and responsibilities of the concurrent, USAID-funded technical assistance project. That project, required in the AUPCS, intends to build the capacity of the ministry.

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<sup>8</sup> This was done in July 2014.

- The 2011 OIG audit of the Partnership Contracts for Health Services Program<sup>9</sup> found that the performance management plan had not been completed 3 years into the program, despite mission documents requiring one. This happened because the requirement to have a plan was not included in the implementation letter. Without it, “USAID primarily relied on the program’s semiannual and annual reports and annual surveys to monitor progress, yet these documents contained limited performance information to make informed decisions.”
- The implementation letters for the Kajaki Unit 2 Project did not list the documents the implementer needed to give USAID to request the disbursement of funds, in accordance with Mission Order 220.02, nor did they specify the dollar amounts to be disbursed. While the initial implementation letter stated that subsequent letters would “provide additional terms and conditions with respect to the Project and disbursement of funds,” the on-budget monitor said no subsequent letters addressed the payment process, and that it had been a major problem. Further, we noted that the letters did not mention USAID’s right to require prior approval on actions throughout the procurement cycle.
- The final performance evaluation for the Regional Airports Project noted that the implementation letter did not define the responsibilities of the Ministry of Finance and the Ministry of Transport and Civil Aviation adequately, and that tasks were ambiguous. For example, reporting requirements were not defined clearly, and “reporting continued to be a major setback in the execution of the project.”
- The implementation letters for the Basic Education, Literacy, and Technical-Vocational Education and Training Project - Textbook Procurement Activity had poorly defined reporting requirements. As a result, performance reporting was not being done when the current on-budget monitor arrived at post. As of July 2014, reporting was being handled by the project management team, which is funded through a separate USAID project.

As in many of the examples described above, poorly defined expectations can result in misunderstandings between the Afghan and U.S. Governments that delay or otherwise impede implementation. It also can mean that the risk mitigation measures described in the AUPCSs are not implemented as expected. For example, while the Agriculture Development Fund is implemented as a cash transfer project, the project’s AUPCS stated, “The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.” Further, poorly worded documents can make it difficult to hold the implementing entities accountable for meeting expectations when projects are audited.

Mission officials said they initially had hoped there would be more buy-in and ownership from Afghan Government officials implementing these projects. They also said they thought details could be worked out as activities were implemented; so they did not define requirements strictly. As these projects become more mature, the implications of decisions the mission made during the project design phase are becoming clearer. Although they said they recognize this is an area for improvement, we did not observe significant improvement in project documents the mission drafted during the review period. Therefore, we make the following recommendations.

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<sup>9</sup> *Audit of USAID/Afghanistan’s On-Budget Funding Assistance to the Ministry of Public Health in Support of the Partnership Contracts for Health Services Program*, No. F-306-11-004-P, September 29, 2011.

**Recommendation 7.** We recommend that USAID/Afghanistan develop or update templates for its government-to-government implementation letters to include more clearly defined expectations based on the revised Automated Directives System 220 and lessons learned.

**Recommendation 8.** We recommend that USAID/Afghanistan implement a procedure to confirm that Afghan Government officials responsible for implementing government-to-government projects understand the expectations described within project documents.

## **Accounting Transactions Were Recorded Late**

ADS 621.3.3 says “Commitments and sub-commitments must be established to set aside funds prior to obligation or sub-obligation”. Once obligations are incurred, ADS 621.3.6 requires the mission controller to “promptly record obligations in the procurement or accounting system” and make sure that “the funding source used is correct and in accordance with policy.” In the context of government-to-government assistance, funds are typically committed and obligated under a bilateral agreement with the partner government and then subcommitted and subobligated to specific projects using an implementation letter.

However, we reviewed 11 government-to-government accounting transactions and found that in 3 cases the mission allowed at least 1 month to pass from the date an implementation letter was signed to when funds were subcommitted and subobligated properly in the system.

- An implementation letter subobligated \$101 million to the Power Transmission Expansion and Connectivity Project in January 2013, but neither the subcommitment nor the subobligation were recorded in the system until March 2013.
- An implementation letter subobligated \$140 million to the same project in April 2013, but neither the subcommitment nor the subobligation were recorded in the system until June 2013.
- An implementation letter subobligated \$7.8 million to the Afghanistan Workforce Development Program in September 2013, but neither the subcommitment nor the subobligation were recorded in the system until October 2013.

These delays occurred because of oversights and because the mission’s program office did not always give accountants the information they needed to record transactions in a timely manner. Both causes stem from the fact that mission staff did not understand how existing processes for providing, receiving, and processing accounting information applied to government-to-government projects.

If subcommitments and subobligations are not recorded promptly, the mission could end up committing more funds than have been obligated for a particular objective. The strategic objective grant agreement that supports “a thriving economy led by the private sector” was used by the mission to pay for seven separate government-to-government projects. It would be

difficult for each project's cognizant officials to know about other projects' accounting activities if they are not recorded in the system. These scenarios could result in a funds control violation.<sup>10</sup> While the mission developed a new process to correct these issues in April 2014, we did not evaluate its effectiveness because it happened after our review period ended. Accordingly, we make the following recommendation.

***Recommendation 9.*** *We recommend that USAID/Afghanistan perform an evaluation of its newly implemented process to verify that government-to-government transactions are recorded correctly and promptly, make necessary adjustments, and document the final results.*

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<sup>10</sup> If an amount exceeds the Agency's budget, it could be a violation of the Antideficiency Act, which may lead to disciplinary and/or criminal penalties.

# OTHER MATTER

## USAID Established Separate Project Units

According to ADS 220.1 (revised in March 2012):

USAID's development policy ultimately must support long-term, sustained progress and make assistance unnecessary in the long term by partnering with countries to use their internal systems, build their capacity, strengthen core institutions, maximize the impact of assistance they receive, and provide for their own people.

ADS 220.3.2.2 states:

Missions and Operating Units are discouraged from negotiating or funding the establishment of separate project implementation/management units. It is USAID policy to use existing partner country government entities and institutions in order to strengthen those already established by the partner country government.

In this vein, USAID/Afghanistan's Mission Order 220.02 states that its policy is to "make every effort to 'stand up' Afghan ministries in their fiscal and budgetary capacity."

Meanwhile, most of the ongoing government-to-government projects funded by USAID/Afghanistan have separate project implementation and management units, run by USAID-funded nongovernmental organizations. For example, USAID's Leadership, Management and Governance Afghanistan project, which is implemented by Management Sciences for Health, pays consultants to help the Ministry of Education manage activities implemented under the Basic Education, Literacy, and Technical-Vocational Education and Training Project. However, officials from USAID/Afghanistan's education office noted that this team of consultants has ended up doing most of the work themselves as an embedded project management team. This was reiterated by officials from the mission's financial management office, who said the majority of their interactions for this project were with staff from Management Sciences for Health.

From a financial management perspective, the mission's establishment of separate project implementation and management units acts as an additional risk mitigation measure during a period when the mission cannot rely on the implementing entities' controls. That is why we make no recommendation. Nevertheless, establishing these units was not the Agency's preference<sup>11</sup> and seemed to run counter to the goal of strengthening the Afghan Government. It also raised questions about the cost-effectiveness of implementing projects using government-to-government mechanisms.

However, it was not in the scope of this review to evaluate whether the mission's government-to-government projects were improving the capacity of the Afghan Government, or whether

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<sup>11</sup> In July 2014 the Agency issued a mandatory reference for ADS 220, "Local Systems: A Framework for Supporting Sustained Development," which further clarified USAID's development goals.

development projects implemented under these mechanisms were cost effective. USAID officials may want to perform this analysis internally.

# EVALUATION OF MANAGEMENT COMMENTS

The mission's comments on the draft report are included, without attachments, in Appendix II. Based on those comments and the supporting documentation provided, we acknowledge management decisions on all nine recommendations, with final action taken on four. Our detailed evaluation follows.

**Recommendation 1.** The mission agreed with the recommendation and said it now has a system to monitor and update audits of government-to-government projects. To strengthen the process, the mission modified the on-budget monitor's administrative approval checklists to require the monitor to certify the status of the most recent audit of the projects. Mission officials also said a financial analyst now conducts a secondary review of vouchers submitted by ministries before disbursing any funds. Based on the mission's comments and the supporting documentation provided, we acknowledge that a management decision has been made and final action taken.

**Recommendation 2.** The mission agreed with the recommendation. It plans to modify the audits clause in its implementation letter templates to describe the Agency-contracted audit process and state that additional funding may not be disbursed until audits are completed. In addition, the mission said it would tell representatives of relevant Afghan Government ministries about the Agency-contracted audit process during post-award briefings for new awards and when new audits are required for existing projects. In subsequent correspondence, the mission set a target date of December 31, 2014, for final action. We acknowledge this management decision.

**Recommendation 3.** The mission agreed with the recommendation. On September 25, 2014, the Office of Financial Management issued a notice to all financial analysts working on government-to-government projects to remind them that OIG should be informed whenever the mission awards an audit of such a project. Based on mission comments and the supporting documentation provided, we acknowledge that a management decision has been made and final action taken on this recommendation.

**Recommendation 4.** The mission agreed with the recommendation and noted that the director mandated the establishment of OBA teams, which include procurement officials and representatives from other mission offices, in May 2014. In addition, the mission is revising its OBA mission order to further document the required participation of procurement officials in the OBA project teams, add primary responsibilities of core OBA committee members, and specify the teams' roles and responsibilities. In subsequent correspondence, the mission set a target date of December 31, 2014, for final action. We acknowledge this management decision.

**Recommendation 5.** The mission agreed and said it will revise Mission Order 220.02 to reflect the July 2014 revision of ADS 220, as well as the mission's current on-budget practices. It set a target date of December 31, 2014, for final action. We acknowledge this management decision.

**Recommendation 6.** The mission agreed with the recommendation and developed an OBA training course that was held on July 16 and 17, 2014. The course will be repeated in

December 2014 and will be conducted twice each year thereafter. Attendance will be mandatory for all on-budget monitors. In addition, these monitors are being encouraged to attend regular OBA staff meetings and complete available online training courses. Based on the mission's comments and the supporting documentation provided, we acknowledge that a management decision has been made and final action taken on this recommendation.

**Recommendation 7.** The mission agreed and stated it will update its implementation letter templates based on the revised ADS. The mission will also incorporate additional information that will include more clearly defined expectations based on the revised ADS and lessons learned. The mission set a target date of December 31, 2014, for final action. We acknowledge the management decision.

**Recommendation 8.** The mission agreed with the recommendation. It plans to revise its OBA mission order to require that a post-award orientation meeting be held with USAID and responsible Afghan Government officials promptly after projects start. The intent is to give them a clear, mutual understanding of all requirements, and help resolve potential problems. The mission set a target date of December 31, 2014, for final action. We acknowledge the management decision.

**Recommendation 9.** The mission agreed with the recommendation. It conducted a review to verify that government-to-government transactions were recorded correctly and promptly, under the mission's newly implemented process, for all 14 implementation letters issued between April 1, 2014, and September 15, 2015. According to the review, only one letter required funds to be subcommitted and subobligated, which had been recorded in the accounting system in a timely manner. Based on the mission's comments and the supporting documentation provided, we acknowledge that a management decision has been made and final action taken on this recommendation.



# SCOPE AND METHODOLOGY

## Scope

OIG/Afghanistan conducted this review in accordance with the Quality Standards for Inspection and Evaluation, as issued in 2012 by the Council of the Inspectors General on Integrity and Efficiency.

The review objective was to determine whether financial management controls associated with USAID/Afghanistan's government-to-government assistance were designed and operating effectively. We focused on the actions the mission took after funds had been committed to government-to-government assistance, but before they were disbursed. We sought to assess both the design and implementation of controls to determine whether relevant financial management risks were being addressed.

This review covered the 13 government-to-government projects, delivered through Afghan entities, in the mission's inventory from October 1, 2011, to January 31, 2014, whether ongoing, completed, or suspended as of the start of fieldwork.<sup>12</sup> As of January 31, 2014, USAID/Afghanistan had committed approximately \$3.2 billion to government-to-government assistance. Of that amount, \$997 million was for the 13 projects in our scope, while \$2.2 billion went to trust funds. During the period covered by our review, USAID/Afghanistan subobligated \$646 million and disbursed \$183 million to the projects included in our scope.

Fieldwork was conducted from March 10 to August 13, 2014. We conducted it in Kabul, where we interviewed key personnel at USAID/Afghanistan, including the various technical offices responsible for the mission's government-to-government assistance processes.

## Methodology

To answer the review objective, we reviewed applicable laws, best practices, and guidelines. Key documents that we reviewed included:

- ADS 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance"<sup>13</sup>
- ADS 305, "Host Country Contracts"
- USAID/Afghanistan Mission Order 220.02
- USAID/Afghanistan Mission Order 201.03, "Project Design and Approval Process"
- GAO's *Standards for Internal Control in the Federal Government*

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<sup>12</sup> Appendix III has the complete list and details.

<sup>13</sup> While USAID has waived these requirements for Afghanistan, officials use the document as guidance.

Then, because several independent oversight bodies had already performed work in this area, we reviewed their work. This included:

- *Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries' Ability to Manage Donor Funds, but Concerns Remain*, SIGAR Audit 14-32, January 2014.
- *Health Services in Afghanistan: USAID Continues Providing Millions of Dollars to the Ministry of Public Health despite the Risk of Misuse of Funds*, SIGAR Audit 13-17, September 2013.
- *Review of USAID's Partner-Country and Local Organization Assessments Under Implementation and Procurement Reform*, No. 9-000-13-003-S, USAID/OIG, June 7, 2013.
- *Audit of USAID/Afghanistan's On-Budget Funding Assistance to the Ministry of Public Health*, No. F-306-11-004-P, USAID/OIG, September 29, 2011.
- *Review of USAID/Afghanistan's Ministerial Assessment Process*, No. F-306-11-001-S, USAID/OIG, November 6, 2010.
- *Actions Needed to Improve Accountability of U.S. Assistance to Afghanistan Government*, GAO-11-710, GAO, June 2011.

We also reviewed related and available testimony and alert letters issued by SIGAR, and asked about its ongoing or planned work.

At USAID/Afghanistan, we met with officials responsible for oversight of government-to-government assistance. We interviewed officials from the technical offices responsible for monitoring each of the 13 projects in our scope, officials from the Office of Financial Management, a representative from the Regional Legal Office, and a representative from the Office of Acquisition and Assistance.

This information helped us understand the mission's goals for government-to-government assistance, its definition of this type of assistance, the scope of activities, the financial risks involved with this type of assistance, and the financial management controls put in place to mitigate those risks.

For the controls identified, we obtained examples of the documentation available to support their implementation. This was done to determine whether controls were designed to address the risks that they were intended to address, whether documented policies and procedures were accurate, and whether the mission retained the documentation necessary to test the controls' operation over a period of time.

Once our design assessment was complete, we selected a sample of transactions to test the controls' operation over a period of time. We selected a unique sample for each control, as shown in the table on the next page.

**Table 2. Sampling Information**

<b>Control</b>	<b>Sampling Methodology</b>	<b>Population Size</b>	<b>Sample Size</b>	<b>Percent Tested</b>
USAID and the Afghan Government agree on the conditions precedent and ongoing commitments under which funds will be disbursed.	We selected projects randomly to give us at least 50 percent coverage of the population.	13 projects	7 projects	53.85
Only authorized individuals have system access to obligate funds.	N/A – tested substantively			
The Office of Financial Management subobligates funds in accordance with an implementation letter.	We selected projects randomly to give us at least 25 percent coverage of the population by both volume and dollar amount.	44 subobligations worth \$646 million	11 subobligations totaling \$341 million	25 by volume; 52.73 by dollar amount
USAID provides ongoing monitoring, technical assistance, and capacity building to the implementing ministry/agency.	We selected projects randomly to give us at least 50 percent coverage of the population.	13 projects	7 projects	53.85
Disbursements are made only if the conditions precedent and ongoing commitments in the implementation letter have been met, and are supported by the required documents.	We selected projects randomly to give us at least 25 percent coverage of the population by both volume and dollar amount.	106 disbursements worth \$183 million	28 disbursements worth \$48.7 million	26.42 by volume; 26.60 by dollar amount
Only authorized individuals have system access to disburse funds.	N/A – tested substantively			
Funds are disbursed to a specific account controlled by the Ministry of Finance that is reviewed by USAID.	We selected 100 percent of active projects with funds disbursed, due to the small population.	5 projects	5 projects	100
Funds disbursed to the implementing ministry/agency are audited.	We selected 100 percent of projects with funds disbursed, due to the small population.	7 projects	7 projects	100

We obtained and reviewed documents to support the controls for each sampled item. As applicable, we identified exceptions. This information was used to assess whether USAID's financial management controls for government-to-government assistance were adequate, and to develop recommendations for improvement. However, because we did not use statistical sampling, we cannot project our results to the entire population. Since the tests were not sufficient to determine that our conclusions were true for the untested items, we answered the review objective using positive assurance.

# MANAGEMENT COMMENTS



## MEMORANDUM

October 07, 2014

**TO:** Robert Mason, OIG/Afghanistan Country Office Director

**FROM:** William Hammink, Mission Director /s/

**SUBJECT:** Draft Report on the Review of USAID/Afghanistan's Financial Management Controls for Government-to-Government Assistance (Report No. F-306-15-00X-S)

**REFERENCE:** RAse/JHope memo dated September 10, 2014

### GENERAL COMMENTS:

Thank you for providing USAID/Afghanistan with the opportunity to respond to the draft report on the Review of USAID/Afghanistan's Financial Management Controls for Government-to-Government (G2G) Assistance.

As noted in your report, USAID/Afghanistan's direct assistance programs have been reviewed thoroughly by the Office of Inspector General (OIG), and the Special Inspector General for Afghanistan Reconstruction (SIGAR). In addition, USAID is continuously reviewing our processes to ensure the accountability of our projects. As a learning organization we reevaluate and employ the best systems available to provide oversight in an environment as challenging as Afghanistan.

USAID/Afghanistan started its direct assistance program before the introduction of the Automated Directive System (ADS) 220, which provides the Agency guidelines for direct assistance. This Mission, along with the Office of Afghanistan and Pakistan Affairs (OAPA), have played a key role in developing the ADS 220 guidance on managing direct assistance based upon the experience of the Mission programs in Afghanistan. The Agency's policy benefitted greatly from lessons learned in Afghanistan. The guidance provided in this report will assist us as we seek to further refine our processes.

USAID employs a comprehensive process to protect USG resources used for on-budget programs in Afghanistan from waste, fraud, and abuse by working with recipient ministries and governmental entities to strengthen their capacity to manage on-budget activities. All direct G2G assistance requires compliance with USAID accountability and oversight procedures.

The Mission takes proactive steps to strengthen G2G assistance policies and procedures. Specifically, the Mission is committed to ensuring project documentation and policies are current by updating Mission Orders, Implementation Letters and operational procedures when

necessary and by confirming that these documents include clearly defined expectations for Afghan Government officials implementing USAID G2G assistance projects. Other proactive steps include the development of an on-budget assistance training course to ensure that Mission staff implementing G2G assistance have a clear understanding of their responsibilities, the establishment of on-budget assistance project implementation teams to guarantee the inclusion of procurement expertise on every project and the development of new accounting procedures to ensure that all G2G financial transactions are correctly and promptly recorded.

The use of partner government systems in Afghanistan was not selected as a cost-saving measure, as implied in section “Other Matter” on page 12 of the report. This decision was made as a policy directive in order to strengthen partner government capacity to improve aid effectiveness and sustainability, which is critical to the Government of the Islamic Republic of Afghanistan (GIROA) stability, legitimacy and effectiveness over the long term. Because long-term sustainability will depend on the ability of Afghans to carry out development programs through their own country systems, USAID is committed to working with the Afghan Government to strengthen their capacity to manage on-budget activities.

Finally, for each activity implemented through direct G2G assistance, USAID conducts assessments of the relevant GIROA government partner and develops risk mitigation strategies based on the findings of the assessment. USAID also conducts follow on assessments of government partners to evaluate whether they have taken necessary agreed upon actions to mitigate risks. Specific safeguards, controls, terms, and conditions are applicable and are discrete to each activity including specific conditions precedent or negotiated conditions that must be satisfied before disbursement of any funds for such activity is provided; audit requirements and inspection rights; and agreed upon and prohibited uses of USAID funds under the activity.

## **COMMENTS ON OIG'S RECOMMENDATIONS**

***Recommendation 1.*** *Implement procedures to evaluate whether the Afghan Government has met its commitments, including audit requirements, before the Agency disburses funds to government-to-government projects.*

**USAID Comments:** The Mission concurs with recommendation 1.

The Mission is current on G2G audits and final reports have been issued for all audits listed in Table 1 of page 4 except the audit of MoPH, which is impending, and the Agriculture Development Fund (ADF), for which the report is with the OIG for final clearance (see *attachment 1 for status of audits*). We also note that a bill for collection was issued to the Independent Directorate of Local Governance on September 30, 2014 to recover the questioned costs resulting from the audit of the District Delivery Program.

**Actions Taken/Planned:** As mentioned in the report, USAID/Afghanistan has a system in place to track the status of G2G audits. An Audit Tracker is maintained for all audits planned for the year, which is continuously monitored and regularly updated with the status of key audit information and dates. Also, prior to disbursements being made, a secondary review of vouchers from ministries is performed by a Financial Analyst from the Mission's Office of Financial Management/Government-to-Government's (OFM/G2G) Section after the On-Budget Monitor reviews a voucher for administrative approval. The financial analyst, who supports the G2G project, and is therefore familiar with the project, reviews the voucher against the terms and conditions of the agreement, including audit requirements. The financial analyst also reviews the voucher for accuracy, follows up on any concerns raised by the On-Budget Monitor, and requests additional documentation from the Afghan Government entity when necessary—prior to forwarding the voucher for payment to OFM's Voucher Examination Section.

To document and thus further strengthen this process, the Mission has included in the On-Budget Monitor's Administrative Approval Checklists additional language (see *attachments 2a and 2b*) where the On-Budget Monitor certifies the status of the most recent audit of the G2G project. With this change, the On-Budget Monitors and the Financial Analysts are able to evaluate whether audit requirements have been met.

### **Closure Request:**

The Mission deems that corrective actions to address Recommendation No. 1 have been taken, and therefore requests OIG's acknowledgement of the management decision and requests concurrence to its closure.

***Recommendation 2.*** *Modify the audit requirements within its government-to-government project documents to describe the Agency-contracted audit process and communicate to these recipients that additional funding may not be disbursed until audits are completed*

**USAID Comments:** The Mission concurs with recommendation 2.

**Actions Taken/Planned:** USAID/Afghanistan will modify the Audits clause in its Implementation Letter (IL) templates to describe the Agency-contracted audit process, which will also indicate that additional funding may not be disbursed until audits are completed. This clause will be incorporated into the IL templates the Mission will be updating, per Recommendation 7. The Mission will also incorporate this into its on-budget assistance (OBA)

mission order that it is updating, per Recommendation 5. Additionally, USAID/Afghanistan will communicate the Agency-contracted audit process to Afghan Government entities during post award briefings for new awards with the representatives of relevant Afghan Government ministries, and when new audits come up for existing projects.

**Closure Request:**

Based on the actions planned as discussed above, the Mission requests OIG/Afghanistan's acknowledgment of the management decision on Recommendation 2.

**Recommendation 3.** *Issue a notice to relevant staff to remind them that OIG's country office should be notified each time the mission awards an audit of a government-to-government project.*

**USAID Comments:** The Mission concurs with recommendation 3.

USAID/Afghanistan's OFM/G2G Section is highly involved in the audit management of the Mission's G2G programs. The lack of coordination on audits with the OIG resulted from a lack of clarity and apparent misunderstanding of discussions with the OIG in late 2012. At the request of the OIG, OFM had agreed to take on additional responsibilities related to the management of audits due to inadequate staffing levels and capacity of the OIG. This agreement led to reduced communication and coordination with the OIG. The Mission did not overlook the OIG for the reason as stated on page 5 of the draft report. We request the statement "Mission officials said they overlooked OIG because audit oversight is a small percentage of the financial management analysts' responsibilities" be removed from the final report.

**Actions Taken:** Financial Analysts in the OFM/G2G Section play a key role in managing the audits of USAID/Afghanistan's G2G projects. OFM issued a notice to all Financial Analysts working on G2G projects on September 25, 2014 reminding them that OIG's country office should be informed during key stages of the audit process including informing them each time the Mission awards an audit of a G2G project (*see attachment 3*). The finding and recommendation was also discussed at the OFM/G2G weekly staff meeting held on September 25, 2014.

**Closure Request:**

The Mission deems that corrective actions to address Recommendation No. 3 have been completed and therefore requests OIG's acknowledgement of the management decision and requests concurrence to its closure.

**Recommendation 4.** *Implement procedures that require procurement officials to be included in the team responsible for individual government-to-government projects, as applicable.*

**USAID Comments:** The Mission concurs with recommendation 4.

**Actions Taken/Planned:** The Mission had already established on-budget project implementation teams, which include procurement officials. In May 2014, the Mission Director mandated the establishment of OBA teams which include specialists from the technical offices, Resident Legal Office (RLO), Office of Acquisition and Assistance (OAA), OFM, and Office of Program and Project Development (OPPD). The teams meet regularly to discuss significant on-budget design and implementation issues (*see attachment 4a for the composition of the teams for each on-budget project and attachment 4b calendar invite documenting the establishment of the OBA teams*).

In addition, USAID/Afghanistan is currently revising its on-budget mission order to further document the required participation of procurement officials in the OBA Project Teams and will also add primary responsibilities of core On-Budget Assistance Committee members (Controller, Resident Legal Officer, Program Officer, Contracting/Agreement Officer, etc.), as well as specify roles and responsibilities of OBA Project Teams, including specialists from the Technical Offices, OPPD, RLO, OFM and OAA.

**Closure Request:**

USAID/Afghanistan has already implemented procedures for procurement officials to be included on G2G project teams; therefore we request concurrence to close Recommendation 4.

***Recommendation 5.** Update its on-budget assistance mission order to reflect its current practices.*

**USAID Comments:** The Mission concurs with recommendation 5.

**Actions Taken/Planned:** The Mission Order 220.02 on Implementation of OBA Projects is currently being revised to reflect the recent revision of ADS Chapter 220 on Use and Strengthening of Reliable Partner Government Systems for Implementation of Direct Assistance (07/28/2014) as well as USAID/Afghanistan's current on-budget practices.

**Target Closure Date: December 31, 2014.**

***Recommendation 6.** Schedule and document periodic training courses for officials designated to monitor on-budget assistance.*

**USAID Comments:** The Mission concurs with recommendation 6.

**Actions Taken/Planned:** The Mission has already developed an On-Budget assistance training course and the first session was conducted on July 16-17, 2014 and will be repeated at the beginning of December 2014 (see attachments 5a for G2G-OBA Training Agenda, 5b for G2G-OBA Training Participants, and 5c for the list of G2G Training Materials located on SharePoint). Starting 2015, the on-budget training course will be conducted twice a calendar year. The training will be mandatory for On-Budget Monitors and attendance will be documented at the trainings. The revised on-budget mission order will also reflect this requirement.

In addition, On-Budget Monitors are encouraged to attend regular (bi-weekly) on-budget assistance staff meetings and complete on-line training courses available under the USAID Local Solutions Initiative: Investing in Partner Governments <http://forward.inside.usaid.gov/content/training>.

**Closure Request:**

The Mission deems that corrective actions to address Recommendation No. 6 have been completed and therefore requests OIG's acknowledgement of the management decision and requests concurrence to its closure.

***Recommendation 7.** Develop or update templates for its government-to-government implementation letters to include more clearly defined expectations, based on the revised Automated Directives System (ADS) 220 and lessons learned.*



**USAID Comments:** The Mission concurs with recommendation 7.

**Actions Taken/Planned:** USAID/Afghanistan already has Mission specific Implementation Letters (ILs) templates that it uses for its G2G projects. The revised ADS Chapter 220 includes IL templates and the Mission plans to update its templates by building upon these templates. The Mission also plans to incorporate additional information specific to the Mission and will include more clearly defined expectations based on the revised ADS and lessons learned.

**Target Closure Date:** December 31, 2014.

**Recommendation 8.** *Implement a procedure to confirm that Afghan Government officials responsible for implementing government-to-government projects understand the expectations described within project documents.*

**USAID Comments:** The Mission concurs with recommendation 8.

**Actions Taken/Planned:** In order to firmly establish a partnership approach to OBA implementation, a post-award orientation meeting will be organized between USAID and Afghan Government officials responsible for implementing a G2G project promptly after the signing of the Bilateral Project Agreement (BPA) or initial IL. This meeting will enable USAID and Afghan Government personnel to achieve a clear and mutual understanding of all bilateral agreements or IL requirements and will help identify and resolve potential problems. This post-award orientation requirement will also be included in the revised on-budget assistance mission order.

**Target Closure Date:** December 31, 2014.

**Recommendation 9.** *Perform an evaluation of its newly implemented process to verify that government-to-government transactions are recorded correctly and promptly, make necessary adjustments, and document the final results.*

**USAID Comments:** The Mission concurs with recommendation 9.

**Actions Taken:** OFM conducted a review of all ILs issued between April 1, 2014 and September 15, 2014. Of a total of 14 ILs reviewed, one IL required OFM to sub-commit and sub-obligate funds into its accounting system. This IL was recorded in Phoenix in a timely manner. The result of the evaluation of the process is documented in *Attachment 6*.

The new procedures developed by the Mission have ensured that all G2G financial transactions are correctly and promptly recorded in Phoenix.

**Closure Request:**

The Mission deems that final actions to address Recommendation No. 9 have been completed and therefore requests OIG's concurrence to its closure.

## **USAID/Afghanistan comments on “Other Matter: USAID Established Separate Project Units”**

USAID/Afghanistan is aware that the Agency’s policy on Use and Strengthening of Reliable Partner Government Systems for Implementation of Direct Assistance (ADS Chapter 220) discourages Missions from negotiating or funding the establishment of separate project management/implementation units (a.k.a. PMUs and PIUs). It is USAID policy to use existing partner country government entities and institutions in order to strengthen those already established by the partner country government.

Afghanistan still relies heavily on outside capacity to deliver services. Several decades of war and civil strife had a highly destructive impact on the civil service and human capital. Since 2008, public administration reforms in Afghanistan have improved the legal, regulatory, and policy framework for government operations; and introduced civil service pay and grading reform and merit-based recruitment at both the national and sub-national levels. However, these reforms have not addressed the challenge posed by the shortage of an educated and experienced civil service workforce. With extensive support from donors, through ongoing technical assistance and capacity-building, the GIRoA’s civil service has developed a range of critical technical skills and capabilities. However, challenges remain in solidifying these gains and further developing GIRoA’s technical, financial, and management capacity.

USAID G2G assistance agreements continue to include, as a risk mitigation measure, third party contractors and advisors on technical, financial, and management capacities to build and transfer civil service capabilities in these areas and to fill any gaps in skills. In addition, ministries utilize numerous non-civil servant staff that are supported by the international community to provide technical, financial, and management advice through numerous PMUs and PIUs or ‘second civil service’.

The key to building long-term GIRoA capacity is to transition donor support in a more coordinated and strategic manner to Afghan government institutions. Such transitions will not be easy in the face of strong vested interests among beneficiaries, and will require government commitment to reform as well as concerted donor effort. Institutional reforms take time. According to the World Bank, even in fast moving countries, bureaucratic reforms to a basic level have taken (on average) 20 years<sup>14</sup>.

USAID/Afghanistan is reviewing its capacity building approach and meeting with other donors to streamline our efforts in order to ensure greater capacity transfer. Future USAID/Afghanistan activities will endeavor to shift the balance from greater capacity support to capacity building.

### **Attachments:**

1. Current Status of G2G Audits
- 2a. OBM’s Administrative Approval Checklist – Performance Based
- 2b. OBM’s Administrative Approval Checklist – Cost Reimbursement
3. OFM Notice to G2G staff

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<sup>14</sup> Capacity Building for Results Facility Project Paper, World Bank, December 6, 2011, p. 11.

- 4a. List of On-Budget Assistance Team Members
- 4b. Calendar Invite – OBA Teams
- 5a. G2G-OBA Training Agenda July 16-17, 2014
- 5b. G2G-OBA Training Participants July 16-17, 2014
- 5c. G2G-OBA Training Materials located in SharePoint (screen print from SharePoint)
- 6. OFM Review of IL's for Posting in Phoenix

Table 3. Completed and Ongoing Projects October 1, 2011, to January 31, 2014

Project	Details	
Partnership Contracts for Health Services Program	Implementing Ministry	Ministry of Public Health
	Dates	7/20/2008 – 1/31/2015
	Description	This program uses nongovernmental organizations to implement basic health services and essential hospital programs.
	Status	Ongoing
	Funding Mechanism	Host country contract
	Total Estimated Cost	\$236.5 million
	Subobligations (Life of Project)	\$190.3 million
	Disbursements (Life of Project)	\$157.7 million
Basic Education, Literacy, and Technical-Vocational Education and Training Project - Textbook Procurement Activity	Implementing Ministry	Ministry of Education
	Dates	11/16/2011 – 12/31/2014
	Description	Planned project activities include the procurement and distribution of textbooks.
	Status	Ongoing
	Funding Mechanism	Cost reimbursement
	Total Estimated Cost	\$27 million
	Subobligations (Life of Project)	\$27 million
	Disbursements (Life of Project)	\$18.8 million
Cash Transfer Program Assistance for Civil Service Reform	Implementing Entity	Independent Administrative Reform and Civil Service Commission
	Dates	10/31/2011 – 2/28/2014
	Description	Project funds are to meet the unfunded operating and administrative expenses of the Independent Administrative Reform and Civil Service Commission.
	Status	Ongoing
	Funding Mechanism	Milestone/benchmark
	Total Estimated Cost	\$15 million
	Subobligations (Life of Project)	\$15 million
	Disbursements (Life of Project)	\$13 million
Sheberghan Gas Development Project	Implementing Ministry	Ministry of Mines
	Dates	5/26/2014 – 4/30/2015
	Description	Planned project activities include the rehabilitation of two gas wells, drilling of up to two additional wells, and the construction of a gas processing plant.
	Status	Ongoing
	Funding Mechanism	Cost reimbursement
	Total Estimated Cost	\$90 million
	Subobligations (Life of Project)	\$30 million
	Disbursements (Life of Project)	\$0

Project	Details	
Agriculture Development Fund	Implementing Ministry	Ministry of Agriculture, Irrigation and Livestock
	Dates	7/18/2010 – 12/31/2014
	Description	The goal is to facilitate increased lending to the agricultural sector.
	Status	Ongoing
	Funding Mechanism	Cash transfer
	Total Estimated Cost	\$74.4 million
	Subobligations (Life of Project)	\$54 million
	Disbursements (Life of Project)	\$29 million
Cash Transfer Assistance to Support Civilian Technical Assistance Program	Implementing Ministry	Ministry of Finance
	Dates	9/30/2009 – 9/30/2014
	Description	The project recruits, hires, places, and supports technical advisors in various government institutions.
	Status	Ongoing
	Funding Mechanism	Cash transfer
	Total Estimated Cost	\$36.3 million
	Subobligations (Life of Project)	\$36.3 million
	Disbursements (Life of Project)	\$28.8 million
Power Transmission Expansion and Connectivity Project	Implementing Entity	Da Afghanistan Breshna Sherkat
	Dates	12/5/2012 – 12/31/2016
	Description	The objective of the project is to expand and improve Afghanistan's electric transmission system.
	Status	Ongoing
	Funding Mechanism	Cost reimbursement
	Total Estimated Cost	\$342 million
	Subobligations (Life of Project)	\$263.3 million
	Disbursements (Life of Project)	\$0
Kajaki Unit 2 Project	Implementing Entity	Da Afghanistan Breshna Sherkat
	Dates	4/30/2013 – 12/31/2015
	Description	Project activities include the installation of Turbine Generator Unit 2 at the Kajaki Dam Hydropower Plant and hiring a construction contractor to help manage the project.
	Status	Ongoing
	Funding Mechanism	Cost reimbursement
	Total Estimated Cost	\$75 million
	Subobligations (Life of Project)	\$75 million
	Disbursements (Life of Project)	\$0
Basic Education, Literacy, and Technical-Vocational	Implementing Ministries	Ministry of Finance; Ministry of Education
	Dates	8/25/2013 – 8/24/2017

<b>Project</b>	<b>Details</b>	
Education and Training, Community-Based Education Project	Description	The project aims to improve children's access to education.
	Status	Ongoing
	Funding Mechanism	Milestone/benchmark
	Total Estimated Cost	\$56 million
	Subobligations (Life of Project)	\$16.3 million
	Disbursements (Life of Project)	\$0
Afghanistan Workforce Development Project	Implementing Ministry	Ministry of Education
	Dates	7/31/2013 – 7/31/2017
	Description	This objective is to build the capacity of the providers of technical and vocational programs, and provide training.
	Status	Ongoing
	Funding Mechanism	Milestone/benchmark
	Total Estimated Cost	\$30 million
	Subobligations (Life of Project)	\$30 million
	Disbursements (Life of Project)	\$0
E-Government Resource Center-II Project	Implementing Ministry	Ministry of Communication and Information Technology
	Dates	8/28/2013 – 6/1/2016
	Description	This project will establish a center of excellence for e-government services in Afghanistan.
	Status	Ongoing
	Funding Mechanism	Milestone/benchmark
	Total Estimated Cost	\$3.9 million
	Subobligations (Life of Project)	\$3.9 million
	Disbursements (Life of Project)	\$0
District Delivery Program	Implementing Entity	Independent Directorate of Local Governance
	Dates	8/16/2010 – 2/5/2013
	Description	This project provided resources to identify and hire public officials, mobilize officials to fill positions in approved districts, and facilitate public services.
	Status	Suspended effective 3/19/2012
	Funding Mechanism	Cash advance
	Total Estimated Cost	\$4.9 million
	Subobligations (Life of Project)	\$4.9 million
	Disbursements (Life of Project)	\$2.3 million
Regional Airports Project	Implementing Ministry	Ministry of Transport and Civil Aviation
	Dates	1/9/2011 – 7/31/2012

Project	Details	
	Description	This project assisted with paving and other improvements at airports in Faizabad and Maimana.
	Status	Completed
	Funding Mechanism	Cash advance
	Total Estimated Cost	\$6 million
	Subobligations (Life of Project)	\$6 million
	Disbursements (Life of Project)	\$5.6 million

**Table 4. USAID/Afghanistan’s Financial Management Controls for Government-to-Government Assistance, as of January 31, 2014**

Control	Details
<p>USAID/Afghanistan and the Afghan Government agree on the conditions precedent and ongoing commitments under which funds will be disbursed to a project.</p>	<p><b>Description</b></p> <p>As part of this control, the USAID mission director, the Minister of Finance, and a high-level official from the implementing entity sign project documents, which should include details such as the amounts that USAID will disburse, what documents need to be provided to USAID to request the disbursement of funds, reporting requirements for the implementing entity, and audit requirements. These details should vary based on the implementing entity’s assessed risk and the funding mechanism USAID selected during the project design phase.</p>
	<p><b>Improvements (10/1/2011 – 1/31/2014)</b></p> <p>The requirements laid out in project documents are now based on an AUPCS, which provide mission director approval to implement assistance using a particular Afghan entity, given the risks identified for planned projects and the officials’ strategy to mitigate those risks. Such documents were not on file for the Independent Directorate of Local Governance, the Ministry of Transport and Civil Aviation, and the Independent Administrative Reform and Civil Service Commission. The projects implemented by these Afghan entities began in August 2010, January 2011, and October 2011, respectively. AUPCSs for later projects, such as the Power Transmission Expansion and Connectivity Project, implemented by Da Afghanistan Breshna Sherkat beginning in December 2012, were on file.</p> <p>Starting in October 2011, USAID/Afghanistan funded its new government-to-government projects using the cost reimbursement or milestone/benchmark methods. Under the first (used for four ongoing projects), the mission reimburses the Afghan Government the costs it incurred in implementing a project. Under the milestone/benchmark method (used for four ongoing projects), the mission disburses a pre-specified amount to the government once an agreed-upon milestone or benchmark is reached. For example, USAID may agree to disburse \$50,000 to a project upon completion of an annual work plan. Earlier government-to-government projects used the cash advance, cash transfer, and host country contracting* funding mechanisms. These were riskier because funds were disbursed before activities were implemented, and it can become difficult to recover funds that USAID later finds were not used as intended.</p>
	<p><b>Weaknesses (as of 1/31/2014)</b></p> <p>USAID/Afghanistan did not describe requirements clearly within project documents. See finding beginning at page 8.</p>
<p>Only authorized individuals have system access to obligate funds.</p>	<p><b>Description</b></p> <p>Only authorized individuals should have system access to obligate funds.</p>
	<p><b>Improvements (10/1/2011 – 1/31/2014)</b></p> <p>Access to the resources needed to perform the mission’s quarterly review of system access was temporarily lost sometime after the June 2013 review. As a result, we identified several users who had access to the system, even though they no longer worked for USAID/Afghanistan. However, the users did not have access to obligate funds, and the access needed to perform the mission’s quarterly review had already been</p>



Control	Details	
		regained.
	Weaknesses (as of 1/31/2014)	None identified
USAID/Afghanistan subobligates funds to a project in accordance with an implementation letter.	Description	By design, USAID/Afghanistan's Office of Financial Management initiates a subobligation in the Agency's accounting system only after funds have been subcommitted and an obligating document—usually an implementation letter signed by the USAID mission director, the Minister of Finance, and high-level official from the implementing entity—is provided. This document should specify the amount to be subobligated, as well as the funding source.
	Improvements (10/1/2011 – 1/31/2014)	None identified
	Weaknesses (as of 1/31/2014)	Breakdowns in this control had not been addressed. (See finding beginning at page 10.)
USAID provides ongoing monitoring, technical assistance, and capacity building to the implementing entity.	Description	The monitoring, technical assistance, and capacity-building activities provided for each project vary based on factors such as the results of an independent risk assessment, the funding mechanism employed, and USAID's previous experience working with the implementing entity. For example, the mission may require that its officials are substantially involved in significant procurement actions, or the mission may appoint a nongovernmental organization to help manage the project.
	Improvements (10/1/2011 – 1/31/2014)	<p>The mission director had not appointed on-budget monitors for the District Delivery Program (August 2010 to February 2013) or the Regional Airports Project (January 2011 to July 2012). The mission director now appoints an on-budget monitor for all new government-to-government projects, and all ongoing projects in our scope had one. This monitor is responsible for facilitating communications between the governments.</p> <p>The mission's OBA process road map, last updated in September 2013, now states that for projects implemented under the reimbursement mechanism, "Upon execution of any contract by the relevant ministry under the project, a copy of the entire signed contract will be provided to the USAID Office of Financial Management." This did not occur previously. For example, in July 2013, mission officials performed a site visit at a Ministry of Education warehouse to confirm that USAID-funded textbooks purchased as part of a textbook procurement activity had arrived and were being stored properly. During the visit, mission officials saw that USAID funds had also been used to purchase the shipping containers in which the textbooks were being stored, inflating the cost of the textbooks. Had a review of the contract been performed initially, these costs could have been discussed before they were incurred.</p>
	Weaknesses (as of 1/31/2014)	Mission staff were confused about their responsibilities (see finding starting at page 7), and the mission's involvement in Afghan procurements was inadequate (see finding starting at page 7).
USAID/Afghanistan disburses funds only if the agreed-	Description	Before USAID/Afghanistan disburses funds to a government-to-government project, officials first check that the conditions precedent has been met. Generally, this includes two items:

Control	Details
upon conditions precedent and ongoing commitments have been met, and are supported by the required documents.	the establishment of a separate project bank account and evidence that the project is included in the Afghan Government's budget. Depending on the funding mechanism used, the mission would also confirm the completion of benchmarks, validity of costs claimed, etc. Responsibility for these checks is shared between the technical office and the Office of Financial Management.
	<p>As discussed previously, USAID/Afghanistan has moved away from using host country contracting and cash advances for its government-to-government projects—a positive move because the disbursement requirements are less stringent. Only one ongoing host country contract remains in the mission's government-to-government portfolio.<sup>†</sup></p> <p>Until recently, disbursements to projects funded as host country contracts or cash advances were approved when a technical official had signed the administrative approval form and checklist. This form required the reviewing official to list the methods used to determine that a disbursement should be made (e.g., site visits performed or meetings with ministry counterparts). We observed several disbursements approved without adequate detail in this section, but noted that the implementation of a new documentation system has encouraged the technical officials to give information that is more precise.</p> <p>In December 2011 a \$500,000 disbursement to the Independent Administrative Reform and Civil Service Commission was disbursed on the sole approval of the technical office. As controls were strengthened, the process was updated to require later disbursements to be approved by the mission director, on the recommendation of multiple offices.</p>
	<p>Improvements (10/1/2011 – 1/31/2014)</p> <p>Weaknesses (as of 1/31/2014)</p>
Only authorized individuals have system access to disburse funds.	<p>Description</p> <p>Only authorized individuals should have system access to disburse funds.</p>
	<p>Improvements (10/1/2011 – 1/31/2014)</p> <p>Access to the resources needed to perform the mission's quarterly review of system access was temporarily lost sometime after the June 2013 review. As a result, we identified several users who retained access to the system even though they no longer worked for USAID/Afghanistan. However, the identified users did not have access to disburse funds, and the access need to perform the mission's quarterly review had already been regained.</p>
	<p>Weaknesses (as of 1/31/2014):</p> <p>None identified.</p>
USAID/Afghanistan disburses funds to a project-specific account controlled by the Afghan Ministry of Finance, and it	<p>Description</p> <p>Each project is required to establish a separate bank account. An official from the Office of Financial Management reviews account activity each month to justify the balance, reconcile the funds released by USAID, and identify any funds disbursed by USAID and not yet received.</p>
	<p>Improvements (10/1/2011 –</p> <p>None identified. We found this control was designed and operating effectively.</p>

Control	Details	
reviews that account on a monthly basis.	1/31/2014)	
	Weaknesses (as of 1/31/2014)	None identified. We found this control was designed and operating effectively.
Funds disbursed to the implementing entity are audited.	Description	Government-to-government projects are audited any time they receive more than \$300,000 in a fiscal year. An independent audit firm typically completes these audits; however, OIG issues the final audit report, which has recommendations to the mission based on the results. These recommendations may address the recovery of misused funds or unsupported expenditures, funds to be put to better use, or the resolution of compliance and internal control weaknesses. Mission officials then have 6 months to develop a plan that addresses the OIG recommendations, generally within 1 year.
	Improvements (10/1/2011 – 1/31/2014)	Many of the required audits were initiated during the review period, though not all were completed.
	Weaknesses (as of 1/31/2014)	USAID/Afghanistan did not ensure that audit requirements were met. (See finding beginning on page 4.)

\* Agency guidance for host country contracting is found in ADS 305. While not traditionally considered a government-to-government mechanism, we have included it in the scope of our review because the mission includes its host country contracts in its calculation for determining progress toward the goal of providing 50 percent of its development aid to Afghanistan directly to the Afghan Government.

† The Partnership Contracts for Health Program continues to be implemented through host country contracting. We did not expand on the risks related to use of this mechanism because the program has been audited already by SIGAR and OIG.

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