AFGHANISTAN: IDENTIFYING AND ADDRESSING WASTEFUL U.S. GOVERNMENT SPENDING

HEARING

BEFORE THE

SUBCOMMITTEE ON NATIONAL SECURITY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

APRIL 3, 2014

Serial No. 113–108

Printed for the use of the Committee on Oversight and Government Reform

Available via the World Wide Web: http://www.fdsys.gov
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

88–070 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
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AFGHANISTAN: IDENTIFYING AND ADDRESSING WASTEFUL U.S. GOVERNMENT SPENDING

Thursday, April 3, 2014,

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL SECURITY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:00 a.m. in room 2247, Rayburn House Office Building, the Honorable Jason Chaffetz [chairman of the subcommittee], presiding.

Present: Representatives Chaffetz, Duncan, Mica, Woodall, Tierney, Maloney, Welch, Kelly.

Staff Present: Andy Rezendes, Majority Counsel; Melissa Beaumont, Majority Staff Assistant; Will Boyington, Majority Deputy Press Secretary; Adam P. Fromm, Majority Director of Member Services and Committee Operations; Linda Good, Majority Chief Clerk; Tyler Grimm, Majority Senior Professional Staff Member; Mitchell S. Kominsky, Majority Counsel; Laura L. Rush, Majority Deputy Chief Clerk; Sang H. Yi, Majority Professional Staff Member; Jaron Bourke, Minority Director of Administration; Devon Hill, Minority Research Assistant; Jennifer Hoffman, Minority Communications Director; Peter Kenny, Minority Counsel; Chris Knauer, Minority Senior Investigator; Julia Krieger, Minority New Media Press Secretary.

Mr. CHAFFETZ. This committee will come to order.

I would like to begin this hearing by stating the Oversight and Government Reform Committee's mission statement. We exist to secure two fundamental principles. First, Americans have the right to know the money Washington takes from them is well spent; and second, Americans deserve an efficient and effective government that works for them.

Our duty on the Oversight and Government Reform Committee is to protect these rights. Our solemn responsibility is to hold government accountable to taxpayers because taxpayers have a right to know what they get from their government.

We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy. This is the mission of the Oversight and Government Reform Committee.

I want to welcome you all here. This is a very important topic. We have entitled this hearing Afghanistan: Identifying and Addressing Wasteful U.S. Government Spending.

I would also like to welcome Ranking Member Tierney of Massachusetts and members of the audience and thank you for being here today. I know Mr. Tierney in particular has a passion for these issues and I appreciate working with him and his staff on this topic.

Today's proceedings continue the subcommittee's series of hearings designed to assess the U.S. reconstruction efforts in Afghanistan. Since 2002, the United States has directed over $102 billion toward relief and reconstruction efforts in Afghanistan. Let me say that again: $102 billion in the reconstruction effort. This does not count the war effort. This is the reconstruction effort.

Afghanistan is by far the leading recipient of U.S. economic and military assistance. Meanwhile, the president intends to withdraw U.S. troops from Afghanistan, known as one of the most corrupt countries on the face of the planet.

On the good side, I have recently read that there were no deaths in Afghanistan for a one-month period, and for that, we are very grateful. I think it is also appropriate that at this time we pause for a moment and thank the men and women who serve in our military, who serve in USAID and other agencies who have put their lives on the line overseas. And certainly our hearts are stricken and our prayers are with those at Fort Hood as they deal with a domestic issue here. I can't even imagine what the families are going through, but I know our hearts and prayers are with them. God bless them and Godspeed.

That said, while the level of U.S. reconstruction funding has escalated every year since 2007, the areas in Afghanistan that U.S. oversight agencies are able to access in order to conduct oversight continue to shrink to small enclaves. As a result, we need to carefully examine whether the United States Government will be spending billions of dollars on this effort effectively, equipped with sufficient oversight mechanisms.

Of the overall reconstruction effort, USAID has appropriated roughly $17 billion. Today I would like to hear from USAID how, $17 billion later, the agency's efforts have improved the environment in Afghanistan. I have visited Afghanistan several times and have serious concerns about the region.

For example, USAID will likely spend $345 million on the Kandahar-Helmand Power Program, designed to improve the Kajaki Dam. The program was supposed to be completed in 2005, yet a decade later and hundreds of millions of dollars dedicated to the program, USAID's work on the enhanced Kajaki Dam is still plagued by sufficient problems. Even now there appear to be more challenges than there are results. This represents the epitome of the issue we face in Afghanistan reconstruction efforts and should not be acceptable to the Administration.

Given these challenges, this subcommittee has been, in bipartisan fashion, working diligently to monitor the progress, challenges and successes of our reconstruction efforts. Specifically, the subcommittee has been looking at how the government is overseeing billions of dollars being given to Afghanistan. We have examined many cases where lack of transparency and accountability exist for U.S. taxpayer money.

The subcommittee has investigated petroleum oil lubricants provided to the Afghan National Army by the United States, totaling nearly half a billion dollars. Meanwhile, the Defense Department failed to properly maintain receipts for these transactions. We have also investigated Dawood Hospital, where the United States provided more than $150 million in medical supplies in just an 18-month period. Unfortunately, theft, mismanagement and human suffering became rampant at Dawood.

Oversight efforts are more important than ever as the United States has promised to give even more direct assistance to Afghanistan. Based on this, I would like to hear how the U.S. Government maintains visibility and control over taxpayer funding once the money goes to Afghanistan and when it is distributed through the Afghan government.

This all leads to a greater need for improved accountability. The United States and other international donors have funded about 92 percent of Afghanistan's total public expenditures. Of that 92 percent, the United States has contributed roughly 62 percent. This means that the United States has made a substantial investment in Afghanistan and we need to make sure the investment has proper oversight and that this is a wise expenditures of taxpayer dollars.

I commend USAID for working diligently on the Afghan reconstruction efforts and SIGAR, the Special Inspector General for Afghan Reconstruction, for working to increase accountability for that funding. I very much appreciate both of your hard work on this issue. We all recognize it is a very difficult problem.

Today I would like to discuss some of SIGAR's recommendations to mitigate risks to U.S. funding and learn the status of whether those suggestions are being implemented and best practices are being implemented to enhance overall oversight in Afghanistan.

Additionally, I also have some concerns about the current relationship between USAID and the Special Inspector General's office. It has been brought to my attention there are serious policy disagreements concerning the examination of documents and release of documents, prompted by FOIA requests, which is a subject matter over which the committee holds jurisdiction.

To the extent of the law, taking account of certain sensitivities on a case by case basis, I support the need for maximum transparency and accountability required in order to provide oversight.

I particularly want to thank Mr. Sampler and Mr. Sopko for being here today. These great patriots who care deeply about their Nation work hard in their respective fields. I have great personal respect for each of these gentlemen, and I appreciate them joining us here today.

Now I would like to recognize the ranking member, the gentleman from Massachusetts, Mr. Tierney.

Mr. TIERNEY. Thank you, Mr. Chairman. I want to thank both our witnesses for appearing here today. This is our third subcommittee hearing in this Congress on foreign assistance in Afghanistan. I want to applaud the chairman for his persistence and diligence of attention to the topic.

This subcommittee has a long history of focusing on waste, fraud and abuse of taxpayer funds in Iraq and Afghanistan, including my tenure as chairman of the subcommittee when we had the investigation into the host nation trucking contract, finding the vast protection networks supported by insurgents and warlords, investigations into fuel contracts and then investigations started and continued with respect to the food contracts and much more.

Today's hearing will focus on oversight and management of the U.S. Agency for International Development's projects and programs in Afghanistan. At a full committee hearing on direct assistance nearly one year, I asked Special Inspector General, Mr. Sopko, who is here today, about a set of documents that he indicated raise significant concerns about the ability of the Afghan government to manage and account for funds that the United States planned to provide directly to it.

The documents at issue were USAID assessments of 13 Afghan ministries, public financial management systems performed by outside auditors. I asked whether Inspector General Sopko would be willing to provide these assessments to the committee and he told us that he had been instructed by USAID not to provide them to Congress due to their markings as sensitive but unclassified. Inspector General Sopko testified that when he asked for an explanation for why these documents were marked sensitive but unclassified, he was told by USAID officials that the materials were "mainly embarrassing."

Mr. Chairman, based on my concerns at that time, I asked for the committee to follow up on this matter. And consequently, we supported your request for the agency's inspector general to provide us with a set of unredacted documents. Shortly after that, USAID in coordination with the State Department did provide the 13 external assessments of Afghan ministries to the committee. In providing those documents in a redacted form, USAID indicated in an April 30th, 2013 letter that the "public disclosure of personally identifiable information could threaten the lives and livelihoods of people named in those asesssments or their associates." It also cited foreign government information such as "information that could be misused to exploit, currently or otherwise, Federal abilities identified in these assessments."

USAID also claimed that the release of the information in totality would have a damaging effect on the United States government relations with the Afghan government. USAID also offered to provide the committee staff with the opportunity to review full, complete, unredacted copies of the 13 ministerial assessments at USAID's offices, as the agency had previously provided to the committee for other types of assessments.

This January, SIGAR released a report reviewing USAID's external as well as USAID's internal assessments of the Aghan ministries' capacity to manage U.S. funds planned for direct assistance. This report found that none of the 16 Afghan ministries examined by outside auditors were able to manage U.S. funds and that the auditors issued nearly 700 recommendations for corrective action. According to the report, USAID then conducted its own risk reviews of 7 of the 13 Afghan ministries and made 333 recommendations on how to mitigate the risks to USAID funds. Yet the report goes on to state that USAID approved direct assistance at all seven

Afghan ministries, while only requiring 24 of the 333 recommendations to be implemented.

While the report acknowledges that it did not examine the effectiveness of the USAID safe guides that are already in place, nor did it determine whether any fraud had occurred, I look forward to a thorough discussion today of these decisions, given the identified risks.

Just this week the committee received copies of the internal risk reviews of the seven Afghan ministries, documents critical to the USAID's decision to approve direct assistance. As a preliminary matter, although SIGAR appears to have redacted some information in these reviews, I have asked the chairman that before these documents are made part of any public record, a proper review by this committee can be conducted to ensure that we are not endangering the lives of anyone. And since SIGAR offered USAID the opportunity to comment on proposed redactions or other agency documents, it only seems fair to do so in this case as well.

Those documents lay bare the substantial, if not seemingly insurmountable risks in providing U.S. funds directly to the Afghan government. For instance, USAID's internal risk review of the Afghan Ministry of Public Health found that the risk of diverting government resources for unintended purposes exists. Waste, fraud and abuse may go undetected as critical, the worst designation based on the likelihood and impact of the risks. Also listed as critical was manipulation of accounting information after approval and posting to hide illegal actions.

It appears that USAID's risk reviews and decision memos approving direct assistance also include a number of risk mitigation recommendations. I look forward to learning more about not only the true extent of the risks to taxpayer funding, but whether and how USAID can maintain current policy and manage to oversee these programs. I think that is the crux, how are we going to manage and oversee these programs, what is the risk to taxpayer funding, and whether or not the risks outweigh any good that we perceive might come from those programs.

Thank you.

Mr. CHAFFETZ. I thank the gentleman.

By mutual agreement, we are going to hold back inserting into the record some of those documents that the gentleman from Massachusetts mentioned. It is our intention of the committee to make those public and to insert those into the record. But we want to give ample time for parties on both sides of the aisle to review those documents and make sure that there is no sensitive information that would be released that would put somebody's individual life in jeopardy. Once we have completed that, again, it is the intention of the subcommittee to release those documents.

Now I would like to recognize the gentleman from Florida, Mr. Mica.

Mr. MICA. Thank you again, Mr. Chairman, thank you to our ranking member, for holding this important oversight subcommittee meeting. This is one of the most important responsibilities of Congress, is, in fact, going after waste, fraud and abuse. I am going to ask, and I just want to give a heads-up to Mr. Sampler and maybe Mr. Sopko, during the last hearing I had requested, and

I guess it was March 13th, if you were aware of any Afghanis who had been prosecuted for missing AID funds. To my knowledge, I have not received it. My key staffer has not received it. Maybe we have gotten information with that list. But I would like that list. If you have people working with you today, I want you to find the list, get us that information.

I am interested in who we have gone after and who we have prosecuted or those folks that need to be held accountable, are held accountable. I think that is an important thing that when I go back to the district, when they find that our Afghani partners are ripping us off, and this appears to be a bottomless pit for the taxpayers, and pouring money into waste, fraud and abuse on various Afghan projects, and those who have abused their responsibility, and again are not held accountable, that is the wrong thing.

So I will be asking that and I want that information. Hopefully some of that information that we could submit in the record here today. And again, I thank you, Mr. Chairman, Mr. Chaffetz, for holding this hearing. We need to continue to do that and hold people accountable to go after the waste, fraud and abuse in this important area. Thank you.

Mr. CHAFFETZ. I thank the gentleman.

I remind members that they have seven days to submit opening statements for the record.

I would now like to recognize our panel. Mr. Donald Sampler is the assistant to the Administrator of the Office of Afghan and Pakistan Affairs at the U.S. Agency for International Development. Mr. John Sopko is the Special Inspector General for Afghan Reconstruction.

Pursuant to committee rules, all witnesses are sworn before they testify. If you would both please rise and raise your right hand.

Do you solemnly swear or affirm that the testimony you are about to give will be the truth, the whole truth and nothing but the truth?

[Witnesses respond in the affirmative.]

Mr. CHAFFETZ. Thank you. Let the record reflect that both the witnesses answered in the affirmative.

Again, we appreciate both of you gentlemen being here. Your full statements will be inserted into the record. But we will allow you time now to give your verbal statements. We will be fairly generous on the time.

Mr. Sampler, we will start with you.

WITNESS STATEMENTS

STATEMENT OF DONALD L. SAMPLER

Mr. SAMPLER. Thank you, Chairman Chaffetz, Ranking Member Tierney, members of the subcommittee. I appreciate the opportunity to testify before you today and to talk about the work of USAID in Afghanistan, and specifically the oversight measures we implement to safeguard taxpayer funds while we support U.S. national security interests in that country.

I am honored to represent the 183 American citizens as well as third country and Afghan employees of USAID in Afghanistan. They implement our programs there under often very difficult and personally trying conditions, apart from their families and their homes.

On Saturday, the people of Afghanistan will go to the polls to elect a new president. A successful election will be a landmark event in Afghanistan. It will be the first transition from one democratically-elected president to another. The men and women serving the U.S. government in Afghanistan, including those of USAID, are working harder than ever and often at significant personal risk, to support their Afghan colleagues in ensuring the elections are inclusive, fair and transparent.

I appeared before this subcommittee just under a month ago to discuss USAID's foreign assistance program in the context of the troop withdrawal. So I will keep my opening remarks very short and focus on the subcommittee's primary topic today: oversight and accountability for U.S. taxpayer funds.

USAID takes our responsibility in this regard very seriously. We work with our auditors to design very rigorous oversight and accountability measures for our programs in Afghanistan. Afghanistan is constantly changing and is constantly challenging. We have learned and implemented hard lessons from the 12 years that we have spent in that country. I welcome the opportunity to talk about that during today's hearing.

In that regard, though, I feel like I need to correct the record with respect to a USA Today story that came out overnight. The story reports that USAID deliberately withheld audits from Congress showing that the Afghan government has failed to monitor the potential risks of contracting with suppliers who may have ties with terrorist organizations. That report is false.

The story also reports that correspondence from the Special Inspector General's general counsel suggests that we covered up information showing some Afghan ministries lack controls for cash and can't track what they own. The allegation that we covered up information coming to Congress is false. And I find it somewhat offensive.

As you know, Mr. Chairman, USAID provided to you and your staff copies of these assessments almost a year ago. This was after the request was made at a hearing. And as per the agreement, with these types of documents we offered you and your staff full access to unredacted versions of the document while providing copies in hard copy that had been lightly redacted. As you noted, these redactions blacked out the names of people whose lives could be put at risk by their exposure.

Unfortunately, the USA Today story has now made public security vulnerabilities about one of the ministries, in fact, that we were concerned about. It is a ministry we chose not to work with ultimately.

I have also been very direct in addressing publicly the fact that USAID does face challenges in programming direct assistance with Afghan ministries. This is hard, this is challenging for us. It has been and it will be.

But we also employ rigorous risk reduction and risk mitigation measures. Again, I look froward to a chance to have a discussion about how those work. I have addressed this in writing prior to the hearings, in December 2013, before both House and Senate committees. And those statements are available for the record.

In conclusion, my written testimony includes details of the remarkable progress made in Afghanistan. I will say here only that the United Nations has identified Afghanistan as among the countries participating in the human development index of having made the most progress in the past decade of any country in the world on that index.

Mr. Chairman, USAID is always mindful of the enormous sacrifices made by Americans, by our allies and by our Afghan partners, to build and secure Afghanistan. We fully understand the need for constant vigilance, particularly during this delicate period of transition. Since my first visit to Afghanistan, and as recently as my visit there last week, I have served with the military in Afghanistan, the Department of State, the United Nations, a private international NGO and now USAID. And I personally lost friends and colleagues to this war. So I know first-hand the risk that we are talking about.

And some of you or some in the audience may remember that it was a year ago this weekend when Foreign Service Officer Ann Smedinghoff was killed delivering USAID-funded textbooks to a school in Zabul Province. So we do understand first-hand the consequences and challenges we face. Problems of limited capacity in the government of Afghanistan, corruption, will certainly exist in Afghanistan for as long as we are engaged there.

There are also problems in many of the other places where USAID operates. And they will continue to challenge us. However, these problems are not something that should cause us to walk way from the national security interests we are pursuing. They should be however, cause, for a careful and deliberate redoubling of our efforts to prevent the fraud, waste and abuse.

Thank you.

[Prepared statement of Mr. Sampler follows:]

Statement for the Record

United States Agency for International Development

Donald L. Sampler

Assistant to the Administrator and Director of the Office of Afghanistan and Pakistan Affairs

Before the House Oversight and Government Reform Subcommittee on National Security

"Afghanistan: Identifying and Addressing Wasteful U.S. Government Spending"

Thursday, April 3, 2014, 10:00 a.m.

Chairman Chaffetz, Ranking Member Tierney, and Members of the Subcommittee, thank you for allowing me the opportunity to testify before you today to discuss the role of the U.S. Agency for International Development (USAID) in support of U.S. civilian development efforts in Afghanistan. Our work in Afghanistan is emblematic of our agency's overall mission: USAID partners to end extreme poverty and promote resilient, democratic societies while advancing our security and prosperity. USAID's role in Afghanistan is to promote a stable, inclusive and increasingly prosperous country. During the past decade, Afghanistan has made remarkable development gains across multiple sectors, thanks to the whole-of-government efforts of the United States, along with our international partners and the Afghan people.

2014 is a pivotal year for Afghanistan as the country navigates a series of three transitions: the presidential election two days from now and the first democratic transfer of power to a new president in Afghanistan's history; the continued withdrawal of non-Afghan troops with the completion of the transfer of security responsibility to the Afghans; and the continuing reduction of International Security Assistance Force (ISAF)-related economic activity in Afghanistan. This is a critical moment in Afghanistan's history, and USAID is working with the Afghan people and our international partners to do what we can to ensure these transitions go as smoothly as possible.

I have been working on and in Afghanistan since 2002, in both civilian and military capacities, and just returned from my latest visit to Kabul a few days ago. In addition to having worked with the Afghan Constitutional Loya Jirga and the Afghan Emergency Loya Jirga in 2003 and 2004, respectively, I served as a representative of an international non-governmental organization, and as chief of staff of the UN Assistance Mission to Afghanistan. I bring these perspectives to USAID's work today, and I know from personal experience that the dramatic progress Afghans have made is remarkable, yet still fragile. That is why, USAID has been planning and adjusting our programming in anticipation of the transitions in 2014, to maximize sustainability and ensure oversight and accountability of the resources the American people have provided in support of Afghanistan. USAID is committed to safeguarding taxpayer funds and ensuring that the development progress that has been made over the last twelve years is maintained and durable.

USAID Impact and Results

USAID's development assistance, which represents approximately three percent of the total military and civilian financial cost of the war in Afghanistan, has helped Afghans achieve gains ranging from a ten-fold increase in the number of children enrolled in school, to a dramatic increase in life expectancy, as well as five-fold increase in per capita GDP. These are extraordinary development gains for a country that in 2002 had virtually no access to reliable electricity, roads or modern telecommunications, and disadvantaged almost half of its population - women and girls, prohibiting them from contributing fully to Afghan society and the economy. USAID has supported meaningful gains in Afghanistan that have contributed to extraordinary results:

- Health: Life expectancy has increased from 42 years to over 62 since 2002; the maternal mortality rate has declined by 80 percent from 1,600 to 327 deaths per 100,000 births; and child mortality decreased by 44% from 172 to 97 deaths per 1,000 live births.
- Education: In 2002, there were approximately 900,000 Afghan children in school, and virtually none were girls. Today, approximately 8 million children are registered to attend school and more than one-third of them are girls.

- Energy: In 2002, only 6 percent of Afghans had access to reliable electricity. Today 42 percent do. In addition, USAID assistance has helped put the Afghan national power company (DABS) on a path to become fully self-sustaining. DABS collected $229 million from the sale of electricity in 2012, an increase of 68 percent from 2010.

More importantly, the Afghan people recognize the progress made and are increasingly hopeful about their future. For the past nine years, The Asia Foundation, with support from USAID, has conducted a nationwide survey of Afghan attitudes and opinions, tracking trends among the population. The results of the 2013 survey show the impact these gains are making. Fifty-seven percent of all Afghans said they believe their country is moving in the right direction. This number has increased steadily since 2008, when it stood at 38 percent. Not surprisingly, the vast majority – 88 percent – said they were better off economically than they were under the Taliban. Three quarters gave their national government a positive assessment although they remained critical of subnational government and Parliament and concerned about corruption at all levels. Five in six Afghans – men and women – believe that women should have an education. Seventy-five percent believe it is acceptable to criticize the government in public—a sign of an active democracy with an independent media, which is the civilian institution in which Afghans have the most confidence.

USAID Moving Forward

USAID understands the challenges facing Afghanistan. In anticipation of this transitional year, USAID has regularly reviewed and adjusted its programs to ensure that they advance the strategic objectives of the United States and are achievable and sustainable. USAID's strategy in Afghanistan is threefold:

- Maintaining and making durable the gains made in health, education, and the empowerment of women;
- Supporting continued economic growth and employment through the agriculture sector, private sector development, operations and maintenance of infrastructure investments, and responsibly developing the extractives industry, which will help to mitigate the effect of the military drawdown; and,

- Fostering legitimate and effective Afghan governance, including support for the 2014 presidential and 2015 parliamentary elections, the rule of law, and a robust civil society.

Operationally, USAID has adjusted its implementation model to improve sustainability and meet the challenges presented by the transition through:

- Focusing assistance in Regional Economic Zones (REZs) that cover major population centers and promote regional trade and economic opportunities, especially with regional markets in Central and South Asia;
- Developing a multi-tiered monitoring strategy to address reduced mobility and decreased field staff that, along with other monitoring and evaluation efforts, will continue to ensure appropriate oversight of projects;
- Transforming USAID's approach in Afghanistan to one of mutual accountability that incentivizes Afghan reforms by conditioning an increasing percentage of our assistance to the government on progress on reforms and that continues to increase government involvement and ownership of development needs; and
- Focusing on long-term sustainability through implementing USAID policies on sustainability, including the principles of: (1) increasing Afghan ownership and capacity; (2) contributing to community stability and public confidence in the Government of Afghanistan; and (3) implementing effective and cost-efficient programming.

Based on this strategy and these objectives, USAID is constantly reviewing and evaluating our portfolio in coordination with the U.S Government interagency and the Afghan Government, including through a biannual portfolio review process. We take these reviews very seriously and are confident that they are helping ensure that USAID's assistance in Afghanistan is having the maximum impact possible. To cite one example, as a result of internal USAID reviews and in consultation with the Government of Afghanistan, USAID determined that a program supporting access to credit for agriculture in southern Afghanistan was not delivering the desired results. While access to credit helped farmers in some ways, it did not provide the desired increase in access to markets. USAID de-scoped that activity and reprogrammed the funds to other elements of the program that continue to deliver results. The lessons learned from that agriculture activity have helped inform the design of new USAID agriculture programs that focusing on strengthening value chains across Afghanistan.

Oversight and Accountability

USAID is well aware that Afghanistan is a difficult environment in which to work. But we have learned important lessons over our twelve year engagement there, and have also drawn on experiences of operating in other challenging environments, including Iraq, Pakistan, Yemen, Sudan and Colombia, to ensure strong oversight of U.S. assistance funds.

In addition to standard USAID oversight measures implemented worldwide, USAID has implemented the Accountable Assistance for Afghanistan (A3) initiative, designed to prevent funds from being diverted from the development purpose to malign actors. Some of the approaches we use under A3 include:

1. Limiting the number of sub-contracting tiers;
2. Implementing a robust vetting system of non-U.S. companies and key individuals, at both the prime and sub-contractor level, and establishment of the Vetting Support Unit;
3. Enhancing financial controls on project funds, such as using electronic funds transfers in lieu of cash payments, using independent audit firms to verify appropriate usage of funds, reviewing of recipients' claims prior to payment, and performing 100% audits of locally incurred costs; and
4. Implementing robust oversight of all USAID projects in Afghanistan through a five-tiered monitoring approach, encompassing monitoring information gathered from USAID and other U.S. Government staff, USAID implementing partners, other donors, Afghan civil society and beneficiaries, as well as independent monitoring contractors.

USAID's multi-tiered monitoring approach focuses on gathering and analyzing multiple sources of data across these tiers in order to compare information and ensure confidence in reporting data, allowing USAID to use the results to make further programmatic decisions. Supporting this approach is the new Implementation Support Team (IST) headquartered at the USAID Mission in Kabul. The IST is charged with providing an additional layer of critical review and analysis for the streams of monitoring information and for providing USAID leadership with alternative courses of action for addressing challenges with project implementation.

Providing independent data inputs to this team is the new Monitoring Support Project, for which USAID just issued a request for proposals. This request for proposals was issued following extensive consultations with international donors, Congress, implementing partners, and a comprehensive analysis of USAID remote monitoring efforts around the world. This project will utilize a variety of monitoring methods to verify project data, including site visits, GPS and time/date stamped photos, interviews, and crowd sourcing. USAID does not rely solely on remote monitoring to provide key monitoring data, nor will independent monitoring take the place of the USAID staff as project managers. It is one tool that USAID can use to validate reporting data from other sources. USAID will not hesitate to terminate projects or specific activity sites if USAID determines that adequate oversight is not possible.

Audits provide useful oversight and discipline, and complement and reinforce USAID's own efforts to ensure U.S. tax dollars are used effectively and efficiently. There are currently over 100 on-going audits of USAID programs in Afghanistan. In fiscal year 2013, the U.S. Government Accountability Office, USAID Office of Inspector General, and the Special Inspector General for Afghanistan Reconstruction completed over 65 financial and program audits in Afghanistan.

Oversight is a process that requires continual re-examination and the ability to adjust to new circumstances as they arise. Although there are inherent risks in doing business in a country like Afghanistan, our first priority is to ensure taxpayer dollars are adequately protected even as we carry out a vital component of the U.S. Government's national security policy.

Direct Assistance in Afghanistan

Direct assistance to the Afghan government is used when appropriate to accomplish certain development outcomes, and to build the Afghan government's ability to sustain the investments and gains that have been made and reduce its dependence on donors over time. This is in keeping with commitments under both the previous and current Administrations to increase our work through local governments and organizations, not just in Afghanistan, but in numerous countries around the world. Such work is critically important to the ultimate goal of assistance – helping countries stand on their own two feet.

In Afghanistan, our work through the government is based on commitments made by the United States and the international community in return for commitments made by the Afghan government to meet certain benchmarks. These agreements were reflected in the Tokyo Mutual Accountability Framework, in 2012. In return, the U.S. reaffirmed support expressed at the London and Kabul conferences in 2010 to provide up to 50 percent of its aid as on-budget assistance, in order to help strengthen the Afghan government's capacity.

USAID implements on-budget assistance in Afghanistan through two mechanisms: multilateral trust funds, such as the Afghanistan Reconstruction Trust Fund (ARTF) managed by the World Bank, and through bilateral direct assistance agreements with the Afghan government. Of the approximately $17.5 billion in obligated USAID funds for Afghanistan since 2001, $770 million is allocated for direct assistance with the Government of Afghanistan, of which USAID has disbursed $283 million, with a little more than half of that disbursement for health sector programming.

USAID recognizes that working directly through local governments, especially in unstable and challenging environments, carries an element of risk. USAID has a rigorous system of oversight for its direct assistance programming with the Afghan government. This means that USAID conducts assessments to identify the strengths and weaknesses of each ministry for which a direct assistance project is being contemplated. To date, USAID has contracted for accounting firms to conduct sixteen ministry assessments. USAID has decided at this time to limit its direct assistance to seven ministries, subject to stringent safeguards. The process begins with a review of a ministry's basic procurement, financial and human resource systems followed by an internal assessment of the risks inherent in the ministry. We then build our mitigating measures and safeguards accordingly. At the same time, through technical assistance, we also seek to build Afghan systems that will be able to prevent fraud, waste, or abuse on their own.

For direct assistance, USAID utilizes multiple levels of protection to mitigate risks to taxpayer funds. These measures may include, but are not limited to:

- requiring the establishment of a non-commingled, separate bank account for each project with USAID;
- disbursement of funds only after USAID has verified that the ministry has achieved a performance milestone or USAID has verified incurred costs;
- an annual audit by a USAID OIG-approved firm;
- substantial involvement and oversight by USAID staff in procurement processes;
- independent management, monitoring and evaluation of services; and
- technical assistance through other projects to increase the capacity of ministries while addressing any vulnerabilities or weaknesses identified in the assessments.

All direct assistance requires compliance with USAID accountability and oversight procedures, including site visits. Ministries are required to fully comply with the conditions precedent prior to and throughout the disbursement process. If Afghan ministries fail to adhere to these conditions, the agreements are subject to immediate suspension or termination. In the cases where USAID uses cost reimbursement for our direct assistance projects, in accordance with USAID risk mitigation measures, USAID disburses funds to a separate, non-comingled bank account at the Central Bank of Afghanistan once we have been assured ourselves of the cost incurred. From that account, those funds are transferred to partners contracted on behalf of the Afghan government for the work performed on behalf of the Afghan Government.

For example, USAID has worked closely with Afghanistan's energy utility, Da Afghanistan Breshna Sherkat (DABS) to assess its financial management systems; and audit its progress and monitor results. USAID negotiated a series of preconditions and financial controls pursuant to the launch of a $75 million program to install a turbine at Kajaki dam. In addition to the tight financial controls implemented with DABS, USAID has been involved in every step of the procurement and implementation process to ensure that results are being delivered as planned. $1.6 million in payments have been made by DABS to the implementing contractors only after being verified financially and technically as appropriate for the delivery of the goods or services in question. This project also includes a phased approach, with increasingly more significant parts of the project being undertaken only after a thorough review of the previous phase to ensure both financial and technical aspects of the project proceed properly.

Conclusion

Afghanistan has changed dramatically in the last twelve years, but we are under no illusions about the challenges we face. USAID always keeps in mind the enormous sacrifices made by Americans to build a secure and stable Afghanistan, and we fully understand the need for constant vigilance, particularly during this delicate transition period. Whether in a military capacity, as a government civilian, or as an implementing partner, I understand the risks and the sacrifices these individuals and their families have taken and sincerely thank them for their service. Every day our staff and our partners are under threat. Since 2001, 434 people working for USAID partner organizations in Afghanistan have been killed and another 768 wounded.

Throughout our efforts, we are applying important lessons from the past twelve years in Afghanistan, as well as from other high-risk environments in which USAID has worked. Weaning Afghanistan from unsustainable levels of assistance is necessary for us, and essential for them, and we are making tough decisions and prioritizing investments that have the greatest potential for long term sustainability. As USAID navigates through the 2014 transition period, we are committed to expending every effort to safeguard taxpayer funds and ensure that the remarkable development progress in Afghanistan is maintained and made durable, in order to secure our overall national security objectives. It is an honor to be able to share with you today a small glimpse of what USAID is doing in that regard. I look forward to answering any questions that you may have.

Mr. CHAFFETZ. Thank you.

Mr. Sopko?

STATEMENT OF JOHN F. SOPKO

Mr. SOPKO. Chairman Chaffetz, Ranking Member Tierney, and other members of the subcommittee, it is a pleasure to be here today to discuss lessons learned from the work of SIGAR and the other oversight agencies as we enter this critical year for reconstruction of Afghanistan.

At the end of this year, America's longest war will come to an end. Most troops will leave by December. Perhaps only a few thousand will remain for training and quick response actions.

The reconstruction mission, however, is far from over. Afghanistan will require significant international assistance for years to come. With over $20 billion of the over $100 billion appropriated by Congress still in the pipeline and billions more promised over the next decade, we must learn from the growing body of oversight work and apply our very best practices to protect the taxpayer.

As you know, I could not attend our last hearing because I was in Afghanistan, where there are high hopes for a successful election, bolstered by a stronger than expected showing of the Afghan military over the last several months. Yet this optimism is tempered with depressing evidence of persistent corruption, continued wasteful spending and increased violence.

I was particularly troubled with the increased violence that placed significant restraints on my ability to travel, as well as the revelation that the European Union and many of our allies no longer trust the UNDP Law and Order Trust Fund's internal controls which were designed to protect billions of dollars provided to the Afghan policemen's salaries.

Added to this, I learned of industrial parks developed by USAID without affordable and sustainable power, a poorly planned and executed soybean project, an Afghan governor alleging that USAID's Kandahar food zone contractor is wasting money, a proposed new bridging solution to the current bridging solution for electricity in Kandahar, based on yet another hydroelectric plant and solar power generation, and the Afghan financial sector's recent downgrading that may eventually result in the international banking community blacklisting it in June.

As in all my trips to Afghanistan, I spent as much time as I could away from the embassy and outside of Kabul. Despite the best efforts of General Dunford and Ambassador Cunningham, for security reasons I could not visit various sites, including a proposed USAID power plant in Sheberghan, a TFBSO pipeline project connecting that plant to Mazar Sharif, and the actual customs facility at Torkham Gate, which is not only our troops' main lifeline for supplies but also the most important customs post for Afghanistan. By this fall, I learned no American official will be able to inspect that important facility.

Now, not only are the security bubbles collapsing, but they now look more like Swiss cheese, with numerous no-travel holes due to security threats from insurgents. The extent of insurgent control is so substantial they even tax the electricity coming from the Kajaki Dam, USAID's signature power project in Afghanistan.

What I saw and heard further reinforced the lessons learned discussed in my written statement and ironically, in a 1988 USAID lessons learned report. Namely, the need to consider sustainability, risk mitigation, oversight and sound planning before embarking upon a massive reconstruction project in a country as poor as Afghanistan.

Let me say, I share the committee's concerns expressed at your last hearing with USAID's current plans to manage and oversee more money with fewer people in a far more dangerous environment. Recent history warns us that too much money spent too quickly with too few safeguards is a recipe for reconstruction disaster. Now, as many of you know, in my prior life as a prosecutor, I gave many closing arguments to juries where I reminded them not to forget their prior experience and common sense before entering the jury room for deliberation. That is probably why I remained skeptical when USAID claimed at the last hearing that no U.S. funds go to the Afghan ministries when it gives direct assistance. How can this be so?

Call it what you like, direct assistance in Afghanistan is risky, especially after considering USAID's own assessment of the ministries, USAID's waiver of its own internal policies and USAID's decision to not mandate 92 percent of its critical protections before providing the funds. It should be noted that USAID admitted to SIGAR auditors that Afghanistan is the only country in the world where it waived its own strict internal policies before providing such direct assistance.

Now, this is in stark contrast to actions taken by our allies in Afghanistan. In discussions I had recently in Kabul with representatives of other donor countries, I learned that they were withhold direct assistance or redirecting it to off-budget programs because of concerns with internal controls and the Afghan government's commitment to the Tokyo Accords.

Let me state very clearly, SIGAR does not oppose direct assistance. However, as we testified before this committee almost exactly a year ago, SIGAR believes that direct assistance must be conditioned on the Afghan government taking serious steps to reduce corruption and ensure vigorous oversight of these funds. It should be conditioned on the Afghan ministries not only meeting measurable outcomes but also providing unfettered and timely access to their books and records as well as the project offices, sites and staff.

More than lip service must be given to accountability, oversight and conditionality by the U.S. Government and its allies. A system of sticks and carrots in administering direct assistance can only be effective if it is credible in the eyes of the Afghan government. We and the other donors must speak publicly and we must speak with one voice to convince the new president of Afghanistan that we mean business. We cannot say we are going to impose conditions on only a small fraction of our assistance while we continue to provide unfettered billions elsewhere.

In summation, if the Afghan government fails to live up to its commitments, then we need to have the courage to say no. Anything less will fail to protect our costly investment and the hard-earned successes of this, our Country's longest war.

Thank you very much, and I look forward to your questions.
[Prepared statement of Mr. Sopko follows:]

Special Inspector General for Afghanistan Reconstruction

SIGAR

Testimony

Before the Subcommittee on National Security
Committee on Oversight and Government Reform
U.S. House of Representatives

Lessons Learned from Oversight of the U.S. Agency for International Development's Efforts in Afghanistan

Statement of John F. Sopko,

Special Inspector General
for Afghanistan Reconstruction

April 2014

Mr. Chairman, Ranking Member Tierney, and Members of the Subcommittee,

I am pleased to be here today to discuss oversight of the U.S. Agency for International Development's (USAID) reconstruction efforts in Afghanistan. Since 2002, USAID has obligated over $18 billion to help rebuild Afghanistan through a wide range of projects and programs in areas such as healthcare, education, and agriculture, among others. This effort has been unprecedented in its cost and scope. It has also provided a unique opportunity to examine the challenges of undertaking a large-scale reconstruction initiative in an environment like Afghanistan.

Since the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) was established in 2008, it has developed a large body of work focused on USAID's efforts in Afghanistan. This work has involved every facet of SIGAR's organization and has been communicated through almost 50 audit and inspection reports, 22 quarterly reports to Congress, and other special publications. Taken individually, these reports provide specific examples of how various USAID projects were planned, implemented, and overseen. They also highlight concrete instances of waste, fraud, and abuse, where it has occurred. Taken as a whole, however, these reports reveal broader lessons about what has worked and what has not—lessons that can be used to inform future contingency operations and, to the extent possible, to strengthen and improve the U.S. government's continued efforts in Afghanistan throughout the "Transformation Decade" and beyond. In my testimony today, I discuss four of those lessons.

Lesson 1: Reconstruction Programs Must Take into Account the Recipient Country's Ability to Afford the Costs of Operating and Sustaining Them

In 1988, USAID released a review of U.S. Assistance to Afghanistan between the years 1950 and 1979.[1] This report, conducted by a private firm with which USAID had contracted, identified a number of lessons learned, based on the U.S. government's experience in Afghanistan. Chief among them was that U.S. assistance to Afghanistan had been "over-ambitious, both as to scale and timing" and that, "in many ways, the program was larger than could be effectively administered by either the US or Afghan governments." This conclusion, although retrospective in its orientation, was prescient. As the work of SIGAR and others has shown, the size of the U.S. government's current reconstruction effort in Afghanistan has placed both a financial and operational burden on the Afghan government that it simply cannot manage.

As SIGAR has noted on several occasions, the U.S. government has committed more money to rebuild Afghanistan than it has any other single nation in its history—over $100 billion. While this figure is noteworthy when compared to other foreign aid investments that the U.S. has made in its history, it is staggering when considered in the context of Afghanistan's economy.

By most estimates, Afghanistan's domestic annual revenue is only about $2 billion, while its overall budget is $7.5 billion. This means that, without donor contributions, the Afghan government will not be able to meet most of its operating expenditures. For example, NATO has estimated that the cost of sustaining an Afghan National Security Force (ANSF) of 228,500 would be $4.1 billion annually. Therefore, if the Afghan government were to dedicate all of its domestic revenue toward sustaining the ANSF at its projected levels, it still could only pay for half of the associated costs. Moreover, all other costs—those required to operate and maintain infrastructure and programs in the non-military sectors—would have to come from international donors.

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[1] "Retrospective Review of US Assistance to Afghanistan: 1950-1979," Submitted to USAID by Devres, Inc., October 31, 1988.

While security is a significant driver of costs and one that often receives the most attention, development in Afghanistan is also a major contributor to that country's growing fiscal gap. Each new development project that the U.S. and other international donors fund increases overall operation and maintenance costs, adding pressure to Afghanistan's operating budget. Indeed, Afghanistan's fiscal sustainability ratio—domestic revenues versus operating expenses—remains one of the lowest in the world. Recent World Bank calculations show that Afghanistan's fiscal sustainability ratio has declined, from 66.5 percent in fiscal year 2011 to 60.1 percent in fiscal year 2012. And this ratio is projected to drop even lower in coming years.[2] As a result, Afghanistan's ability to pay for discretionary services will become increasingly limited, and its progression toward self reliance will be further delayed.

USAID has acknowledged this reality. For example, a 2011 report on Afghanistan's fiscal sustainability, prepared for USAID by Chemonics International, Inc., found that, even under conservative assumptions, the size of operation and maintenance expenditures associated with all external development spending is almost equal to Afghanistan's current operating budget.[3] USAID officials have also told SIGAR they are concerned that the United States and the Afghan government could be left with "stranded assets" if project implementation and follow-up are not handled correctly. SIGAR has found, however, that USAID has not consistently translated this understanding into a realistic approach for designing and implementing projects.

Limited Sustainability of Energy Sector Programs

The problem of planning and implementing programs without considering the cost and feasibility of sustaining them is, perhaps, no more strikingly evident than in the U.S. government's efforts to develop Afghanistan's energy sector. As highlighted in the Afghanistan National Development Strategy and other key planning documents, the United States, other international donors, and the Afghan government agree that improving the energy sector is essential to Afghanistan's economic progress and long-term viability.

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[2] World Bank, *Afghanistan Economic Update*, October 2013.

[3] Afghanistan Fiscal Sustainability Model Summary Report, produced for USAID by Chemonics International, Inc., September 2011.

However, the energy sector remains largely undeveloped. According to the World Bank, Afghanistan has one of the lowest rates of electric-service connection in the world, with only 28 percent of its population connected to the power grid. Of those who are connected, an estimated 77 percent live in urban areas.[4]

In January 2010, SIGAR issued an audit report on USAID's efforts to build the Kabul Power Plant, a 105 megawatt power plant on the outskirts of Kabul city.[5] The decision to build the plant had been made jointly by the U.S. and Afghan governments and, in 2007, the Afghan government had committed to, among other things, paying for the fuel required to operate the plant and commercializing the operations of Afghanistan's electricity revenues to cover fuel costs and operation and maintenance expenses of the plant within one year of its creation.

In June 2008, the USAID Mission Director in Afghanistan certified to Congress that USAID had concluded the Afghan government was capable of meeting these commitments.[6] However, it soon became apparent that this conclusion was highly unrealistic. One key basis for USAID's certification was the expectation that the Afghan government would be able to commercialize its utility sector. By 2010, though, the utility sector for the Kabul area was projected to suffer an annual operating loss of $250 million. Similarly, although the Afghan government had committed to paying fuel costs for the plant, the Afghan Minister of the Economy requested in 2009 that USAID reserve $28 million in funds originally set aside for its contribution to the Afghanistan Reconstruction Trust Fund, in part to cover fuel costs at the Kabul Power Plant and other power plants in southern Afghanistan.

One contributing factor behind the high costs associated with operating and maintaining the Kabul Power Plant was the Afghan and U.S. governments' joint decision to build a dual fuel plant—one capable of operating on diesel or heavy fuel. According to staff of the contractor

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[4] World Bank, "Afghanistan Partnership: Country Program Snapshot," 8/29/2013.

[5] SIGAR Audit 10-6, Contract Delays Led to Cost Overruns for the Kabul Power Plant and Sustainability Remains a Key Challenge, January 2010.

[6] This certification was submitted in compliance with Section 611(e) of the Foreign Assistance Act of 1961, which provides that whenever certain types of funds are proposed to be used for a capital assistance project exceeding $1 million, the USAID Mission Director must certify that the country has the capability to effectively maintain and utilize the project.

hired by USAID to build the plant, a senior Afghan government official had advocated for a dual fuel plant since heavy fuel oil is considerably cheaper than diesel fuel and would increase the chances that the Afghan government could operate the plant with its own resources. The USAID contractor's staff noted, however, that the full costs of using heavy fuel oil include additional infrastructure investments, handling costs, and operation and maintenance expenses associated with greater wear and tear placed on the generators. Moreover, heavy fuel oil is not available in Afghanistan and would require the creation of a heavy fuel import and distribution network solely for the Kabul Power Plant. The contractor estimated that up to $4 million could be saved if the plant were converted to a diesel-only plant, but USAID officials declined to pursue this option due to political sensitivities surrounding the issue and prior commitments they had made to the Afghan government.

Last year, SIGAR reexamined USAID's efforts to strengthen the electricity sector in Kabul. In an audit report focused on USAID assistance to support commercialization of the Kabul regional department of Da Afghanistan Breshna Sherkat (DABS), Afghanistan's national power utility, SIGAR found that USAID's assistance had helped DABS-Kabul reduce its losses and increase revenues, a positive development.[7] However, SIGAR also found that DABS-Kabul—the same power utility that USAID had expected in 2008 to produce enough revenue to cover operation and maintenance costs of the Kabul Power Plant—was not self-sufficient and, without an Afghan government subsidy, scheduled to expire in March 2014, would operate at a loss unless it significantly improved its revenue generation capability.

Troublingly, DABS-Kabul is well ahead of other DABS regional departments, including that in Kandahar, which the U.S. government expects to cover the costs of a number of critical energy sector projects funded by the U.S. and other international donors in that region. In July 2012, SIGAR issued a report on the Afghanistan Infrastructure Fund, which provides funding for large-scale infrastructure projects jointly managed and implemented by USAID and the U.S. Forces-Afghanistan (USFOR-A).[8] Many of these projects are in the energy sector

[7] SIGAR Audit 13-7, Afghanistan's National Power Utility: Commercialization Efforts Challenged by Expiring Subsidy and Poor USFOR-A and USAID Project Management, April 2013.

[8] SIGAR Audit 12-12, Fiscal Year 2011 Afghanistan Infrastructure Fund Projects Are behind Schedule and Lack Adequate Sustainment Plans, July 2012.

and include such significant initiatives as the Kandahar Bridging Solution, which provides fuel, operation, and maintenance for all Department of Defense and USAID-procured generators in Kandahar, and improvements to the Northeast and Southeast Power Systems, two high voltage transmission networks. SIGAR found that, although USAID and USFOR-A prepared sustainment plans for these projects, as required, the plans did not include any analysis of the costs of sustaining them. Moreover, the likelihood that the Afghan entities charged with financing these projects can afford them is questionable. For instance, DABS-Kandahar, which is responsible for sustainment of the Southeast Power System and, ultimately, the operation of U.S. government-procured generators in Kandahar, has limited capability to bill customers, collect revenues, and maintain its infrastructure. As SIGAR noted in this July 2012 report, estimates at the time called for the U.S. government to support the Kandahar Bridging Solution through calendar year 2012, when either DABS would take over fuel procurement or other power sources would come online. Not surprisingly, those estimates were overly optimistic, and U.S. funding for the Kandahar Bridging Solution has continued.

During my most recent trip to Afghanistan, a senior U.S. military official told me the fuel provided through the Kandahar Bridging Solution will start declining this year and end by December. Afghan officials also told me that if the U.S. military stops providing the fuel, DABS will probably not have the financial resources necessary to purchase the fuel needed to maintain the power provided by the generators funded through the Afghanistan Infrastructure Fund. In other words, unless the U.S. government or another international donor provides more fuel to DABS, thousands of homes and businesses in Kandahar will no longer have access to power beginning in early 2015, even assuming the most optimistic estimates for the time needed to complete the Kajaki Dam and other key electrical grid projects designed to connect Kandahar to the country's larger electrical grid.

USAID and DABS officials in Kandahar are well aware of this potential problem. To help offset the gap in power generation, they have developed a "bridging solution to the bridging solution." Under their draft proposal, DABS will obtain power through a new solar power plant in eastern Kandahar and a hydro-electric turbine at Dahla Dam. Although I commend USAID and DABS for trying to develop a solution to this serious challenge, I have concerns about the ability of USAID and the Afghan government to jointly develop, undertake, and complete two new large-scale infrastructure projects before the end of this year.

Limited Sustainability of Health Sector Programs

Over-ambitious expectations of the Afghan government's ability to afford development projects have not been limited to the energy sector. In April of last year, SIGAR reported that USAID built two hospitals for the Afghan Ministry of Public Health (MOPH) that the ministry would likely not be able to afford.[9] Specifically, SIGAR found that the estimated annual operation and maintenance costs of the two new hospitals could be over five times more than the annual operating costs for the hospitals they were replacing. For example, while the old Gardez provincial hospital had operating costs of approximately $611,000, including costs for operation and maintenance, salaries, and supplies, the International Organization for Migration, which received a USAID cooperative agreement to build the hospital, estimated that operation and maintenance costs alone for the new Gardez hospital would exceed $1.1 million annually. A USAID-contracted engineering firm, which conducted a study of projected operating costs for the new facilities, estimated that annual operation and maintenance costs for Gardez hospital would be even higher—as much as $2.1 million. And USAID estimated higher fuel costs for the new hospital, ranging from $1.6 million to $3.2 million annually. Similarly, the old hospital in Khair Khot district had total operating costs of about $98,000, including costs for operation and maintenance, salaries, and benefits, but USAID estimated annual operating costs for the new facility of more than $587,000.

Despite these projections, neither USAID nor the Afghan government allocated funds to cover these additional costs. And, although the USAID Mission Director in Kabul had certified in 2007 that the Afghan government would be capable of effectively maintaining and using the hospitals, USAID could not provide SIGAR any documentation to indicate that its review and approval of the design plans for the two hospitals took into account the higher operating costs estimated for the new facilities or the Afghan government's financial capability to maintain them once completed. The problems with these two hospitals are indicative of

[9] SIGAR Audit 13-9, Health Services in Afghanistan: Two New USAID Funded Hospitals May Not Be Sustainable and Existing Hospitals Are Facing Shortages in Some Key Medical Positions, April 2013.

larger problems with USAID's efforts to build a sustainable health sector. In a September 2011 report on USAID's health services program,[10] the USAID Office of Inspector General (OIG) reported that sustainability has emerged as a risk to USAID investments in Afghanistan's health sector and that about 94 percent of the Afghan Government's expenditures on health care programs are donor supported.

Other Examples of Sustainability Concerns in Reconstruction Programs

USAID OIG has identified other instances in which USAID has implemented projects or built infrastructure without articulating a clear plan for ensuring that the Afghan government can sustain them. In a June 2007 report on Afghanistan's urban water and sanitation program,[11] for instance, USAID OIG reported that USAID/Afghanistan's overall objective underlying this program was to develop sustainable supplies of suitable quality water for certain areas of Afghanistan. However, during project implementation USAID/Afghanistan did not take appropriate measures to ensure financial and operational sustainability of the constructed water systems beyond the project completion date. As a result, USAID OIG concluded that the constructed water distribution systems could have significant short and long-term financial and operational problems, ultimately impacting the supply of water to the intended populations of Afghanistan.[12]

In a December 2008 report on Afghanistan's higher education project,[13] USAID OIG reported that, although sustainability was a core element of USAID program design, professional development centers constructed under the program would not be self-sustaining because the program design did not include an exit strategy that identified ways to keep the centers operating after the project ended.

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[10] USAID OIG, *Audit of USAID/Afghanistan's On-Budget Funding Assistance to the MOPH in Support of the Partnership Contracts for Health Services Program*, Audit Report No. F-306-11-004.

[11] USAID OIG, *Audit of USAID/Afghanistan's Urban Water and Sanitation Program*, Audit Report No. 5-306-07-006-P, June 2007.

[12] Next month, SIGAR will release an audit report broadly assessing USAID's efforts to help Afghanistan develop a sustainable water sector.

[13] USAID OIG *Audit of USAID/Afghanistan's Higher Education Project*, Audit Report No. 5-306-09-002-P, December 2008.

Failure to consistently and adequately plan for the Afghans to sustain reconstruction projects has not been USAID's alone. In January 2011, SIGAR released an audit report on the Department of Defense's Commander's Emergency Response Program (CERP) in Laghman Province.[14] SIGAR found that nine asphalt roads, which accounted for the vast majority of CERP funds spent in that province, were at risk for waste because they were approved without adequate assurance that the Afghan government had the resources to maintain them. According to officials on Laghman Province's Provincial Reconstruction Team, the Afghan Directors of Public Works and Rural Rehabilitation and Development did not have the resources to maintain roads, particularly asphalt roads, which require more resources and equipment to maintain than dirt roads.

Whether it be the energy sector or the health sector or any other, the pitfalls of placing unreasonable expectations on the Afghan government regarding its ability to afford the costs of operating and maintaining development projects are clear. Among them are cost overruns, delays, and waste of reconstruction funds, to name a few. Perhaps most significant, though, is the possibility that the Afghan public and the Afghan government will lose confidence that their key partner in the reconstruction effort, the U.S. government, has their best interest at heart.

Lesson Two: Reconstruction of a Conflict-Ridden State Is Inherently Risky and That Risk Must Be Properly Mitigated

As one of the world's most impoverished, insecure, and corrupt countries, Afghanistan presents remarkable challenges to those committed to helping it address its very serious problems. USAID and other donors must not only worry about the safety of all those who work in Afghanistan on their behalf; they must also take every possible step to safeguard the funds their governments have entrusted them with spending in Afghanistan from waste, fraud, and abuse.

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[14] SIGAR Audit 11-07, Commander's Emergency Response Program in Laghman Province Provided Some Benefits, but Oversight Weaknesses and Sustainment Concerns Led to Questionable Outcomes and Potential Waste, January 2011.

Corruption poses the most severe threat to the integrity of U.S. government reconstruction aid to Afghanistan. And, as the U.S. military noted in a recent study it published, "corruption directly threatens the viability and legitimacy of the Afghan state."[15] Afghans themselves agree. In a number of internationally recognized surveys, Afghans identify corruption as one of the most serious challenges facing their country. In a 2013 survey conducted by the International Security Assistance Force, for instance, 80 percent of Afghans described corruption as a major problem, and 65 percent said it was worse than a year before. Integrity Watch Afghanistan, a nongovernmental organization committed to improving governance, has reported that about one in every seven Afghans, or 15 percent, paid at least one bribe in 2012.[16]

One of SIGAR's earliest reports related to safeguarding reconstruction funds was an audit of USAID's efforts to safeguard funds provided for salary support to Afghan government employees and technical advisors.[17] SIGAR found that, although USAID had provided salary support to Afghanistan since at least 2005, it did not begin collecting information on that support until 2008. Moreover, it was only through the process of compiling an inventory of salary support it had funded that it discovered it had been violating its own policy. Specifically, USAID had supplemented the salaries of Afghan ministers and senior presidential advisors, even though its policy prohibited supplementing policy-making officials' salaries under any circumstances.[18] SIGAR also found that, although USAID had conducted an assessment of the Afghan government's financial management capabilities, it had not conducted similar assessments of the human resources and payroll systems used to implement U.S. salary support to determine if necessary internal controls were in place to protect salary payments from mismanagement, waste, or misuse. SIGAR's own analysis of these systems found they had a number of significant weaknesses, such as incomplete

[15] Joint Coalition Operational Analysis (JCOA), a division of Joint Staff J-7, *Operationalizing Counter/Anti-corruption Study*, 2/28/2014.

[16] Integrity Watch, "National Corruption Surveys," www.iwaweb.org.

[17] SIGAR Audit 11-05, Actions Needed to Mitigate Inconsistencies in and Lack of Safeguard over U.S. Salary Support to Afghan Government Employees and Technical Advisors, October 2010.

[18] See USAID Automated Directives System 201.3.11.10, "Policy Guidance on Criteria for Payment of Salary Supplements for Host Government Employees" [Cable 88 State 119780, April 1988]. After discovering these violations, successive USAID Administrators twice waived the policy to allow for continued salary support to the Office of the President.

implementation of an electronic payroll system and an inability to detect multiple supplements paid to single recipients.

In SIGAR's opinion, failing to adequately assess the internal controls within Afghan ministries responsible for handling U.S. salary support payments assumed an unacceptable level of risk. And this problem was not isolated to the issue of salary support. In July 2008, USAID and the MOPH signed an implementation letter establishing the Partnership Contracts for Health (PCH) program—a five-year program to provide funding to the ministry for the delivery of health services throughout Afghanistan. USAID had conducted two assessments of the ministry prior to establishment of the PCH program. The first concluded that the ministry's operations were adequate for the purposes of accounting for and managing USAID funds provided directly to the ministry. The second found that the ministry had adequate experience and procurement capabilities to handle procurements funded under USAID host-country procurement procedures. However, in November 2010, USAID OIG reported that these pre-award assessments—which USAID used to certify the ministry's ability to manage the $236 million PCH program—were inadequate and did not provide reasonable assurance of detecting significant vulnerabilities.[19] Indeed, SIGAR's own review of these assessments found that they consisted primarily of observations, walk throughs, and documentation reviews and that USAID conducted little testing of internal controls.[20]

When SIGAR examined USAID's management of this program in 2013, it found that, despite USAID OIG's 2010 findings, USAID had not reassessed operations within the ministry to determine whether funds provided under the PCH program were at risk. Moreover, although a later, more thorough assessment of the ministry was conducted through a USAID contract with Ernst & Young, and that assessment found significant internal control weaknesses at the ministry, USAID officials told SIGAR they had no obligation to address the deficiencies

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[19] USAID OIG, *Review of USAID/Afghanistan's Ministerial Assessment Process:* F-306-11-001-s, November 6, 2010.

[20] SIGAR Audit 13-17, Health Services in Afghanistan: USAID Continues Providing Millions of Dollars to the Ministry of Public Health despite the Risk of Misuse of Funds, September 2013.

identified or to verify any corrective actions that the ministry may have implemented for the ongoing PCH program.[21]

USAID cited two main arguments for this position. First, the PCH program was executed through what USAID calls a host-country contract. And, according to certain USAID officials, that type of contracting did not constitute "direct government-to-government assistance," thereby negating any need to address the findings of the Ernst & Young assessment, which was conducted solely as part of a different program that fell explicitly under the rubric of direct bilateral assistance. Second, USAID stated that the weaknesses identified through the Ernst & Young assessment did not matter because USAID had established a separate unit, the Grants Contracts and Management Unit (GCMU), through which all PCH funds would flow—separate from the rest of the ministry and better able to protect USAID's funds. In its comments on SIGAR's draft audit report, USAID stated plainly, "It is in part because of the GCMU that the [ministry] and USAID have had such a strong success with the PCH program over the past several years and confidence in the management of the funds for the PCH program."

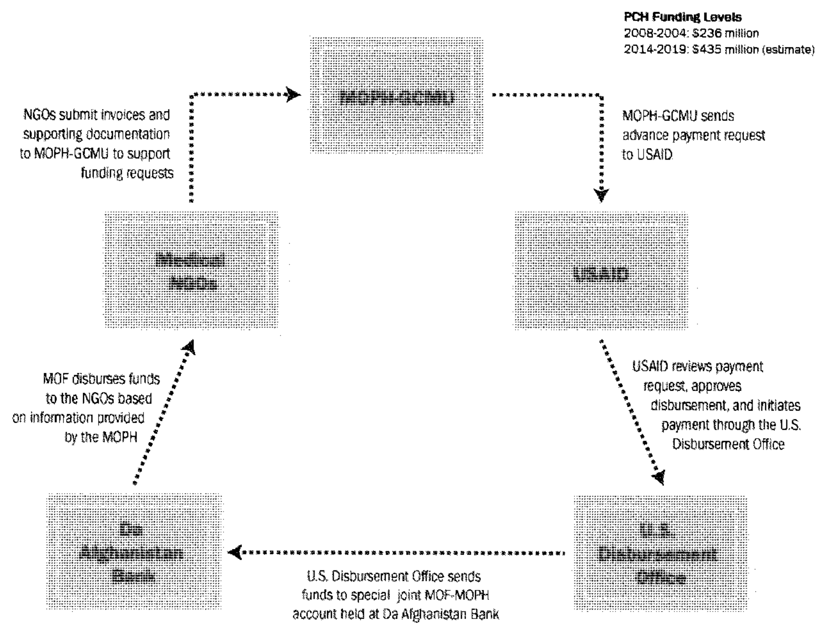
These arguments were troubling for a number of reasons but, particularly, because SIGAR's own investigative work has found that the GCMU has done little to protect USAID's funds from waste and mismanagement. While details of SIGAR's ongoing criminal investigation cannot be shared at this point, it is safe to say that, based on information SIGAR's auditors and investigators have collected and corroborated, the GCMU constitutes, in many ways, a single point of failure when it comes to the protection of USAID funds for the PCH program.

To provide direct assistance funds to MOPH for the PCH program, USAID depends heavily on cooperation and information from MOPH's GCMU. As shown in figure 1, MOPH-GCMU submits an advance payment request to USAID every 45 days to cover the estimated cost of the PCH program. This estimate is based on requests and supporting information provided to MOPH-GCMU by the nongovernmental organizations providing goods and services under the program. USAID reviews MOPH-GCMU's payment request, approves disbursement, and initiates payment through the U.S. Disbursement Office. The U.S. Disbursement Office then

[21] See SIGAR Audit 13-17, p.4, for a more complete discussion of this matter.

sends funds to an account at Afghanistan's central bank, Da Afghanistan Bank, jointly held by the Ministry of Finance and MOPH for the PCH program. Using information provided by MOPH-GCMU, the Ministry of Finance disburses funds to individual nongovernmental organizations to cover their anticipated expenses for goods and services.

Figure 1 - MOPH-PCH Payment Process



Source: SIGAR analysis of interviews and documentation.

This system presents a number of vulnerabilities.

- First, although the nongovernmental organizations implementing PCH submit invoices and other supporting documentation to MOPH-GCMU, MOPH-GCMU does not, as Ernst &Young found in its assessment of MOPH, have strong monitoring capabilities. Notably, Ernst & Young found that internal audit was a critical area within MOPH that needed improvement. Moreover, there is a risk that nongovernmental organizations and individuals within MOPH-GCMU could collude to inflate the estimated costs of the program.

- Second, MOPH-GCMU does not have to provide any supporting documentation to USAID. Therefore, there is nothing to prevent MOPH-GCMU from submitting payment requests to USAID for more than is actually needed for the program.
- Third, the Ministry of Finance releases funds to the nongovernmental organizations based on information provided to it by MOPH-GCMU. Again, there is no control preventing MOPH-GCMU from falsifying the information it provides to the Ministry of Finance regarding the amount of funding that each nongovernmental organization should receive.

USAID has, however, made substantial progress since the days of its salary support program and, even, since the PCH program. Most notably, USAID has strengthened its efforts to assess the capacity of a number of Afghan ministries to manage U.S. direct assistance funds. As SIGAR reported earlier this year, USAID contracted with both Ernst & Young and KPMG to conduct thorough public financial management assessments of 16 Afghan ministries.[22] These assessments were a significant improvement over the earlier, more limited assessments that USAID had conducted and that USAID OIG had criticized in its 2010 report. For example, SIGAR found that the contracted firms not only identified the internal controls in place at each of the ministries, but tested these internal controls, as well. Moreover, USAID conducted an additional internal risk review of seven Afghan ministries in an effort to better understand the risks associated with using their systems to manage USAID's direct assistance funds.

Unfortunately, USAID's progress in assessing the risks associated with awarding funds directly to the Afghan ministries has not been matched by an equally robust strategy to ensure the Afghan government mitigates those risks. As noted in SIGAR's recent report on the ministerial assessments, Ernst & Young and KPMG concluded that all of the 16 ministries assessed were unable to manage and account for funds unless they implemented

[22] SIGAR 14-32-AR, Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries' Ability to Manage Donor Funds, but Concerns Remain, January 2014.

specific recommendations outlined in the assessments. Similarly, USAID found, in each of its seven internal risk reviews, that the ministry was unable to manage direct assistance funds without a risk mitigation strategy and that the mission would not award direct assistance to the ministry "under normal circumstances." Issues uncovered through the risk reviews include such serious problems as internal control environments inadequate to safeguard assets against theft and unauthorized use; failure to fully comply with Afghan procurement laws and regulations; and limited capacity to encourage and enforce code of government ethics.

Some of USAID/Afghanistan's risk reviews also discussed each ministry's ability and willingness to combat corruption. Specifically, USAID/Afghanistan found that DABS and the Ministries of Agriculture, Irrigation, and Livestock; Communication and Information Technology; Education; Mines and Petroleum; and Public Health had control environments that were "not adequate to mitigate risk of corruption." Of those ministries, USAID/Afghanistan only identified DABS as demonstrating, "to a certain degree, the will to address concerns that could lead to corrupt acts." Although USAID formulated 333 mitigating measures in total to address the serious risks identified within the seven ministries, it only required the ministries to implement 24 of them before they received direct assistance funds.

In response to SIGAR's report on the ministerial assessments, USAID noted that it has taken a number of additional safeguards to protect direct assistance funds from waste, fraud, and abuse. For example, unlike its arrangement with MOPH for the PCH program, it now provides funds to ministries on a reimbursement basis for specific projects using separate, non-interest bearing bank accounts to which it has viewing access to provide the funds—a practice that USAID sometimes refers to as "projectizing" the money. These steps are important and, in many ways, represent a best practice. Indeed, as SIGAR will report next quarter, USAID has done a better job of protecting direct assistance funds than other U.S. agencies, particularly the Department of Defense.[23]

[23] SIGAR is currently conducting an audit of the processes USAID and the Departments of State and Defense use to provide direct assistance funds to Afghanistan and the extent to which these agencies implement

However, it is important to note that these safeguards are primarily external measures and, as such, do not directly address the underlying problems within the ministries identified through the risk reviews. In other words, they do little to build ministries' organic capabilities to manage donor funds—one of the primary purposes of providing direct assistance to the Afghan government. To illustrate, the risk mitigation measures included in USAID's risk review of the Ministry of Agriculture, Irrigation, and Livestock identified several concrete actions that the ministry could take to address its internal problems. These actions included, among others, "define and restrict systems access to staff according to their roles and functions," "develop a policy for accounting for revenue," and "verify that adequate reference checks have been made on every prospective employee and properly documented." None of USAID's external measures—whether it be creation of separate bank accounts or distribution of funds on a reimbursement basis—would require the ministry to implement these basic and important steps.

Moreover, the effectiveness of USAID's external risk mitigation measures may be limited by ongoing problems within the ministries. For example, although USAID has developed a written monitoring and evaluation plan specific to its direct assistance program with the MOPH—as it has with a number of other ministries—USAID's risk review of that ministry found there was a serious risk of the ministry "concealing vital monitoring and evaluation information." In SIGAR's opinion, failing to address the underlying problems within the ministries constitutes, once again, an unacceptable assumption of risk.

Lesson Three: Oversight Is a Critical Element of Reconstruction

Another lesson learned is that an essential element of mitigating risk is the implementation of robust oversight. Last month, SIGAR hosted a symposium on managing and overseeing programs in contingency environments. This event, attended by a host of nongovernmental, think tank, and government officials, including USAID officials, highlighted the specific challenges of remote monitoring—assessing how projects are proceeding in areas that U.S.

certain safeguards to protect those funds from waste, fraud, and abuse. A report on that audit is expected next quarter.

government officials typically cannot visit. SIGAR's work has shown that USAID's adoption of oversight techniques has been impressive in some cases and less so in others.

For example, in April 2012, SIGAR reported on one of USAID's flagship stabilization programs, the Local Governance and Community Development Program, designed to contribute to the creation of a stable environment for medium- and long-term political, economic, and social development.[24] SIGAR found that because USAID personnel were limited in their ability to visit sites where the program was being implemented, even as early as 2003, USAID had authorized the use of alternative methods to keep mission personnel safe while satisfying the need to visit project sites and meet with project beneficiaries to assess project implementation. These methods included the collection of photographic evidence; the use of local and/or third-party monitoring; engagement with other U.S. government agencies, such as regional security officers or the U.S. military; the use of other technology for consultation or oversight; and cooperation with other donors.

SIGAR found that USAID's contracting personnel did a good job of employing these alternative oversight methods. However, SIGAR also found that USAID contracting personnel were hampered in their oversight because neither the contractors' task orders for the program nor the overall contract under which the task orders were issued required the contractor to submit documentation in support of invoices.

Moreover, SIGAR found that USAID delayed arranging a financial audit of the Local Governance and Community Development Program. This type of audit is intended to be a key control to help ensure that prices paid by the government for needed goods and services are fair and reasonable and that contractors are charging the government in accordance with applicable laws, the Federal Acquisition Regulation, Cost Accounting Standards, and contract terms. Indeed, in a larger audit of USAID's compliance with requirements for financial audits, SIGAR found a significant backlog of incurred cost audits

[24] SIGAR Audit 12-08, USAID Spent Almost $400 Million on an Afghan Stabilization Project despite Uncertain Results, but Has Taken Steps to Better Assess Similar Efforts, April 2012.

of USAID projects.[25] Specifically, SIGAR identified nearly $1.1 billion disbursed by USAID since 2003 for reconstruction projects in Afghanistan that had not been audited. SIGAR also found that, although as much as half of the funds that USAID provided for contracts, grants, and cooperative agreements may flow down to sub-recipients, USAID lacked transparency with regard to whether financial audits of sub-awards were being conducted, as required.

USAID OIG has also had mixed reviews of USAID's oversight of its programs in Afghanistan and elsewhere. For example, in September 2012, USAID OIG released a report on USAID's monitoring and evaluation system in Afghanistan.[26] This review found that USAID's Afghanistan mission had implemented several elements of an effective monitoring and evaluation system. At the same time, however, USAID OIG reported that the mission did not have a current mission order addressing monitoring either generally or for on-site monitoring, in particular. Further, no mission order detailed the roles and responsibilities of mission staff members in monitoring on-budget assistance.

Lessons can also be learned from USAID's experience in a similar environment—Pakistan. There, USAID OIG found that USAID had not taken full advantage of a five-year, $71 million program on independent monitoring and evaluation.[27] Although the mission implemented some recommendations from five of eight monitoring and evaluation reports produced as part of the program, USAID OIG also found that the majority of the mission's project activities had not made use of information learned through the program. In addition, neither the contractor implementing the program nor USAID had established a monitoring and evaluation plan to ensure that ongoing development programs were aligned with relevant project objectives of the mission.

In one of the broadest looks at USAID's oversight of its Afghanistan programs, the Government Accountability Office (GAO) reported that there were systematic weaknesses in

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[25] SIGAR Audit 12-09, USAID Has Disbursed $9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, but Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources, April 2012 (reissued on May 2, 2012).

[26] USAID OIG, Review of USAID/Afghanistan's Monitoring and Evaluation System (Report No. F-306-12-00 2-S) September 26, 2012.

[27] USAID OIG, Audit of USAID/Pakistan's Independent Monitoring and Evaluation Program [Revised] (G-391-13-003-P) October 28, 2013.

USAID's oversight and monitoring of project and program performance.[28] For example, USAID did not consistently follow its established performance management and evaluation procedures for Afghanistan agriculture and water sector projects. Moreover, GAO found that the USAID mission in Kabul was operating without a required performance plan.

In sum, while USAID has exercised due diligence in some cases to ensure proper oversight, it has not done so in others. SIGAR is, however, sensitive to the fact that oversight in an environment like Afghanistan is uniquely challenging. Without a doubt, one of the greatest impediments to strong oversight is the problem of limited mobility due to insurgent violence. As SIGAR has reported, it is likely that no more than 21 percent of Afghanistan will be accessible to U.S. civilian oversight personnel by the end of the transition—a 47 percent decrease since 2009.[29] Recent examinations of Department of Defense projects constructed in these inaccessible areas illuminate how significant this challenge is.

Last month, for example, SIGAR issued an inspection report on an Afghan National Army base in Jawzjan province—Camp Monitor, built under contract with USFOR-A.[30] When SIGAR inspectors visited the site, they found that the facility had, for the most part, been constructed in accordance with contract requirements, with one notable exception. The contractor had run out of funds and, therefore, stopped work before building a dining facility at the site. As a result, the camp was unusable. In March 2013, USFOR-A told SIGAR inspectors that action was underway to find a new contractor to build the dining facility, but its efforts were hampered because the camp was in a location that would soon be inaccessible to U.S. government contracting personnel. As a result, in November 2013, the Combined Security Transition Command-Afghanistan (CSTC-A), the USFOR-A organization responsible for managing construction of ANSF facilities, gave $1.2 million directly to the Afghan Ministry of Defense to complete construction of Camp Monitor. At this point, CSTC-A's oversight of the project essentially ceased. Although CSTC-A documents indicated that the NATO Training Mission-Afghanistan (NTM-A) would track the expenditure of this direct

[28] GAO, Afghanistan: USAID Oversight of Assistance Funds and Programs (GAO-12-802T) June 6, 2012.

[29] SIGAR 14-4-SP, Oversight Access Inquiry Letter to Department of Defense, Department of State and U.S. Agency for International Development, October 2013.

[30] SIGAR 14-41-IP, Camp Monitor: Most Construction Appears to Have Met Contract Requirements, but It Is Unclear if Facility Is Being Used as Intended, March 2014.

assistance and the project's progress, CSTC-A/NTM-A officials were unable to tell SIGAR the status of the dining facility, when and if Afghan National Army personnel began occupying the camp, or the number of personnel currently occupying it. A draft of SIGAR's inspection report contained a recommendation to the Commander, USFOR-A, to direct the Commanding General, CSTC-A, to determine and report on the status of U.S. funds provided to the Afghan government for construction of the dining facility at Camp Monitor and that such reporting should continue until the facility is completed. In response, CSTC-A stated that once funds are "donated" to the Afghan government, it may use those funds without further coordination with the U.S. Department of Defense.[31]

SIGAR strongly disagrees with the notion that once funds have been committed as direct assistance to the Afghan government, the U.S. government's stewardship over those funds ends. While USAID has not done all it could to address significant weaknesses within the ministries slated to receive direct USAID assistance, to its credit, it has also not espoused this view that the Afghan government can use U.S. government funds freely and without oversight. As SIGAR continues its examination of U.S. direct assistance to Afghanistan, it will look to ensure that this perspective is shared more widely within the U.S. government.

Lesson Four: A Reconstruction Effort Must Have Clearly Articulated Goals and a Sound Way to Measure Progress toward Those Goals

Taking a strategic approach to program implementation promotes transparency and helps ensure that a program is based on a sound plan that can achieve results and reduce potential risks to U.S. investments. Yet, while it is widely acknowledged that strategic planning is a must, SIGAR has repeatedly found that it has often been ignored throughout the Afghanistan reconstruction effort. For example, SIGAR has noted that the U.S. government has never articulated a clear anti-corruption strategy in Afghanistan. In August 2010, for example, SIGAR reported that, even though U.S. agencies had been heavily involved in Afghan reconstruction since 2002, the U.S. government did not begin developing

[31] Although CSTC-A did not concur with SIGAR's recommendation, USFOR-A committed, in its response to SIGAR's draft inspection report, to track the status of construction at Camp Monitor and provide updates to SIGAR. As a result, SIGAR deleted the recommendation from its final inspection report.

an anti-corruption strategy for Afghanistan until 2009.[32] And, although a draft strategy was substantially completed by the end of 2009, it had still not been approved by the State Department by July 2010. As a result, as SIGAR reported, more than $50 billion in U.S. assistance had been provided for reconstruction in Afghanistan without the benefit of a comprehensive anti-corruption strategy.

SIGAR recommended in that 2010 report that the U.S. government approve and implement the draft comprehensive anti-corruption strategy. However, last year, when SIGAR's Office of Special Projects followed up on the status of this recommendation, it found that the U.S. anti-corruption activities in Afghanistan were still not guided by a comprehensive U.S. strategy or related guidance that defines clear goals and objectives for U.S efforts to strengthen the Afghan government's capability to combat corruption and increase accountability.[33] The Department of State had never finalized the draft 2010 U.S. anti-corruption strategy for Afghanistan and, according to agency officials, the draft strategy and its related implementation plan were no longer in effect.

SIGAR has also found that, even when nominal strategic plans exist, U.S. government implementing agencies, including USAID, do not consistently articulate the goals they hope to achieve with each reconstruction program or project and the metrics they intend to use to assess whether those goals have been achieved.

For example, in July 2010, SIGAR reported that, while the United States had a stated policy to support women's rights and gender integration, it did not clarify how U.S.-funded activities supported these goals.[34] Nor did the policy provide linkages between U.S.-funded activities and Afghan goals and benchmarks detailed in its National Action Plan for Women of Afghanistan, the Afghan government's primary vehicle for promoting women's rights and participation in building Afghanistan.

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[32] SIGAR Audit 10-15, U.S. Reconstruction Efforts in Afghanistan Would Benefit from a Finalized Comprehensive U.S. Anti-Corruption Strategy, August 2010.

[33] SIGAR SP-13-9, U.S. Anti-Corruption Efforts: A Strategic Plan and Mechanisms to Track Progress Are Needed in Fighting Corruption in Afghanistan, October 2013.

[34] SIGAR Audit 10-13, Greater Coordination Needed in Meeting Congressional Directives to Address and Report on the Needs of Afghan Women and Girls, July 2010.

Similarly, in March 2011, SIGAR reported that, although the National Solidarity Program, designed to build local governance by setting up community development councils and training them to manage small-scale projects funded by block grants, had met or exceeded most of its quantitative goals, it had not effectively measured progress toward its qualitative objective of improving local governance in Afghanistan.[35] Metrics tracked, for instance, outputs such as the number of communities mobilized and the number of projects funded. But, it was not until more than seven years into the program that more qualitative and meaningful metrics tied to the program's core purpose were established, such as the percentage of communities that recognize community development councils as legitimate bodies; the percentage of women representatives on community development councils involved in decision making; and the number of community development councils that attempt to form linkages with government and non-government actors.

Finally, in October 2011, SIGAR reported that the U.S. Embassy in Kabul was not able to determine how much progress had been made to date in building the capacity of the Ministry of Agriculture, Irrigation, and Livestock because it did not have sufficient or complete data for doing so.[36] Although some meaningful, outcome-oriented measures had been defined, no effort had been made to collect the data needed to assess progress against them. Moreover, SIGAR found that USAID's evaluation efforts had not been coordinated with other U.S. government agencies involved in strengthening the ministry, most notably the U.S. Department of Agriculture. For example, while USAID's program on agricultural research and extension was the only program designated to provide performance data on improving Afghan government agricultural and extension services, the U.S. Department of Agriculture also had a program focused on the same goal. Failure to consider all agencies' efforts in this area ran counter to USAID's guidance on performance management, which recognizes that, while individual projects and activities produce specific outcomes, it takes the combined effect of several projects to produce a sustainable impact.

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[35] SIGAR Audit 11-08, Afghanistan's National Solidarity Program Has Reached Thousands of Afghan Communities, but Faces Challenges that Could Limit Outcomes, March 2011.

[36] SIGAR Audit 12-01, Actions Needed to Better Assess and Coordinate Capacity-Building Efforts at the Ministry of Agriculture, Irrigation, and Livestock, October 2011.

USAID is certainly not alone in its tendency to emphasize outputs over outcomes. Outputs are easier to measure and, therefore, present an expedient way to justify program expenditures. But, they offer little meaningful information about whether a program is working and worth the investment to begin with.

The importance of performance measurement was underscored most notably in correspondence between SIGAR and USAID and the Departments of State and Defense last year. In March 2013, SIGAR asked each of these three agencies to provide SIGAR with information on what each considered to be the 10 most and 10 least successful of its projects or programs for the reconstruction of Afghanistan, supplemented with explanations of selection and evaluation criteria for the choices.[37] Unfortunately, while each agency provided anecdotes of what it deemed successful programs and cited general improvements within Afghanistan related to health, education, and other important areas, none could show how any of its programs had directly contributed to these positive outcomes.

For example, in its joint response letter to SIGAR, USAID and the Department of State noted that the proportion of the Afghan population within an hour's walk of a health care facility has risen from 9 percent in 2001 to more than 60 percent today. This statistic is, indeed, impressive. However, it is not clear to what extent, if any, USAID and the State Department's efforts contributed to this improvement. Afghanistan has been slowly urbanizing for decades, with estimates of 4.7 percent annual growth in urban populations in the 2010-2015 period. So some part of the observed increase in the one hour's walk parameter simply reflects a demographic trend. Moreover, the indicator may also reflect the presence of more direct or better-surfaced roads and paths, rather than programs to build health care facilities. It simply is not clear and never will be without more robust performance measurement.

[37] See "SIGAR Asks State Department, Defense Department, and USAID to Identify 10 Best and 10 Worst Projects in Afghanistan; Request Will Improve Evaluation of Afghan Reconstruction Efforts," April 1, 2013; "SIGAR Receives State Department-USAID and Department of Defense Response to Inquiry Requesting Lists of 10 Best and 10 Worst Reconstruction Projects in Afghanistan," June 24, 2013; and "SIGAR Response to State Department-USAID and Department of Defense List of 10 Best and 10 Worst Reconstruction Projects in Afghanistan," July 5, 2013. SIGAR News Releases, www.sigar.mil.

Conclusion

Implementing, managing, and overseeing reconstruction programs in Afghanistan is uniquely challenging. No government and no agency will do it perfectly. In many ways, USAID has made substantial progress since it began its efforts following the U.S. military's invasion in 2001. However, there are additional steps that USAID can take to strengthen its reconstruction programs. It can incorporate more realistic expectations of the Afghan government's ability to afford the costs of operating and sustaining projects into individual project plans. It can be bolder in holding Afghan ministries accountable for addressing severe problems as a condition for receiving direct assistance.[38] It can engage in more robust financial oversight of its reconstruction regime. It can experiment with more meaningful outcome measures. And it can be more forthright in providing complete information to both Congress and the American people about its reconstruction activities in Afghanistan.[39]

But, it is not up to USAID, alone, to bring greater integrity to the U.S. government's reconstruction effort in Afghanistan. Congress, too, has a role to play. It can continue to ask the tough questions that this committee is asking today, and it can help articulate for USAID and other agencies charged with rebuilding Afghanistan what it is that the U.S. government hopes to achieve in Afghanistan in the years to come.

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[38]Although USAID has withheld some funding due to the Afghan government's failure to meet certain conditions, such as withholding $30 million from the Afghan Reconstruction Trust Fund (ARTF) due to inadequate progress on meeting certain Tokyo Mutual Accountability Framework benchmarks, these amounts are small, compared to the $16.7 billion in Economic Support Fund monies committed for Afghanistan reconstruction.

[39] SIGAR has reported that USAID and the State Department did not fully disclose to Congress the risks associated with providing direct assistance to the Afghan ministries. For example, while USAID notified Congress in November 2012 that, with the "successful implementation" of risk mitigation strategies, the Afghan ministries were qualified to manage direct assistance funds, it did not disclose the full extent of the risks identified at each of the ministries or that over 90 percent of the mitigating measures identified in the risk reviews had not been implemented. See SIGAR 14-32-AR, pp. 14-16 for further discussion.

Finally, SIGAR can continue to provide strong oversight and, most importantly, constructive recommendations for protecting U.S. taxpayer funds and improving the effectiveness and efficiency of the reconstruction effort.

Thank you for the opportunity to testify today. I look forward to answering your questions.

Appendix I - SIGAR, GAO, and USAID OIG Reports on USAID's Reconstruction Efforts in Afghanistan

SIGAR

Performance Audits

1. "Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries' Ability to Manage Donor Funds, but Concerns Remain," Audit Report 14-32, January 2014.
2. "Afghanistan's Banking Sector: The Central Bank's Capacity to Regulate Commercial Banks Remains Weak," Audit Report 14-16, January 2014.
3. "Health Services in Afghanistan: USAID Continues Providing Millions of Dollars to the Ministry of Public Health despite the Risk of Misuse of Funds," Audit Report 13-17, September 2013.
4. "Stability in Key Areas (SIKA) Programs: After 16 Months and $47 Million Spent, USAID Had Not Met Essential Program Objectives," Audit Report 13-16, July 2013.
5. "Afghanistan Public Protection Force: Concerns Remain about Force's Capabilities and Costs," Audit Report 13-15, July 2013
6. "Contracting with the Enemy: State and USAID Need Stronger Authority to Terminate Contracts When Enemy Affiliations Are Identified," Audit Report 13-14, July 2013.
7. "Health Services in Afghanistan: Two New USAID Funded Hospitals May Not Be Sustainable and Existing Hospitals Are Facing Shortages in Some Key Medical Positions," Audit Report 13-9, April 2013.
8. "Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan," Audit Report 13-8, May 2013.
9. "Afghanistan's National Power Utility: Commercialization Efforts Challenged by Expiring Subsidy and Poor USFOR-A and USAID Project Management," Audit Report 13-7, April 2013.
10. "Afghanistan's National Power Utility: $12.8 Million in DoD-Purchased Equipment Sits Unused, and USAID Paid a Contractor for Work Not Done," Audit Report 13-2, December 2012.
11. "Fiscal Year 2011 Afghanistan Infrastructure Fund Projects Are behind Schedule and Lack Adequate Sustainment Plans," Audit Report 12-12, July 2012.

12. "Progress Made Toward Increased Stability under USAID's Afghanistan Stabilization Initiative-East Program but Transition to Long Term Development Efforts Not Yet Achieved," Audit Report 12-11, June 2012.

13. "Increases in Security Costs Are Likely under the Afghan Public Protection Force; USAID Needs to Monitor Costs and Ensure Unlicensed Security Providers Are Not Used," Audit Report 12-10, June 2012.

14. "USAID Has Disbursed $9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, But Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources," Audit Report 12-09, April 2012.

15. "USAID Spent Almost $400 Million on an Afghan Stabilization Project despite Uncertain Results, but Has Taken Steps to Better Assess Similar Efforts," Audit Report 12-08, April 2012.

16. "Afghan First Initiative Has Placed Work with Afghan Companies, but Is Affected by Inconsistent Contract Solicitation and Vetting, and Employment Data Is Limited," Audit Report 12-06, January 2012.

17. "Actions Needed to Better Assess and Coordinate Capacity-Building Efforts at the Ministry of Agriculture, Irrigation, and Livestock," Audit Report 12-01, October 2011.

18. "The World Bank and the Afghan Government Have Established Mechanisms to Monitor and Account for Funds Contributed to the Afghanistan Reconstruction Trust Fund, but Some Limitations and Challenges Should Be Addressed," Audit Report 11-14, July 2011.

19. "Limited Interagency Coordination and Insufficient Controls over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash," Audit Report 11-13, July 2011.

20. "USAID's Kabul Community Development Program Largely Met the Agreement's Terms, but Progress Toward Long-Term Goals Needs to be Better Tracked," Audit Report 11-11, June 2011.

21. "Afghanistan's National Solidarity Program Has Reached Thousands of Afghan Communities, but Faces Challenges that Could Limit Outcomes," Audit Report 11-08, March 2011.

22. "Actions Needed to Mitigate Inconsistencies in and Lack of Safeguards over U.S. Salary Support to Afghan Government Employees and Technical Advisors," Audit Report 11-05, October 2010.

23. "Weakness in Reporting and Coordination of Development Assistance and Lack of Provincial Capacity Pose Risks to U.S. Strategy in Nangarhar Province," Audit Report 11-01, October 2010.

24. "Greater Coordination Needed in Meeting Congressional Directives To Address and Report on the Needs of Afghan Women and Girls," Audit Report 10-13, July 2010.

25. "Afghanistan's Control and Audit Office Requires Operational and Budgetary Independence, Enhanced Authority, and Focused International Assistance to Effectively Prevent and Detect Corruption," Audit Report 10-08

26. "Contract Delays Led to Cost Overruns for the Kabul Power Plant and Sustainability Remains a Key Challenge," Audit Report 10-06, January 2010.

27. "Afghanistan Energy Supply has Increased but an Updated Master Plan is Needed and Delays and Sustainability Concerns Remain," Audit Report 10-04, January 2010.

28. "Afghanistan's High Office of Oversight Needs Significantly Strengthened Authority, Independence, and Donor Support to Become an Effective Anti-Corruption Institution," Audit Report 10-02, December 2009.

29. "Strategy and Resources Needed to Sustain Afghan Electoral Capacity," Audit Report 09-06, September 2009.

30. "A Better Management Information System Is Needed to Promote Information Sharing, Effective Planning, and Coordination of Afghanistan Reconstruction Activities," Audit Report 09-03, July 2009.

Inspections

1. "Balkh Education Facility: Building Remains Unfinished and Unsafe to Occupy after Nearly 5 Years," Inspection Report 14-24, January 2014.

2. "Gardez Hospital: After almost 2 Years, Construction Not Yet Completed because of Poor Contractor Performance, and Overpayments to the Contractor Need to Be Addressed by USAID," Inspection Report 14-6, October 2013.

Financial Audits

1. "USAID's Strategic Provincial Roads Program: Audit of Costs Incurred by International Relief and Development, Inc.," Financial Audit Report 14-39, February 2014.

2. "USAID's Health Service Support Project: Audit of Costs Incurred by Jhpiego Corporation," Financial Audit Report 14-34, February 2014.

3. "USAID's Food Insecurity Response for Urban Populations Program: Audit of Costs Incurred by CARE International," Financial Audit Report 14-29, January 2014.

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SIGAR | Special Inspector General for Afghanistan Reconstruction

John F. Sopko was sworn in as Special Inspector General for Afghanistan Reconstruction on July 2, 2012. Mr. Sopko, appointed to the post by President Obama, has more than 30 years of experience in oversight and investigations as a prosecutor, congressional counsel and senior federal government advisor.

Mr. Sopko came to SIGAR from Akin Gump Strauss Hauer & Feld LLP, an international law firm headquartered in Washington, D.C., where he had been a partner since 2009.

Mr. Sopko's government experience includes over 20 years on Capitol Hill, where he held key positions in both the Senate and House of Representatives. He served on the staffs of the House Committee on Energy and Commerce, the Select Committee on Homeland Security and the Senate Permanent Subcommittee on Investigations.

In his most recent congressional post, Mr. Sopko was Chief Counsel for Oversight and Investigations for the House Committee on Energy and Commerce, chaired by Rep. John D. Dingell (D-Mich.), during the 110th Congress. There, he supervised several investigations focused on matters regulated by the Food and Drug Administration, Department of Energy, Department of Commerce, Federal Communications Commission, Federal Energy Regulatory Commission, U.S. Commodity Futures Trading Commission and Consumer Product Safety Commission.

Mr. Sopko also served as General Counsel and Chief Oversight Counsel for the House Select Committee on Homeland Security, where he focused on homeland security and counter-terrorism investigations and issues.

At the Senate Subcommittee on Investigations, chaired by then-Sen. Sam Nunn (D-Ga.), Mr. Sopko conducted investigations on a broad range of issues, from healthcare insurance to complex weapons systems. From 1982 to 1997, Mr. Sopko led investigations for the chairman and subcommittee members that included a multi-year investigation related to health insurance; union infiltration by organized crime; protection of critical infrastructure; the potential spread of weapons of mass destruction in the former Soviet Union and elsewhere; enforcement of the Foreign Corrupt Practices Act; cybersecurity; international drug interdiction programs; counter-terrorism policies and procedures; government procurement fraud and the illegal export of dual-use technologies.

After his work in the Senate, Mr. Sopko was recruited by the Commerce Secretary to manage to department's response to multiple congressional, grand jury and press inquiries. While at the Commerce Department, Mr. Sopko was named Deputy Assistant Secretary for Enforcement for the Bureau of Export Administration, and Deputy Assistant Secretary for the National Telecommunications and Information Administration.

Mr. Sopko previously served as a state and federal prosecutor. As a trial attorney with the U.S. Department of Justice Organized Crime and Racketeering Section, he conducted numerous long-term grand jury investigations and prosecutions against organized crime groups. He was the lead attorney in the first successful federal RICO prosecution of the entire leadership structure of an American La Cosa Nostra crime family. In 1982 he received the Justice Department's Special Commendation Award for Outstanding Service to the Criminal Division, and in 1980 he received the department's Special Achievement Award for Sustained Superior Performance.

Mr. Sopko began his professional career as a state prosecutor in Dayton, Ohio, with the Montgomery County prosecutor's office. He served as an adjunct professor at American University's School of Justice, where he received the Outstanding Adjunct Faculty Teaching Award in 1984 and the Professor of the Year Award in 1986. He received his bachelor's degree from the University of Pennsylvania in 1974, and his law degree from Case Western University School of Law in 1977. He is a member of the bars of Ohio and the District of Columbia.

Mr. CHAFFETZ. Thank you.

I will now recognize myself for five minutes.

Mr. Sampler, on November 2nd, 2012, USAID Administrator Shaw approved a memo which waived USAID's requirements for Afghanistan to meet USAID's internal risk measures before it could be eligible for direct assistance. Why the need to waive the requirements?

Mr. SAMPLER. Thank you for the question, Mr. Chairman, and allowing me to clear this up. Our internal mechanisms are indeed rigorous. I appreciate the recognition of that fact.

The regulations we are referring to here are ADS 220. It was written as a single unified package of regulations. It consists of two stages. Stage one is a rapid assessment that is done and includes a number of very high level indicators.

Mr. CHAFFETZ. Well, I know what it is and our time is short. I want to know why it was waived.

Mr. SAMPLER. Because the government-to-government engagement in Afghanistan predated the creation of ADS 220. And ADS 220 was created in part based on lessons learned in Afghanistan.

Mr. CHAFFETZ. So let me ask you, well, it seems like the oversight requirements got less, not more rigorous. So Mr. Sopko, what do you see in this situation?

Mr. SOPKO. We are concerned that they did waive those internal controls. But we thought they were very good internal controls.

We actually are concerned for two reasons. Number one, as you said, Mr. Chairman, rather than them being more stringent, we are now less stringent. Number two, this was a tremendous opportunity that we wasted, or I should say AID did. This was a tremendous opportunity to really follow through with conditionality before we started the direct assistance. We could have required them to comply with those internal controls. We could have required the Afghans to comply with those 333 recommendations by AID to fix internal problems. It didn't.

Mr. CHAFFETZ. Your office, Mr. Sopko, issued a report on this assessment. There were 333 recommended risk mitigation measures. USAID only required the implementation of 24 of those. And when I asked Mr. Sampler at our last hearing about this, and Mr. Sampler, your response was that the finding was "true but inaccurate" and I gave you an opportunity to respond. I would like to give Mr. Sopko an opportunity to provide his perspective on this.

Mr. SOPKO. I believe our statement is not only true, it was accurate. I think Mr. Sampler seems to think that because the funds are what he calls projectized, USAID only needs to address specific problems that it deems to be directly related to each project. USAID has got this wrong. The types of problems uncovered in the risk assessments will likely affect every project.

Let me describe for you some of the findings from USAID's risk assessments. And I know you have some of them here. If you look at the one for the Ministry of Mines, funds being used for unintended purposes, that risk is being ignored. Paying higher prices for commodities and services to finance kickbacks and bribes, that is being ignored. Collusion to skirt liquid assets, such as cash, that is being ignored in the Ministry of Mines and Petroleum.

The Ministry of Public Health, of which none of the recommendations were implemented by Mr. Sampler and USAID, the first one is diverting government resources for unintended purposes. That was ignored. Waste, fraud and system abuse may go undetected, that was ignored. Losing vital data and information, that was ignored. Manipulation of accounting information after approval and posting to hide illegal actions, that was ignored. Misappropriation of cash arising from payment of salaries in cash, that was ignored.

Mr. Chairman, I could go through ministry after ministry. These also were the documents as far as I know were not provided to this committee in any form until we provided it to them this week. These we believe were very significant.

The problem is, the reforms they have set up, the plan for reforms they have set up deal with external issues. They don't really deal with these basic, inherent problems in each of the ministries. I am happy to walk through what we have found in the Ministry of Public Health when the time allows.

Mr. CHAFFETZ. Mr. Sampler?

Mr. SAMPLER. Thank you. Where to begin. Nothing was ignored. Again, as the Special Inspector General has pointed out, these were our risk assessments that were done by our mission at our request and for our use.

Mr. CHAFFETZ. This idea that you only had to implement 24 of the 333, is that accurate or inaccurate?

Mr. SAMPLER. Over time, they will all be addressed. But to begin a project, we only addressed the ones that were necessary to safeguard taxpayer resources on that project.

Mr. CHAFFETZ. So there were more than 300 that you didn't think were important here? The problem is, you give a waiver on the front side of it, then we go back and do an assessment, you ignore more than 300 of them. The Special Inspector General comes in to look at it, an independent third party having a look at it and says, this is a huge fundamental problem. We have billions of dollars going out the door. And you say, well, we will address it down the road. Meanwhile, we have spent over $100 billion there and don't see the results we should probably get for that money.

Mr. SAMPLER. And Congressman, we haven't spent $100 billion going out the door on these programs.

Mr. CHAFFETZ. We have between what USAID and the Department of Defense has done, yes, we have, and other agencies as well.

Mr. SAMPLER. The programs that the Special Inspector General has cited are very specific programs with very specific ministries. And not a dollar flows to any of those accounts until safeguards are in place that are adequate to that.

Mr. CHAFFETZ. Let's just take that statement. Mr. Sopko, what is your assessment of that?

Mr. SOPKO. Unfortunately I have to disagree. And I know my time is short. But I would like to talk about how the money flows to the Ministry of Public Health.

Mr. CHAFFETZ. Please. In agreement here with Mr. Tierney, go ahead and let's walk through this and then I will turn the time to Mr. Tierney.

Mr. SOPKO. I think we have given you smaller charts, and I apologize, that is kind of small, it is hard to read. Comparing the different.

Mr. CHAFFETZ. The graphics on those maybe that are watching on television, which one are you going to go to first?

Mr. SOPKO. I am looking at the PCH payment chart.

Mr. CHAFFETZ. That is what is up on the screen.

Mr. SOPKO. The one to the right. That is the smaller one. We couldn't afford the big chart.

[Laughter.]

Mr. SOPKO. That shows how the money flows. And part of it is the explanation given that no money actually goes to the Afghan ministries. Well, this is how the money flows. This is based upon our audits of the Ministry of Public Health and our criminal investigation that is ongoing right now.

So let's not quibble over whether funds don't go or do go to the government. The important question is the risk here. As you can see from the chart, the Ministry of Public Health, up at the top, GCMU requests money from USAID. The Ministry of Public Health and the GCMU unit, that is their internal control unit that they are very proud of, submits a payment request to USAID every 45 days.

Now, the problem is, there is no support for those advances. MOPH and GCMU does not provide any supporting documentation to USAID when it requests the advance in money. And again, just looking at that chart, we are talking about big sums of money. From 2008 to 2014, that is $236 million. And they are planning to spend $435 million. That is the estimate from 2014 and beyond.

Then we go to MOPH and GCMU invoices, and what we found in our criminal investigation could well be bogus. Although the NGOs submit invoices and other supporting documentation to MOPH and GCMU, Ernst and Young, the accounting firm that AID hired, said that the MOPH does not have a strong monitoring capability. Ernst and Young also found that the Ministry of Public Health's internal audits are a critical area that needs improvement.

Now, to show how bad things are, USAID has implemented a process for reconciling expenditures, not only in MOPH, but all of the ministries are giving direct assistance. The results of that internal investigation, that internal review, that they are holding you out, as protecting the U.S. taxpayer dollar. They uncovered a total of $77 in unexplained funds.

Now, I don't know if Afghanistan is the most honest country in the world. But I know we do our own financial audits on U.S. firms working in there. And we have identified millions of dollars in funds that are suspicious. So I just throw that out in consideration for how adequate those reviews are done.

The money then flows from USAID to a U.S. disbursing office, which sends funds to Afghanistan Central Bank. There we are, an Afghan ministry, that is the Afghan Central Bank. The account is jointly held by the Ministry of Finance, another Afghan ministry, and the Ministry of Public Health. And then the Afghan government pays the NGO.

The Afghan Ministry of Finance uses the special account to pay the NGOs based on information provided by the Afghan Ministry of Public Health. Now, admittedly, USAID has the ability to monitor that. That is great. The problem is you are dealing with ministries that their own internal auditors said manipulate documents.

So on the one hand, the lower part of the chart, that is the money going from AID, the U.S. disbursement office, to the Afghanistan bank, that is probably pretty safe. Our problem is the upper part of the chart and what eventually happens with the money once we give it to the ministries.

Now, we have been doing a criminal investigation that we can't really discuss in great detail. But we have witnesses who have worked in their internal unit who indicate that fraudulent invoices are being used for closed health facilities, fraud is centered around rental vehicles that aren't being used properly, that GCMU officials are soliciting bribes from NGOs and they are purchasing goods from Iran with U.S. funding.

The witnesses we are talking to have first-hand knowledge. They were inside the ministry. And a key witness who has met with my head of investigations, a career FBI man I met almost 30 years ago, and my deputy IG, who had 38 years of experience, all believe the allegations are credible.

But what they show are weak points if we don't really fix the problem. Thank you.

Mr. CHAFFETZ. Thank you. I now recognize the gentleman from Massachusetts, Mr. Tierney.

Mr. TIERNEY. Thank you.

Mr. Sampler, I want to start back at the very basic part of this. Can you articulate for us here, the committee, the United States national security interest in the amount of aid going to Afghanistan?

Mr. SAMPLER. Certainly. I can speak specifically to USAID's amount of aid going to Afghanistan.

Mr. TIERNEY. I want you to speak to the national interest. What is our national security interest in that aid going to Afghanistan?

Mr. SAMPLER. We have invested 12 years in blood and treasure to make sure that there will never be another attack on U.S. soil from Afghanistan. Rather than perpetually police a foreign state, it is in our best interest to make sure that Afghanistan has both the wherewithal, the political will and the capacity to police itself.

Mr. TIERNEY. Back that up. So one rationale, you are saying, is we have invested 12 years, and that is one of our national security interests to protect with that investment?

Mr. SAMPLER. Correct.

Mr. TIERNEY. And then you went on to say, what was the rest of that?

Mr. SAMPLER. Rather than continue to have to police the territory of Afghanistan, it would be better if we stood up a government that could do that itself.

Mr. TIERNEY. So what would we be policing the territory of Afghanistan for?

Mr. SAMPLER. We won't.

Mr. TIERNEY. But if we didn't do this, what would be being forced to police them for?

Mr. SAMPLER. Congressman, Afghanistan is a place where it is incredibly difficult to detect and prevent organizations from setting up training camps.

Mr. TIERNEY. Would that be similar to Yemen and Somalia and Sudan, Djibouti?

Mr. SAMPLER. I have been to Yemen. The others I have not. The difference in Yemen, in my experience, is that the population of Yemen is spread out so much that no, there are not the same numbers of ungoverned spaces, desolate places where people just don't go. And you can get away with setting up base camps and training camps.

But certainly in principle, it would be similar to those locations.

Mr. TIERNEY. All right, I think that is the first base question we have to ask here, is why do we continue spending money. What is the proportion of total aid from foreign countries to Afghanistan, what proportion is being spent by the United States versus other nations or other international organizations?

Mr. SAMPLER. Congressman, I don't know the answer to that.

Mr. TIERNEY. Arguably there are some others who have a higher national security interest in Afghanistan than the United States. I would be interested to know whether or not they are paying their proportional share relative to everybody's risk and their own risk.

Mr. SAMPLER. And I can say, we are certainly the largest donor. But I don't know the exact proportion.

Mr. TIERNEY. Mr. Sopko, if we were to wake up one morning and USAID would decide to implement all of the recommendations that their own assessments have put forth and the Inspector General's office put forth, what additional resources would the USAID offices need?

Mr. SOPKO. We haven't done an assessment on what type of resources.

Mr. TIERNEY. Would they need more?

Mr. SOPKO. They probably would need more. But a lot of this is requiring the Afghan government to implement these changes. So we think that is money well spent.

Mr. TIERNEY. Do you think the Afghan government in its current situation is capable and willing to implement those changes?

Mr. SOPKO. Those are two questions. The willingness and the capability. We are hopeful the new government will.

Mr. TIERNEY. What makes you hopeful of that? Do you know the characters or individuals that are involved there? What gives you hope?

Mr. SOPKO. My hope is always eternal. This is a chance for an election, a new government, we are hoping for the best. I can't comment on any individual running for office. I don't think it would be proper for me. But we are very hopeful. It gives us an opportunity to do that conditionality. It gives us that opportunity which we don't have, I believe, with the current government.

Mr. TIERNEY. And now the capability?

Mr. SOPKO. The capability is something we are going to have to work on. But the important thing is, we have training missions, AID has done some good work. As a matter of fact, we highlighted one of the ministries as being done the right way. So obviously they know how to do it. They came up with a plan. We are not certain it has been implemented, but at least they came up with a plan with DABS. So they know how to do it. And we can do it. What we are saying is they should have done it for the rest of the ministries before we gave them money.

Mr. TIERNEY. Mr. Sampler, is there any going back and putting the types of conditionalities that Mr. Sopko speaks to on the issuance of aid?

Mr. SAMPLER. Congressman, there are two levels of conditionality. One is a political level that USAID doesn't have. That is a State Department decision about conditionality of the assistance to Afghanistan. But I would like to set the record straight with respect to the chart.

Mr. TIERNEY. I will let you do that in a second. But I want to go back to the full answer of my question if I could. So you have your own internal process used here, the conditionalities that you would generally put on something you say were waived on that basis.

Mr. SAMPLER. They were not waived.

Mr. TIERNEY. They were not waived. All right. So the second set, you have your political considerations.

Mr. SAMPLER. Yes.

Mr. TIERNEY. And then you have your own processes that set aside political considerations you would normally put on there?

Mr. SAMPLER. Yes.

Mr. TIERNEY. So what about those?

Mr. SAMPLER. Congressman, we do have a set of safeguards. When I say they weren't waived, ADS 220 was waived, but despite the waiver, we have implemented safeguards that replicate both the letter and intent of what ADS 220 would require.

Mr. TIERNEY. Why didn't you just implement ADS 220?

Mr. SAMPLER. ADS 220 has two components. The first component we couldn't implement. We had already begun the engagement and we had moved past that chronologically.

Mr. TIERNEY. I'm sorry, let's break it down step by step. What is it that you have moved past that you couldn't go back and do better?

Mr. SAMPLER. An initial comprehensive assessment of things like the status of democracy and governance, the status of human rights. It is, I call it, well, we will run over the world perspective of is this a government where we wish to do GDG asesssments.

Mr. TIERNEY. Why couldn't you stop at whatever point you were at and do that?

Mr. SAMPLER. That was a policy decision that was made in 2001 when we went to Afghanistan. We were already there. This is a decision of do we go there or do we go to Yemen or Somalia or to some other deserving country to do this work. We made the decision that we are in Afghanistan and we made the decision that we have to proceed.

Mr. TIERNEY. Okay, so you are saying, we have, are you saying political actors have?

Mr. SAMPLER. The U.S. Government has made the decision that we will be there. And USAID is part of that engagement in Afghanistan. The second stage is where we do have rigorous mechanisms to provide checks and balances. I wouldn't call it conditionality, I would just say, we won't do it until these things are met.

Mr. TIERNEY. That would be pretty conditional.

Mr. SAMPLER. And that is a very focused approach to individual projects. The risks that we identified when we did the initial assessments to these ministries are all credible and very important risks, I don't deny that.

Mr. TIERNEY. So why not condition every dime that goes out on the satisfaction of all those points?

Mr. SAMPLER. We prioritize the risks that directly affect the projects we are trying to accomplish. If we waited to have perfect ministries before we began working on things like health care and education, we would not be working on health care and education.

Mr. TIERNEY. Because you don't think the government would respond to do those things, it was not important enough for them?

Mr. SAMPLER. Congressman, in 2002 when I was in Afghanistan——

Mr. TIERNEY. Well, it is not 2002 any more, right? It is 2014. So today, you think putting conditionalities on that that the Afghan government isn't interested enough in having those things done with our assistance that it would rabidly comply with whatever conditionalities we are putting?

Mr. SAMPLER. They are and will rapidly comply with the things they are capable of doing and the things that they have the will to do. So absolutely, they will. But the capacity isn't there. These ministries are being built from the ground up.

Mr. TIERNEY. So it is your assessment, I guess, that despite the fact that they don't have the capacity and they may not have the will to implement all the things that are necessary to be risk-free, you think the risks are worth it? You have made that assessment? Somebody in your entity has made the assessment that risk is worth just doing these things without all assurances in place?

Mr. SAMPLER. Congressman, I don't want to accept the way that is stated.

Mr. TIERNEY. Well, restate it if you want. But you know what I am getting at.

Mr. SAMPLER. I do. And I will accept that we recognize there are risks that we are not mitigating at this point in time. Those are risks that must be mitigated before these ministries are fully functioning.

But in the interim, we are projectizing our assistance, on very specific things. And the risk associated with that project will and must be mitigated before we move any money to that ministry.

Mr. TIERNEY. But you are not totally mitigating, you understand that, and you know that some money is going out the door?

Mr. SAMPLER. I don't know that you can totally mitigate a risk in Afghanistan. We are mitigating the risks specific to a project to a level that satisfies us that we can control the funds going to that project.

Mr. TIERNEY. Mr. Chairman, I know I am over my time and I thank you for that. I would like to go back hopefully to some sort of question as to how much is that risk, how much is going out there, and make an assessment on that.

Mr. CHAFFETZ. I concur, thank you very much.

I now recognize the gentleman from Florida, Mr. Mica.

Mr. MICA. Thank you, Mr. Chairman. Mr. Inspector General, as I recall when you came before us before, you testified that we had approximately, I believe the amount was $20 billion that, in Afghanistan money that was backed up, that they had neither the ability nor capacity to spend or steal, I think it was, was that an accurate statement?

Mr. SOPKO. I think you are correct. It is about, actually it is more than $20 billion right now, that has been appropriated, authorized but not yet spent.

Mr. MICA. And I think you had said that, then I asked you again, was that correct. In fact, later on I called your office to make sure I wasn't misquoting you. Because I was just stunned by that.

We spent over $100 billion, the chairman said, $100 billion in 10 years, is that about right, Mr. Sampler, in U.S. money in AID? I am not talking about military aid, I am talking about economic aid.

Mr. SAMPLER. That is not correct, Congressman.

Mr. MICA. How much is it?

Mr. SAMPLER. USAID's number is $14.2 billion.

Mr. MICA. In how many years?

Mr. SAMPLER. Since 2001.

Mr. SOPKO. Mr. Mica, if I could just correct. That was the amount of money for reconstruction. Now, reconstruction isn't just USAID. The bulk of that money is actually DOD.

Mr. MICA. Okay, but we are approaching $100 billion in reconstruction. An that is not military money, is that right?

Mr. SOPKO. We draw the distinction between reconstruction and money actually for the war fighting. So reconstruction can also be paying the salaries, we are paying the salaries of all the soldiers.

Mr. MICA. So since there is not much infrastructure and not much in the way of sophisticated communities that we are spending an awful lot of money in a country whose annual budget, the federal budget is at $5.7 billion, in that range? Anybody know?

Mr. SOPKO. They collect revenue of about $2.2 billion, that is how much they collect. They spend a lot more.

Mr. MICA. All right. Well, they have great models in spending more than they take in.

But my point is again, first of all, I would like to cut off all economic aid, reconstruction aid, AID aid, any reconstruction money to Afghanistan, period. I would also like to know, Mr. Sampler, what have we done, schools? I was over there and saw some schools, I saw some roads, I saw some bridges, infrastructure. Is that some of what we are doing in infrastructure and aid?

Mr. SAMPLER. Yes, sir, it is.

Mr. MICA. Yes. Well, I can tell you, I come from communities that could use all of that. In fact, I may have an amendment in Appropriations that we open that $20 billion that is backed up to my communities. I might get a few votes on that. Because we have those same needs in our communities.

And again, when I have someone charged with oversight who tell us they have neither the capacity to spend or steal, that gives me great heartburn. I think of people getting up early in the morning, going to work and trying to feed their family, pay their mortgage and just get by week to week. And we are sending that money over there, that drives me bananas.

I was there, I saw the schools. A school pointed out, I went through the school. And it was the community joke. Everyone was telling us, the troops were telling us, the locals were telling us, we paid five times what we should pay for construction of that particular facility. We are getting ripped off.

My question earlier was, have the Afghans held any accountable of either violating Afghan law or has the U.S. gone after anybody and held them accountable? Do we have that list yet?

Mr. SOPKO. Congressman, I don't have the list. We can provide that list from what we have done.

Mr. MICA. That was promised before. That was March 13th. And we haven't gotten that I know of.

Mr. SOPKO. I didn't testify then, sir.

Mr. MICA. Okay, well, whoever came. But I have been promised a list, we don't have the list. I want to know, do you know if many have been prosecuted within Afghanistan?

Mr. SOPKO. I don't know how to define many. We brought a number of investigations, we prosecuted individuals, Afghan individuals. The difficulty is, we have to have a nexus to the United States, since we can't extradite. But we have turned some information over to the Afghan Ministry of Justice and they have actually prosecuted some individuals, not many. They are the small fry, the prosecutors and police readily admit that they can't get us the big fry, the big players. So they have done some of that work.

Mr. MICA. Mr. Sampler wanted to respond.

Mr. SAMPLER. If I could just add, we received actually just yesterday a press release from our inspector general that an Afghan, Abdul Kulial Kaderi, was arrested and charged with embezzlement by the Afghan National Security Police for attempting to embezzle $539,000 from a partner. Now, I admit this with some reservation.

Mr. MICA. I was told that the theft goes from the lowest official to the president's office, the president's family and others. And it is widely known that people are ripping off the United States through our various aid and assistance programs. People have to be held accountable. I think we have to stop pouring money into this black hole.

I yield back. Thank you.

Mr. CHAFFETZ. I now recognize the gentlewoman from Illinois, Ms. Kelly, for five minutes.

Ms. KELLY. Thank you, Mr. Chair.

Mr. Sampler, I would like to draw your attention to a February 11th, 2014 Associated Press article that discusses the effects of the planned U.S. troop drawdown on the continuing U.S. presence in Afghanistan. While the article raises some concerns over the drawdown, it does not indicate how much USAID programs and projects will be affected.

The article quotes your thoughts on this transition, and according to the article you say as international military forces leave, Afghanistan will more closely begin resembling a normal operating environment for USAID. Can you explain what you mean by a normal operating environment?

Mr. SAMPLER. Yes, ma'am. The USAID operating environments around the world range from highly permissive to highly non-permissive environments. I have some experience with Colombia where in one country there are places where we can work in open, soft-skinned vehicles and in other places where we can't go without armed guards.

So it will resemble a normal operating environment, however, in that development decisions will be based on development principles and priorities and less focused on stabilization priorities. That is the challenge in Afghanistan, has been balancing good, sound development principles with the requirement to provide stabilization support at the same time. That is how it becomes a bit more normal for us.

Ms. KELLY. Okay. And I know USAID operates in many challenging environments, such as Iraq and Pakistan without direct military security support, is that correct?

Mr. SAMPLER. Yes, ma'am, it is.

Ms. KELLY. And in these high risk environments, how do you ensure the safety of your staff and implementing partner staff?

Mr. SAMPLER. It is different in each situation. We have the tremendous support of the regional security officers that the State Department provides at the embassy. And they assist us, in fact they guide us on where we can and can't go. But we do a lot of our work in support of local communities and then we are able to rely on the local community to assist us in dissuading malign actors from interrupting the work. That is one of the fundamentals of development.

But it is different in each case. In parts of Pakistan we don't send U.S. citizens there because it is not safe. We again rely on third party monitors to observe the work there. In other parts of Pakistan, we do engage with U.S. direct hire citizens.

Ms. KELLY. The article also stated that U.S. officials have predicted that as a result of the troops drawing down by the end of 2014, USAID workers, investigators and auditors will only be able to travel to just 21 percent of Afghanistan, down from nearly 50 percent of the country in 2009. Is it reasonable to assume that as the U.S. military completely withdraws by the end of the year, as is now being considered, that areas accessible to U.S. personnel, including your workers, will be reduced even further? This raises serious concern about continued oversight and monitoring and evaluation.

So how are you going to ensure continued oversight of the projects and programs that you have in the field? Can you give us a few examples?

Mr. SAMPLER. Yes, ma'am. The military drawdown actually began for us about 18 months ago. And the military transition occurred last June. So we are living now in a situation where the U.S. military doesn't provide direct logistical support to get us out to any of these sites.

In terms of the prognosis going forward, it is hard for me to predict. I actually hope that five years from now, when we visit Afghanistan, it will be a much more permissive place and that the new government will have taken the steps necessary to make the government one that is respected in all 34 provinces. But whether that is true or not, in each of our programs, we work with the control or contract officer, who runs that program, to find ways for them to get the information they need to decide, does this program continue or does it not. That is the first point of responsibility. And that individual, a young American man or woman, has to decided, do I have enough information coming in.

Part of my job is to create systems that will allow them to collect that information. They may collect some of it from the local community, they may collect some of it from other partners working in the area to say, we drive across that bridge every day. We may still collect some of it from the international military, where they have flights that overfly or they have experience with our projects, they can report back to us as well.

But the question of sufficiency is one that the contract or the agreement officer has to make. When she or he feels like they don't have enough information, they raise their hand and say, we have to stop.

Ms. KELLY. Are the Afghan nationals who travel to the more challenging locations, what about their safety and security?

Mr. SAMPLER. There are a couple of different mechanisms for moving Afghans around to support these programs. Some do it as contractors. And they make a decision, it is their corporate entity, whether or not they wish to go to a particular place. Some do it as U.S. government foreign service nationals, they are employees of our embassy. And the decision is being made at this point in time that when an Afghan working for our embassy travels, she or he has the same security requirements as I have.

Ms. KELLY. I am out of time. Thank you, I yield back.

Mr. CHAFFETZ. I thank the gentlewoman.

We now recognize the gentleman from Tennessee, Mr. Duncan, for five minutes.

Mr. DUNCAN. Thank you, Mr. Chairman, and thank you for your efforts to stay on top of all this.

This whole thing is so ridiculous that it is just very, very sad. I have read so many examples of just horrendous waste over the years in Afghanistan, and a $34 million military headquarters built that stands empty because nobody is going to use it, totally wasted. NBC News just reported about an Afghan prison built with $11 million, an American-funded prison that is falling down before it opens.

Five days ago, Farah Stockman, a reporter for the Boston Globe, who served over there with the Massachusetts National Guard, wrote this. She said "Corruption in Afghanistan is now considered as great a threat to the country as the Taliban." Now, this is a report from five days ago. "But as the U.S. military is starting to acknowledge, it was baked into the system from the start. We toppled the Taliban in 2001, not with massive American firepower, but with proxy warriors, local warlords who received cash and weapons in return."

And she goes on and says, "But as the years went by, those militia leaders we worked with kept expecting more money, more favors, more sweetheart deals. Even Karzai himself is reported to have accepted suitcases full of cash. Is it any wonder that the country has turned into a place where loyalty is sold to the highest bidder?"

I am wondering, I heard one time about, in one of our hearings a few years ago, about plane loads of cash being flown over to Afghanistan. Mr. Sopko, are we still dealing a lot in cash over in Afghanistan, to your knowledge?

Mr. SOPKO. To my knowledge, there is still some cash being used. That causes some concerns. As a matter of fact, the ministerial asesssments that we have alluded to in the past have highlighted problems of cash in the individual ministries.

We have tried to get away from cash in some of our programs, but it still does exist and it is a problem.

Mr. DUNCAN. This $100 billion figure that Mr. Mica referred to, I remember seeing that in an article I think last July. And of course, we have spent another billion or two or more since then. So we keep adding to it.

But I saw in an interview you gave a few days ago, there was some coverage in the Washington Post, to talk about a very large trust fund being used to pay the salaries of the Afghan national police. And you say in this interview that we just uncovered some allegations about the Afghan national police and there are certain funds or monies taken out of the police salaries every month that we don't know where the money went, nor do our allies.

How large is this trust fund and how much are we spending on the Afghan national police and are we still not able to account for is it a small percentage, large percentage of it? What is the story on that?

Mr. SOPKO. Just so you understand, the trust fund reference there is the Law and Order Trust Fund for Afghanistan. It is managed by the United Nations on behalf of the donors. We contribute a significant amount of money of that, but so does the European Union and all of our other allies. They actually contribute more. We basically pay all the salaries of all the police and all the soldiers and all their support staff. So we are talking about billions of dollars.

What I was alluding to is information we uncovered that the European Union was so concerned about the internal controls based upon audits that they had done that they were concerned that the money, particularly, was going to ghost workers. So we are following up on that. We brought that information to the attention of DOD on my last trip back in July, or I should say November. They weren't aware of it, but they followed up and they have been very aggressive. They are concerned, too.

In the course of my latest trip there and meetings with the European Union and other of our allies, a number of other issues arose, including a 2.5 percent, so this is 2.5 percent of all the salaries, money was taken out to pay for something, we don't even know exactly what it is. But they can't find that amount of money. So we are talking about millions of dollars if you multiply that by the number of police.

And there is a 5 percent fund taken out, a 5 percent deduction taken out going toward retirements. Apparently the UN can't find where that money ended up.

Then there is also the question of approximately 1,000 generals who are not supposed to be paid who are getting salaries. So a number of issues, ghost workers, the 2.5 percent, the 5 percent pension fund and the unauthorized generals, to cite Senator Dirksen, after a while, we are talking real money. And the problem is the internal controls are so bad that there may be some serious money lost. To not only us, but also our allies.

Mr. DUNCAN. My time is up, but let me just say this. There was a column in the Politico a few weeks ago by Roger Simon in which he says the Administration has a plan to keep anywhere from 10,000 to 16,000 troops in Afghanistan until at least 2024 at a cost of mega, mega billions. I think that is very, very sad. I yield back. Thank you, Mr. Chairman.

Mr. CHAFFETZ. I thank the gentleman, and I appreciate your concern about this issue and our persistence on it.

I now recognize the gentlewoman from New York, Mrs. Maloney, for five minutes.

Mrs. MALONEY. I thank the chairman and the ranking member for calling this important hearing on tracking taxpayer money. But on my visit to Afghanistan, right outside of the headquarters there was a memorial to 9/11 and all those that died. That is the district I am privileged to represent.

So we are there to combat terrorism. And I want to mention something very positive that USAID has done. I strongly believe the best way to fight terrorism is an educated population, particularly a female population. And when you went there, no women were going to school. Six hundred schools have been built, teachers have been trained. And of the 8 million students now in USAID-supported schools, a third of them are women. I would say that that is a very positive contribution to combating terrorism. And I want to thank you for that.

But corruption should not be tolerated. One of these reports I was reading, the transparency international corruption perception index ranked Afghanistan as the most corrupt country in the world alongside North Korea and Somalia. That is certainly not good company and a terrible, terrible tab or brand on them.

So I would like to first ask Mr. Sopko and Mr. Sampler, do you agree with this assessment? Is it the most corrupt country in the world, along with North Korea and Somalia?

Mr. SAMPLER. Ma'am, thank you for your comments about USAID and our role supporting women. I will update your information.

Mrs. MALONEY. And education in general.

Mr. SAMPLER. And education in general. One of the things that I find encouraging in Afghanistan is that now, after 12 years of supporting education, we are seeing the students who have been educated in Afghanistan moving to vocational training and universities. We now have about 40,000 women attending either vocational training or universities, which represents about 20 percent of the total.

So it shows that with persistence and with strategic patience, these things do actually make progress.

Mrs. MALONEY. I would just like to say, I think that is wonderful. I have constituents who had relatives who were shot and killed because they went to school, women. And I really do think there is a correlation between an educated population, particularly women, in countries where women are educated, the degree of terrorism is not there, because the population combats it with their government. So I think that is an important aspect.

In fact, I would like to see, Mr. Chairman, a hearing on the correlation between an educated population and educated women, where women are treated like people and allowed to be educated, and the ability of that country to combat terrorism. I think it is an important aspect that hasn't been looked at.

But that is not the purpose of this hearing. So I would like to hear your assessment of the corruption and what you have put in place to combat it.

Mr. SAMPLER. Yes, ma'am. To the comparison with North Korea and Somalia, I can't comment. There is no question that Afghanistan is the most corrupt place that I have ever worked. The challenge for USAID is helping Afghanistan build institutions that can fight corruption and can withstand corruption when the political will is there, so that they will be able, on their own, to eliminate corruption within their government.

The challenge for me and for USAID specifically is making sure that our programs are able to operate in Afghanistan without being subject to the corruption that is endemic in the government and in society.

Mrs. MALONEY. I would like to add to that. I share the concerns of my friends on the other side of the aisle that we need to combat it, and that no American aid should be used in any corrupt area.

But the Administration and the international community pledged roughly 50 percent of a development aid to Afghanistan as direct assistance. And it conditioned this assistance on progress toward combating corruption. So I would like, Mr. Sampler, for you to build on one of the comments that you made at the last subcommittee hearing on this topic. You said that USAID released $30 million out of $75 million available to the World Bank's Afghan Reconstruction Trust because the Afghan government had achieved certain benchmarks.

Can you tell us what reform goals were put in place and what reform goals were met? And certainly, Mr. Sopko, if you could help clarify that, too. But first, Mr. Sampler, then Mr. Sopko.

Mr. SAMPLER. Yes, ma'am. At the senior officials' meeting in Kabul last year, I announced that there would be $75 million that would be an incentive fund to encourage the Afghans to make some politically difficult decisions with respect to progress within the construct of their government institutions. There were five general categories for those funds. And it has been our determination last month that the Afghans had met the goals we set in two of those particular categories.

So of five different funds, of about $15 million each, and we have awarded them $30 million of the incentive fund. This is important to the government, because the funds are sent in such a way that they can be used not specifically for a general, these are not projectized funds in the same way. They are overseen and they are controlled, but it is an area, it is a type of funding that the minister of finance is very attracted to.

The first and most specific and most time sensitive of those upgrades and improvements in Afghan government had to do with the elections. There were some very difficult decisions with respect to the independent election commission and the appointment of commissioners. There were some very difficult challenges with respect to who will oversee the election complaints commission and who gets to adjudicate disputes after the elections happen on Saturday. We wanted those decisions to be made in a particular way, in a way that was transparent. And they were. The governor of Afghanistan, after some wrangling, made those decisions. And I believe the incentive fund was part of that.

Separate from that, at the other end of the spectrum, with respect to the Ministry of Mines and Petroleum, we have asked that a minerals law or a mining law be passed in Afghanistan that would keep Afghanistan from falling down the mineral wealth trap some other countries have had, or problem that some other countries have had.

That has not yet been done. But the mining law has been proposed two or three times by parliament, President Karzai at several different points said that he would do this by fiat. It hasn't been done. So those funds have been taken off the table.

Our greatest hope with respect to the challenges and the changes that you are alluding to with respect to corruption and building institutions in the government of Afghanistan have to do with the election. In some period of weeks, there will be a new president of Afghanistan. We hope and expect that he will appoint an attorney general who will end the endemic corruption in Afghanistan or at least begin to end the endemic corruption. And we hope that he will appoint ministers and deputy ministers who share that vision.

Mrs. MALONEY. My time is expired. Thank you for the goals you have reached.

Mr. CHAFFETZ. Thank you. We will now recognize the gentleman from Vermont, Mr. Welch, for five minutes.

Mr. WELCH. Thank you very much. I again want to thank our chairman and ranking member for pursuing this together for several years now.

The turning point for me on this came when I was at a meeting in Kabul with attorneys that had been sent over to Afghanistan to help train Afghanis how to detect and stop corruption. I asked them, how is the program going. And they told me they had to end it. The reason they ended it is because in training people how to detect corruption, they used the information to do corruption. And that is literally the frustration that we are having.

Now, Congress cooked up this policy in Afghanistan and supported the nation-building. And you guys are trying to deal with it, AID, I so admire the work you do, and we have made a very tough job, you do it. In a way you are like our soldiers, we give you the mission and you do your best to do it.

Your office has been fantastic, just giving us the lay of the land and what the facts are. But I think a lot of us are just wondering whether there is any confidence that we can have, on behalf of being custodians of the taxpayer money, that it won't go south.

Just a couple of things I will ask about. The bridge, I guess, Mr. Sopko, you were talking about $300 million or so that has been spent on the bridge. What is the status of that?

Mr. SOPKO. Are you talking about the bridging solution?

Mr. WELCH. Yes.

Mr. SOPKO. Well, the bottom line is because we are not getting electric power out of Kajaki like we want, we of course created these diesel generators at Kandahar. And I was told by DABS, which is the electric utility company, as well as USAID officials, as well as the general who is paying the checks for the fuel, that they are going to stop soon. And we don't have a real solution for it.

So they came up with a new solution, which I am encouraged by, except it is talking about another hydroelectric plant and it is talking about solar power as the answer to the first bridging solution, which they can't afford any more.

Mr. WELCH. So we will have gone from spending hundreds of millions of dollars at the Kajaki Dam that failed to hundreds of millions of dollars in this bridging project that looks like it is going to fail to yet another new way to spend more money without any confidence that it will work.

Mr. SOPKO. The problem here with the Kajaki Dam is that we are still working on it, and starting back in the 1950s. I think building the pyramids in Giza was faster. There is no likelihood, and with all due respect to my colleague, that their new solution is going to end up with the third turbine finally in.

And even if the third turbine is put in, that still doesn't guarantee that you are going to have enough power in Kandahar, which is significant.

Mr. WELCH. I get it. This is amazing. I think what I am hearing from my colleagues is whether we just have to call the question at a certain point. It is realistic for the Congress to appropriate money, and then ask AID or the military related reconstruction, to do the impossible when the structural foundations of Afghanistan are based on the benefits of corruption.

And let me just ask you a question. Because whatever oversight we have, I don't have confidence that it can work. They will find ways around it. Would it make sense for us as a condition of releasing any money to require Afghanistan to put its own money into the project, 10 percent, 15 percent, or 20 or 25 percent? On the theory that the only way we can have any confidence that there will be an incentive on the part of the Afghan government to not steal the money is to require them to have some skin in the game themselves?

I will start with you, Mr. Sampler.

Mr. SAMPLER. Congressman, thank you. With respect to energy, which is one of the areas that actually is the least corrupt and is actually making the most progress, DABS, the public utility, is working to install the turbine in Kajaki. Mr. Samadi told me on my trip last week that what he intends to do with the diesel program in Kandahar is to do what he says he has done in 12 other provinces where they use standalone diesel generators, and that is to set up a cost system where it will be paid for. The community that gets the electricity will pay for the electricity.

He has some track record for being able to do that. He went from receiving subsidies of over $60 million a year to this year receiving no subsidies. And in fact, he has collected from the users of electricity enough money to now buy electricity from other countries rather than generate it, because they don't yet have the generation.

Your notion of having Afghan skin in the game is exactly the right thing to do. And I think what Mr. Samadi is proposing is to even take it a step lower, so that local communities have skin in the game. It will be their money that pays for these diesel generators and pays for the power that they actually consume. So yes.

Mr. SOPKO. Can I respond? If it is okay, Mr. Chairman. The problem with that is, I was down in Kandahar and got a briefing from the DABS officials down there. And there is no way, they told us, they can pay for the diesel. So there is a reality, you have to get out of the embassy and get down there. They are saying, we can't charge the fees because the law is set so low that we cant collect the fees.

Their other concern is that the power will go out. They are saying they will be able to do another hydroelectric plant and come up with solar power generation within the year. Because within the year, we stop subsidizing them. And that is the whole problem with, and I think it is an excellent point, Mr. Welch, and we are happy to introduce the briefing slides from them explaining why they need this solution because they can't afford the diesel fuel.

The whole problem with putting skin in the game, Mr. Welch, is they only have $2 billion they collect. The game is billions more. We overbuilt for Afghanistan.

Mr. WELCH. We overbuilt and they don't have a tax system.

Mr. SOPKO. And they don't have the sustainability, the capability to sustain what we gave them. In my statement itself, USAID even admits that there are going to structures, things that we are just going to have to abandon because the Afghans can't afford to maintain them.

So that is the problem from poor planning up front and putting too much money too fast in a country that is too poor to handle it.

Mr. WELCH. Thank you. Thank you, Mr. Chairman.

Mr. CHAFFETZ. I thank the gentleman.

Mr. Sampler, do you care to expand on that? That is the concern, we are out there spending billions of dollars for things they can't maintain.

Mr. SAMPLER. It is easy at this point in the process to armchair quarterback decisions that were made eight or ten years ago. So I don't accept the notion that this was poor planning. It was wartime contracting and war planning.

Mr. CHAFFETZ. But wait a second. We have spent $102 billion, and now we are going to spend more money then ever, we are accelerating the spending as we are drawing down the troops.

Mr. SAMPLER. Congressman, I don't know that I accept the notion that we are accelerating spending. USAID is not accelerating our spending.

Mr. CHAFFETZ. The overall spending, which includes USAID, Mr. Sopko, what is the number we have that you said has been appropriated?

Mr. SOPKO. It is $22 billion, although Congress did cut some of the money, the end result is the amount of money sitting there that has been authorized and appropriated but not spent has actually increased.

Mr. SAMPLER. Your point, though, your question, Congressman, is what are we doing to make sure that the Afghans can maintain the work that has been done. The environment from 2003 or 2004 or 2005 up through 2008, 2009 and even last year has been one focused on stabilization.

Mr. CHAFFETZ. Well, we are talking about moving forward here. You say it is easy to be that quarterback on the armchair. But you have to look back, you have to understand what we have done and the mistakes that we have made.

One of the key concerns, one of my biggest concerns is that we have U.S. money flowing to the very terrorists that wish to do us harm. I believe that everybody in USAID and the U.S. government wants to do good and help the basic Afghan person who is probably a good and decent person. But the reality is the terrorists know how to get this money from us. And they have been getting that money. That was highlighted in the report that my colleague here, Mr. Tierney, Mr. Flake, others had done through the host nation trucking. It was a great report.

But we have to learn from that. You take issue with this USA Today article that came out. You said it was false. Mr. Sopko is quoted in there as saying USAID kept this information from Congress and the American people.

Mr. SAMPLER. That is correct, Congressman. We have not withheld any information from your committee or any other committee in Congress.

Mr. CHAFFETZ. Mr. Sopko, do you care to comment on this USA Today article?

Mr. SOPKO. I would start with, Mr. Chairman, did you get copies of the stage two assessments a year ago when you wanted all this information on reconstruction, or did you have to wait until I provided it to you?

Mr. CHAFFETZ. We had to have a hearing and we had to insist that we get the information. We had to instruct and hope and push the Inspector General to be able to get that information.

There is a difference in camera review and giving this information to Congress. As is pointed out in this article, a KPMG audit of the Ministry of Rural Rehabilitation and Development says "A mechanism has not been developed for screening of beneficiaries for the possible links with terrorist organizations before signing contracts or providing funds to the suppliers."

This is an independent KPMG assessment. But the next sentence in this article, a copy of USAID's version of the same document shows that mentions to links of terrorism were blocked out.

Now, that is just projecting against something that is embarrassing. It is not protecting some individual from life and limb. And that is the concern.

Mr. Sopko?

Mr. SOPKO. Mr. Chairman, can I add a little bit, and I am happy to put a chronology in, the reason we were concerned is, back in May, if you recall, you originally asked for these documents you had problems getting. We had problems getting them. And I don't want to spend too much time on chronology, we originally were told, when I first found out about these documents, these assessments, that they were an embarrassment and we couldn't get them. We had to give them, AID had to give them to the Afghan ministry, and this is what I was told by AID officials in Kabul, so they could review them, excise any of the embarrassing material. Nobody raised any concern about people getting hurt. It was embarrassment.

Eventually you asked the AID IG to get them. Eventually he couldn't. We were contacted back in April of 2013 by the USAID Inspector General's general counsel, the USAID general counsel, a State Department legal advisor, requesting that SIGAR not provide copies of the ministerial assessments to any Congressional committee or member of Congress. SIGAR's general counsel informed USAID and SIGAR that we had not received the Congressional request but we would, and we intended, to provide them.

On May 1st, SIGAR was told that USAID provided redacted copies of the ministerial assessments to the House Oversight Committee. OGR staff then requested the unredacted versions from us. At that time, we received from USAID copies of the redacted copies that you got, and that is how we were able to do the comparison when later we got a FOIA.

Now, what is of great concern to me is, not only were these things about terrorism excised. Now remember, the allegation was, this was to protect individuals. We were going to delete individuals' names all the time. But also what was deleted was the fact that some of the ministries lacked controls on management of cash, I don't know how that implicates any security issue. And that they could not keep track of fixed assets and were using pirated copies of Microsoft software. And we are happy to give you, and it is listed in the letter my general counsel sent, about the other things that were redacted.

The thing is, these are the redacted copies that we got from the AID general counsel's office. These were the documents they gave to you. And I would add, my understanding, and only you can answer, Mr. Chairman, is did you get these? Which are far more damning and far more important to your work.

The further question I would ask is, did the appropriating committees get these? Did the other authorizing committees that are interested? Remember, the language requiring these assessments was put into multiple appropriations bills because the appropriators and the authorizers were concerned about the loss of direct assistance money in Afghanistan.

Now, we were told during our audit by USAID headquarters officials they had never even seen the stage two assessments. So we doubt seriously that they gave them to the Hill.

Mr. CHAFFETZ. And this is the concern, that we are having to pry this information out, that it is not being forthright in giving us that information.

Mr. Sopko, you mentioned that you believe that you have come across some funds that are actually being used or going to Iran. Can you expand on that?

Mr. SOPKO. We have an ongoing criminal investigation, as I told you, on the Ministry of Public Health. And specifically, the criminality is focused in the system that AID praises as the great protection of our assets. Allegations we have received, and I can't really go into too much detail, is that money is being diverted to go to purchase items from Iran.

Mr. CHAFFETZ. Do you have a sense, can we get a sense of the dollar amount that we are talking about here?

Mr. SOPKO. At this point I couldn't tell you. I would have to talk to my investigators.

Mr. CHAFFETZ. Have you come across any other allegations that money is being diverted to Iran? I am specifically concerned about the PLO, the petroleum oil lubricants.

Mr. SOPKO. We haven't gotten any new information on that, but as I told you the last time I testified, we have not, and by we I mean the U.S. government, has not instituted the real corrections they need to ensure that we are not buying fuel from Iran. And that is because of expense. So yes, we could be buying Iranian fuel to support our troops in Afghanistan.

Mr. CHAFFETZ. I am well over the time. I am going to turn the time to my colleague, the ranking member, Mr. Tierney.

Mr. TIERNEY. Thank you. First of all, let me just start by saying, Mr. Chairman, I assume that we should tell Mr. Sampler now that as we review the stage two assessments and other assessments with regard to the redactions on that or whatever, does the chairman agree that Mr. Sampler has an opportunity between now and then to submit a blow by blow description of why each redaction was made. That would help you answer the issues that Mr. Sopko raised. And we will consider those. But it is concerning to listen to those considerations. And if you think of some reason why the comments or the statements that Mr. Sopko said were redacted, then tell us.

Mr. CHAFFETZ. Oh, absolutely. If the gentleman would yield, the spirit here is to get to your full and complete perspective on this. But the allegations are pretty serious. It has been going on for close to a year. We are just trying to get the clean, unfettered information and of course, we will work in a bipartisan way and allow you to comment on those as well.

Mr. TIERNEY. Exactly. Now, to both of the witnesses, has anybody ever assessed whether or not the country of Afghanistan is going to have a revenue trajectory other than foreign aid that is going to enable it to cover its general operating costs and when?

Mr. SOPKO. The World Bank has done that assessment. I believe we reference it in our statement. And it is not a pretty picture. I think we are talking about 30, 40, 50 years out. And so the discussion about minerals, we are talking 50 years out, 70 years out, assuming the best. So in all likelihood they will be a client state for years to come.

Mr. TIERNEY. So the more infrastructure that aid from any source helps to build, the more operating and maintenance costs accrue to a country that doesn't have revenue to cover its existing operation and maintenance costs, never mind additional ones, is that correct?

Mr. SOPKO. That is very correct, and we reference that with, unfortunately, gory detail with all the audits, and we are happy to provide others about roads that have no sustainability, buses that have no sustainability, you name it. They can't sustain it.

Mr. TIERNEY. Can either of you identify for me any other nations in the world that are substantially operated only by virtue of foreign assistance and that would not be able to be liquid in and of themselves?

Mr. SOPKO. I only cover Afghanistan. I will turn to my colleague, here.

Mr. SAMPLER. Congressman, most of my work has been in failed states, that for a number of years after emerging from failed state status are client state and continue to be for some period of time.

Mr. TIERNEY. Has that period ever been 40, 50 years out?

Mr. SAMPLER. Congressman, I don't accept the notion of 40 or 50. I don't have an alternative to it. It is predicting the future. Certainly more than a decade there will be some form of client state.

But the notion that infrastructure should be subsequent to being able to be self-sustaining is, I think, flawed.

Mr. TIERNEY. I am not sure that anybody made that case. They are just making the case that as it happens, it increases the cost of maintenance and operation.

Mr. SAMPLER. It also increases economic opportunity and growth, which pays for that.

Mr. TIERNEY. That would depend on whether or not it was well-constructed and actually worked.

Mr. SAMPLER. And it does work, Mr. Congressman.

Mr. TIERNEY. Well, let's see whether or not the Kabul power plant actually works and has the fuel necessary to do that. Is the government subsidy from Afghanistan, I understand it was supposed to expire this month, last month, actually. What happened with that, Mr. Sopko?

Mr. SOPKO. I don't have the answer to that. Maybe Mr. Sampler does.

Mr. TIERNEY. Did the Afghan subsidy to the power plant expire last month?

Mr. SAMPLER. They have stopped subsidizing DABS, yes.

Mr. TIERNEY. So who is paying for the fuel now?

Mr. SAMPLER. In Kabul, the fuel that the Tarakhil power plant generates is paid for from electrical subscribers in Kabul.

Mr. TIERNEY. And how about the rest of the patrons that are supposed to be served by it?

Mr. SAMPLER. I am sorry, the rest?

Mr. TIERNEY. More than just Kabul is supposed to be served by that power plant, correct?

Mr. SAMPLER. The 105 some odd megawatts that it generates is generated to what they call an island of distribution. And that island of distribution pays for that power. And Mr. Samadi tells me that they have done that in 12 other provinces, smaller places, where they have diesel generators providing power.

But it is important to note that Tarakhil is not meant to provide regular, routine power. As Samadi acknowledges, it is more expensive than importing electricity. He calls it a peaking plant. I would call it reserve power. Just last week, the power line coming from the north into Kabul, snowfall shorted out the power line and they lost it. But rather than have brownouts and blackouts in Kabul, Tarakhil fired up and they run this expensive diesel.

But Mr. Samadi, who is the CEO of DABS, assures me that they pay for it out of the revenues they collect.

Mr. TIERNEY. Have you been able to verify that?

Mr. SAMPLER. I have been out to Tarakhil a number of times and in fact, stood by a generator when it fired up without me knowing it was happening. They do turn it on and they do turn it off.

Mr. TIERNEY. An awareness issue, right?

Mr. SAMPLER. Right. But I can't confirm that the payments they make cover the cost of diesel. I can take that as a QFR and come back.

Mr. TIERNEY. Thank you. Thank you, Mr. Chairman.

Mr. CHAFFETZ. The gentleman from Vermont, Mr. Welch.

Mr. WELCH. I would like to get back to what are some practical steps we can do that will work. As a precondition of having aid, number one, shouldn't there be some confidence there will be a sustainable revenue system? And my understanding is Afghanistan is taking steps toward doing that.

And then number two, should we condition aid on Afghanistan putting their own money in a project? Both of those would go hand in hand because if they are going to put money in a project, they have a way to raise money and they do have an economy.

So I would really appreciate your opinion as to whether those might be simple ways to try to get greater accountability. A, do we want it as a condition that they establish a revenue system and B, do they have to put money in any project? I will start with you, Mr. Sampler.

Mr. SAMPLER. Certainly. The World Bank actually has incentive programs that are driven to encourage the Afghans to generate revenue streams. USAID has programs in place, the Afghan Trade and Revenue program is an example. It specifically focuses on allowing the Afghans to collect tariffs at customs stations and makes sure that the money goes into the coffers at Afghan banks.

Mr. WELCH. My question is, is it being done? In other words, we can conceive of these things, but there are so many impediments on a practical level in a country such as Afghanistan to do things that haven't been part of their tradition.

Mr. SAMPLER. Right.

Mr. WELCH. What I understood from Mr. Sopko is that on the other hand, if we come in and put in these huge projects that have as an unstated but necessary assumption a local capacity for raising revenue to sustain it, for having engineering expertise to fix it, all of these things that actually don't exist, then we are just ships passing in the night. And a lot of this is, from my perspective, guaranteed failure even before you get to the corruption.

So my view is that there has to be something really simple that takes into account the practical limitations of the Afghani revenue stream, the practical limitations of their skill test, and then have a right size approach which would be intended to actually have a chance at working.

Mr. SOPKO. Mr. Welch, I think you have hit on it. And they key thing is conditionality. It is great that Mr. Sampler is talking about, we are going to help raise revenue at the border. I just noted in my speech, I just came back from Torkham Gate, which is the largest customs post. And we can't get to it any more. No American will be able to get to Torkham Gate to check and see if they are stealing half of the revenue. And that is the problem of corruption.

We know it is endemic. We have to build programs that deal with it. And that is why conditionality. And I applaud Mr. Sampler and USAID for their conditioning, I believe it was, $30 million held back. Unfortunately, it was on a $17 billion program. So the conditionality has to be not just on an incentive program, it has to be with one voice, with our allies, to condition putting the internal controls in, putting the asesssments in, fighting the corruption.

On the corruption issue, we still have a dysfunctional judiciary over there. We have never conditioned on that. We have a dysfunctional financial system, and I know the chairman is very interested in the Kabul bank issue.

Well, FATF, the Financial Action Task Force, just came in and downgraded, downgraded Afghanistan and if they continue to downgrade it because they don't have a money-laundering statute, just like Mr. Sampler said, they still don't have that statute dealing with minerals.

What will happen in June is, they will be blacklisted, which could have tremendous implications to any corresponding bank. If you don't have a banking system, you are not going to have financial investment. So the thing is, you have to prioritize, our U.S. government, not just AID, it is everyone, prioritize the conditionality and fixing these issues. We still, and I will end by this, Mr. Welch, we still don't have a coordinated anti-corruption strategy for the U.S. government. We have highlighted that in two audits. If we are really serious about corruption, why don't we have a strategy?

Mr. WELCH. Here would be what I would find some comfort in. If the two of you had an agreement that could be stated on one piece of paper that said what the conditions were, or the preconditions really, is it a revenue stream, is it putting money into the account at the same time we put money in an account? But things that are up front that are very simple to measure and don't depend on trust, they really just depend on checking the bank account.

Mr. SOPKO. We do that in every audit we have. We have recommendations. The problem is, I have to be independent. So I can't design a program, as much as I would like to, with Mr. Sampler. Because then I can't come back in and audit it. So by definition I can't design programs.

But we have many recommendations, and if you look at my statement, Congressman, there are like 40 or 50 audits done by us, the AID IG, the State IG, the DOD IG, and the GAO with tremendous recommendations that USAID and the rest of the government should follow.

Mr. WELCH. I just want to say one last thing. Mr. Sampler, I really appreciate the work that you guys do, USAID. You are just dealing with an incredibly difficult situation. And you are on the receiving end of a lot of the frustration we have. But a lot of us are responsible for some of the policies that got us to where we are.

So I just want to say a sincere thank you for your service and to you as well. We are not beating up on you as much, not today.

[Laughter.]

Mr. CHAFFETZ. The gentleman yields back.

I do have a few more questions and I appreciate the indulgence of my colleagues here, to go through some of these. It have looked at maps, and it is hard not to do it with the maps, but one of the biggest concerns is the diminished security situation and our ability to get out, review these projects, see these projects. Remind me again what percentage of the areas, do we have percentages or some sort of metrics to try to quantify, we are investing, spending money on all these projects in various parts of the country, we can't get out and see them.

Mr. SOPKO. Mr. Chairman, it is hard to do that. Because we don't know the number of troops we are going to have. We also don't know the number of enduring bases. So we are guessing. But at our guesstimate, I think we are saying less than 20 percent of the country.

Now, what I also mentioned is, that is assuming the very best. That is assuming good weather, we can get out there. The problem with those circles, as I indicated, is they are now turning into Swiss cheese. I have auditors and inspectors who can no longer travel to certain sites, even inside the bubbles, because they have to go down a road where there is an Afghan security base and booth and they check them out. The next kilometer down, there is an insurgency toll booth and base. So we can't go there.

That is the problem. Bottom line is it is getting harder.

Mr. CHAFFETZ. Is there any other update? I appreciate your bringing up the information on the Kabul bank. Do you have anything else you can share with us regarding the Kabul bank situation?

Mr. SOPKO. I think the important thing is not focusing on the exact money inside the bank. But it had to be recapitalized, and that money had to come out of the central bank, and that is over $500 million. When you are dealing with a country like Afghanistan where they have very little money of their own, we know that donor money had to be used for that instead of better purposes. I think that is the thing to consider. And also the problem with the whole financial sector.

It hasn't gotten any better. That is what people are telling me on the last trip, with their financial sector and their ability to oversee the financial sector.

Mr. CHAFFETZ. Mr. Sampler, there are these news reports about USAID and Cuba, relating to Twitter accounts and that sort of thing. Do you have any insight into that?

Mr. SAMPLER. I don't. Those are in my pile of things to read after this hearing, Congressman. I haven't had a chance to look at that.

[Laughter.]

Mr. CHAFFETZ. Put that at the top of your pile, if you would. I would appreciate it.

I want to go back to this what you called the mineral wealth trap. What are the concerns there? What are the things that you are suggesting they need to do or not do?

Mr. SAMPLER. Congressman, the Task Force for Business and Stability Operations that the Defense Department ran started early on working with the Ministry of Mine and Petroleum to build their capacity to manage contracts. And to manage contracts for what may be up to $3 trillion worth of wealth that is buried in the soil of Afghanistan.

They recognize that if the government gets ahead of the contractors and of the vast multinational corporations who want to exploit that wealth, the government can benefit directly and in significant ways. The resource trap is one, however, where the government never builds that capacity. The institutions don't reach maturity before the external bidders can take control of the resources.

So the notion is, Afghanistan owns these resources. The people of Afghanistan should benefit from them. How can we get laws on the books and transparency into those laws so that as the resources are exploited, the benefits accrue to the government and to the people of Afghanistan?

Mr. CHAFFETZ. That is interesting. In the long term, I really would appreciate being kept up to date on that. I would appreciate it.

One other thing I want to talk about are these incentive funds. I believe the number you used was $75 million?

Mr. SAMPLER. That is correct. In last year's budget, we used $75 million. In this year, we incentivize $100 million.

Mr. CHAFFETZ. Are these bonuses?

Mr. SAMPLER. They are not. This is money that comes out of existing programs that we incentivize.

Mr. CHAFFETZ. But where does that money go? Does it go to individuals?

Mr. SAMPLER. No, it doesn't, Congressman. It goes to the Ministry of Finance for something that we will negotiate with the Ministry of Finance.

Mr. CHAFFETZ. Give me an example.

Mr. SAMPLER. The $50 million they receive for having succeeded in getting the election laws on the books in a timely manner and appointing the different chairmen and the different commissioners, that money went to the Minister of Finance for a particular program that the Minister of Finance wanted to fund but that we had not funded heretofore.

The money that we don't award can be awarded by USAID for programs that the government of Afghanistan has no interest in seeing. So in other words, he gets to choose programs that are of more interest to him if they meet the objectives. If they don't meet the objectives, and we choose programs that are of interest to us, then we put the money somewhere else.

Mr. CHAFFETZ. I just fundamentally don't understand. Again, it is above and beyond just USAID. But here we are spending $102 billion and we have to provide these guys incentive bonuses to achieve their metrics and their goals? It sounds like a bonus to me. You may say, oh, it was appropriated. But we wouldn't have spent it otherwise. It is not as if we saw some critical individual need. And you are going to up that from $75 million to $100 million?

Mr. SAMPLER. What is useful about the incentive, Congressman, it is not incentivizing individuals, it is incentivizing the parliament, for example, to make difficult decisions.

Mr. CHAFFETZ. But isn't it incentive enough to say, you are not going to get any of our U.S. money unless you do the right thing and set up the metrics and the oversight that you need, we are not going to give you that money?

Mr. SAMPLER. Some of these are more institutional. The elimination of Violence Against Women law was something that was not politically palatable to the parliament in Afghanistan but is absolutely essential to us that that be done. So we have incentivized the passage of that law and the implementation of quarterly reports about violence against women in the provinces. Without some sort of incentive, the president and the minister of finance and the cabinet would not have had the horsepower to turn Afghan parliamentarians in the direction of doing this thing.

Mr. CHAFFETZ. Wait a second. Lobbying money?

Mr. SAMPLER. No, I wouldn't describe it as lobbying money. It is an incentive to get the parliament to do the things that we need them to do.

Mr. CHAFFETZ. So the parliamentarians get this money? Who gets the money?

Mr. SAMPLER. No, that is not correct. The Minister of Finance, the money that is received

Mr. CHAFFETZ. Going back to the specific example of the women's violence issue, where does that money go?

Mr. SAMPLER. Again, it goes to the Minster of Finance, it does not go to members of parliament or even to the parliament, but it goes to the Minister of Finance for programs that he has identified that he would like us to fund that we heretofore have not. And then the same project oversight measures kick in.

Mr. CHAFFETZ. So we go through all these assessments, we have all these things, we have these objectives. It doesn't even show up on our top 200 list. But he has his own pet project over here, which we will fund if he passes legislation that—I mean, we have a lot of laws here in the United States of America that prohibit that type of thing happening here in the United States, and we are upping the amount of money that we are going to use for this program?

If we incentivize the Secretary of Education to get some laws passed here in the United States Congress, and by the way, we are going to go ahead and take your pet project over here and fund it, we weren't going to do it otherwise, but we will fund that, are you kidding me? That is the very essence of corruption. And we are funding that?

Mr. SAMPLER. Congressman, it is not his pet project. These are programs that

Mr. CHAFFETZ. It is a project that he gets to pick. It didn't show up on our list.

Mr. SAMPLER. The government of Afghanistan, I should not characterize it as the Minister of Finance. It is a project of importance to the government that we have not yet chosen to fund. We still, it isn't a matter of we are obligated to do certain things. It is a sense that if the government can make these certain milestones that are a part of the Tokyo mutual accountability framework then we will incentivize their compliance and their achievement of those milestones.

Mr. CHAFFETZ. I don't want to get caught up on semantics, but I am just telling you, you have an incentive fund, it sounds like a bonus, it sounds like a slush fund, it sounds like a lot of very negative things. I guess my question to you is, would we do that here in the United States. Would we do that with our own government? Would we do that? And I don't expect them to mirror everything we do in the United States. But you are going to have to help explain why we have $100 million sitting over here that we have this great discretion from, we are going to take it from $75 million to $100 million, and if they do things that they want to do then—I just don't understand.

Mr. SAMPLER. Congressman, one of the challenges in Afghanistan is that their government is chronologically where we were when we disbanded the Articles of Confederation and started over.

Mr. CHAFFETZ. Oh, it is more like the Stone Age. Fred Flintstone is more progressive than a lot of places in Afghanistan. And that is the problem. We are $100 plus billion dollars later, and they don't have the infrastructure to do the basics. I feel for those people.

But the Special Inspector General asked for a list of the ten most impressive, most successful programs in USAID and the ten least. There are going to be some failures, we all understand and appreciate that. When are you going to provide him, and I would like to have a copy of this as well, a list of the projects, the most successful and the least successful?

Mr. SAMPLER. Congressman, we don't rack and stack our projects by most and least successful.

Mr. CHAFFETZ. But you go back and assess them, right?

Mr. SAMPLER. We do. But they are not compared one against another. It is like asking me which of my sons do I love the most.

Mr. CHAFFETZ. No, but you are going to tell me whether or not they were successful in doing something or not. These are very tangible items. If we are building a power plant or we are building a school, we are trying to build a water well, you have to know.

Mr. SAMPLER. Congressman, we can share on any given project what they succeeded at doing and what they haven't yet succeeded in doing.

Mr. CHAFFETZ. So you are not going to comply with the request from the SIGAR?

Mr. SAMPLER. We have provided a list of our top ten accomplishments in Afghanistan.

Mr. CHAFFETZ. Has USAID satisfied your request, Mr. Sopko?

Mr. SOPKO. Absolutely not. They have given us just some generalities. We have increased health, we have increased education, we have increased the lives of women and children, which is great, we all support it. But we are in the game of what particular program or programs or policies led to this tremendous doubling of the age or the increase. Because you are required by OMB regulation to have that information and they are not providing it.

So no, they have been totally non-responsive.

Mr. SAMPLER. To my knowledge, we are not required to rack and stack one contract or one program against another. I am more than happy to share any information about the successes of specific programs. But I do not rack and stack one program against another and say, this one was better than that one.

Mr. CHAFFETZ. You can understand the concern when we get the report from the Special Inspector General for Afghan Reconstruction, Congress set this up so we can have some third party verification of what is happening and not happening. And he uncovers lists of things that don't happen. It is a tough place. We have good people in the most difficult circumstances I can think of on the face of the planet. The people out there, USAID, are doing yeoman's work. We understand that things are going to fail.

But the concern is, when we are $102 billion into it, and most of that is DOD, it is not USAID, we continue to pour money into this thing and we haven't tackled the most basic problem which I think is corruption. If I had to list my top three or top four concerns, corruption is right near the top of that list.

Mr. SAMPLER. It is at the top of everyone's. And Congressman, it is not correct that we haven't addressed it, we just haven't licked it.

Mr. CHAFFETZ. But when you have 333 different recommendations and you only insist that they implement 24, I have a problem with that. We have an example of the SIGAR coming in and seeing an agency or ministry that is doing it the right way. Why don't we insist that everybody do it the right way? They don't get the money unless they do it the right way. More than a decade later, and you think we would have learned this lesson.

Mr. SAMPLER. The DABS report that I think you are referring to as having a ministry that does it the right way actually is the model that is used in other ministries. What we are not doing at this point in time is disbursing our resources across all 700 risks that have been identified. We are focusing our resources on the risks that surround U.S. taxpayer dollars. In other words, we are huddling around money

Mr. CHAFFETZ. NBC News just had this report out today or yesterday, Afghan prison built with U.S. money falling down before it opens.

Mr. SAMPLER. I wish I could comment on that, but that is not something we built, Congressman. I saw the story and expected to hear about it, but I just don't know what it is.

Mr. CHAFFETZ. It says if falls within U.S. State Department. This is the first paragraph, an $11 million American-funded prison in Afghanistan is falling apart before it even opens. And the U.S. State Department plans to rebuild it, call for shoddy construction, a government watchdog said Wednesday.

I have gone way past my time. I will yield to the gentleman from Vermont, if he has questions.

Mr. WELCH. I actually don't have any more questions. But I am hoping that we can do is find a way, Mr. Chairman, to perhaps legislate some conditions and bring that to the full House for consideration. We just can't keep asking taxpayers to blow this money.

And it is not just about blowing money, if we have a model there that simply doesn't work, where this is a total mismatch between their resources, their governmental structure and their ability to sustain projects in hindsight may have been grandiose or misaligned. Let's just not keep pouring good money after bad.

The dilemma, of course, is that it is in our interests as well as the Afghans' interest that they don't have a failed state. So the goal here is one I share, I think that is a very important goal, both for strategic and security reasons and humanitarian reasons.

But the fact that we share a goal doesn't necessarily mean we have the means of achieving it. That is the dilemma. And I just think that the responsibility that we have in Congress and oftentimes have not accepted is to call the question. And I think that if we are asking our soldiers or we are asking our State Department people to do something that is trying to fit a square peg into a round hole, when we ask you to do it, you will do it. Then we will go to you to say, why is it not working and we forget that we are the ones who started the whole thing in the beginning.

So there is a certain amount of looking in the mirror that I think Congress has to do on these policies. But Mr. Chairman, I do think it is time, we are asking the question here, but I would like to see our committee make that statement to the Congress as to what the findings are that your work and Mr. Tierney's work has provided, and then maybe as a committee come to some conclusions about next steps that we can take that will not have us keep digging in the same hole.

So I thank you and Mr. Tierney for your leadership on this.

Mr. CHAFFETZ. Thank you. This is truly an effort that I believe is bipartisan in its nature. I do think it is important for Congress to understand and look back on what has worked well and what hasn't worked well. We are honest about the fact that there are good things and there are bad things. If you are refusing to rack and stack, as you said, I would appreciate it if the Special Inspector General would go through that exercise. You highlighted a lot of concerns. But we will do it that way, if USAID doesn't want to participate.

Mr. SOPKO. We will do that, sir, it is part of our mandate. But as I tried to explain and maybe it wasn't artfully enough, I can draw lessons learned upon failures or successes. I am required by statute to do lessons learned reports. I would prefer to do them on a mix of information. But I can't get generalities that health care has been improved. Well of course, it improved. If you throw a hundred billion dollars at it, obviously it is going to improve. If you stop the shooting war, of course it is going to improve.

And then I hear education has improved, and at the same time, there were no buildings. Well, they start comparing education right during the war or right after the war. Of course there was no education. Everybody was scurrying from the Taliban and the bullets.

So I need something specific because you are demanding from me, look at the programs. And if the information isn't provided to you, what are you left to do? Across the board cuts. And that is not the way to do it. Because that cuts the good programs as well as the bad programs.

So that is what we need to know. Thank you, sir, we will try to do that.

Mr. CHAFFETZ. Thank you. Thank you both. I appreciate this hearing and the good work that the men and women do on the front lines.

This committee stands adjourned.

[Whereupon, at 12:01 p.m., the committee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

USAID
FROM THE AMERICAN PEOPLE

2014

April 16, 2014

The Honorable Jason Chaffetz, Chairman
The Honorable John Tierney, Ranking Member
Subcommittee on National Security
Committee on Oversight & Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Chaffetz and Ranking Member Tierney:

Thank you for your continued interest in and oversight of the work of the United States Agency for International Development (USAID) in Afghanistan. Pursuant to USAID's ongoing discussions with you and your staff regarding our programs in Afghanistan, I am writing to provide the Committee with copies of USAID's Approval of Use of Partner Country Systems (AUPCS) memoranda and Stage 2 Risk Assessment reports prepared by Agency staff on seven Afghan ministries.

These documents represent an essential component of USAID's approach to minimizing risk and developing stringent safeguards in the implementation of direct government assistance programs in Afghanistan. Direct government assistance is an important part of USAID's bilateral assistance program in Afghanistan in support of U.S. national security objectives and is crucial to building the Afghan government's ability to sustain the investments and gains that have been made and reduce its dependence on donors over time.

The AUPCS memoranda and Stage 2 Risk Assessment reports are being provided pursuant to the agreement between the Chairman and Ranking Member of the Subcommittee as reflected in a colloquy at the hearing held by the Subcommittee on April 3, 2014. These documents are mutually supporting and should be read together rather than as distinctly separate documents.

The documents are being provided in addition to the information on USAID's direct assistance program in Afghanistan that USAID has already provided to Congress through Congressional Notifications (CNs), briefings on CNs and on direct government assistance, independent risk assessments, and written and oral testimony. As you know, USAID has also worked closely with the Special Inspector General for Afghanistan Reconstruction (SIGAR) and USAID's Office of Inspector General (OIG) to provide information about the Agency's programs in Afghanistan.

Based on the colloquy at the hearing on April 3, we understand these documents may be entered into the official hearing record. For privacy and security purposes, the documents include redactions of the names of Afghan individuals, other than the names of Afghan Ministers that are publicly available, and the Agency's non-Afghan employees below the level of Deputy Mission Director.

USAID will continue to make available to Congressional committees upon request full access to unredacted versions of its assessments, including these AUPCS memoranda and Stage 2 assessments, either in the Committee's or USAID's offices. As a result, the Subcommittee will be able to review the information that has been redacted for privacy and security purposes.

We would also be pleased to meet with you or your staff to provide a briefing and answer any questions you may have regarding USAID's assistance to Afghanistan.

Cordially,

T. Charles Cooper

T. Charles Cooper
Assistant Administrator
Bureau for Legislative and Public Affairs

Enclosures

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

~~SENSITIVE BUT UNCLASSIFIED~~

January 10, 2013

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

TO: S. Ken Yamashita, Mission Director

FROM: (b)(6) [redacted] (b)(6) [redacted]

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) – The Ministry of Public Health (MoPH) under ADS Chapter 220

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Ministry of Public Health (MoPH). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the MoPH through FYE 2015.

The initial proposed G2G direct assistance activities include:

- Integrated Health Services Systems Strengthening Program (IHSSSP) – USAID total contribution estimated at $430 million (of which $326.8 million is on-budget).

BACKGROUND:

The MoPH is the steward of the Afghan health sector and ensures access to quality healthcare for all Afghans as guaranteed in the Constitution of Afghanistan. The Ministry is led by H.E. Minister Soraya Dalil and three Deputy Ministers for Administration, Policy and Planning, and Service

Provision, respectively. Under ADS 220, the MoPH as a GIRoA Ministry constitutes a partner-government entity.

In 2003 the MoPH decided to adopt a stewardship role rather than directly implement health services. This strategy resulted in the MoPH contracting for the Basic Package of Health Services (BPHS) and the Essential Package of Hospital Services (EPHS) through non-governmental organizations (NGOs), and ensured that a standardized package of basic services would be available in all health care facilities. USAID's G2G assistance to the MoPH will support GIRoA's implementation of the BPHS and EPHS. Both the BPHS and the EPHS are directly managed by the MoPH, with funding commitments provided by three donors - USAID, the World Bank, and the European Union (EU). In 2003, the MoPH divided Afghanistan's 34 provinces among the three major donors: USAID (13 provinces), the World Bank (11 provinces), and the EU (10 provinces), with each donor's funding supporting the provision of BPHS and EPHS within the allocated provinces—a situation that continues to this day.

USAID will provide off-budget technical assistance to systematically accelerate the continued transfer of technical capacity and improve program management by the MoPH; promote greater Afghan leadership in the public, private and non-governmental health sectors; ensure appropriate USAID oversight of the on-budget initiatives; and further empower the MoPH to effectively deliver health services and manage programs in a transparent manner.

Complying with USAID Policy

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and to maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risks and may contain risk-mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the appropriate fiduciary relationship with the institution can exist.

Due to the formal date of issuance of ADS 220 (March 2012) and previous on-budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements was initiated for USAID/Afghanistan in August 2012. The waiver was approved by the USAID Administrator on November 20, 2012. The waiver focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro-level assessments, which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the Stage I assessments upon GIRoA, as required under currently issued ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the USG to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the MoPH which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA, contracted a third-party to carry out the Stage II equivalent Risk Assessment of the MoPH. The report was issued in April 2012.

DISCUSSION:

Fiduciary Risk

The mission recognizes that Afghanistan is a high-risk environment, but is both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The Mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursement of US government funds to assure maximum protection of U.S. taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The Mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The Mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through the application of the ADS 201 and other guidance to project design. This AUPCS, therefore, focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

<u>Managing Risk</u>

On November 27, 2012, the Mission Partner Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II assessment report was prepared to determine whether USAID could rely upon the MoPH systems operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon the MoPH current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with the MoPH. The complete Stage II Risk Assessment Report, including the Risk Schedule with identified risks and suggested mitigation measures, is attached in Appendix Number 1.

USAID's initial activity to be implemented through direct on-budget assistance with the MoPH is the Integrated Health Services Systems Strengthening Program (IHSSSP). The programmatic objectives are described below.

Integrated Health Services Systems Strengthening Program (IHSSSP)

The objective of IHSSSP is to continue to improve access to, and availability of, quality BPHS and EPHS, particularly for women and children. IHSSSP will place special emphasis on strengthening community participation in order to ensure improved governance and accountability, and increasing sustainability through health care financing schemes and public-private partnerships. In addition, the program will increase demand for quality services and promote healthy behaviors. Increased MoPH stewardship at both the central and provincial levels is a high priority that will result in increased sustainability and institutionalization of the health program. Finally, the program will further strengthen the private sector's ability to provide quality services and products at affordable prices.

Although IHSSSP involves certain risks, the Mission is structuring the program to include a number of measures that will mitigate the dangers and ensure the successful implementation of the program. Most significantly, USAID is supporting on- and off-budget technical assistance to MoPH to:

- Strengthen MoPH functions in key areas, including service delivery; administration; financing and procurement; strategic planning; monitoring; and coordination among directorates and provinces, ministries and donors;

- Foster provincial and district level MoPH and community working relationships in identifying and addressing local constraints/problems, and in holding the MoPH accountable for results and high-quality service delivery that addresses community needs;

- Build the capacity of the MoPH to become self-sustaining through hospital autonomy, social and community health insurance, public-private partnerships, and the development of innovative health financing options; and

- Assist the MoPH at all levels to identify innovative and cost-effective approaches to addressing specific challenges to health care access.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement. The IL specifically will include USAID prior-consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and other conditionalities required throughout the activity period. The conditionalities also will require MoPH to plan and begin to address some of the general weaknesses identified in the April 2012 contracted PFM assessment report. In particular, the off-budget assistance will explicitly work with MoPH to develop controls and procedures to mitigate identified risks. Details reflecting interventions to address the findings of the Stage II Risk Assessment Report will be included in designs under IHSSSP. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreement will require an annual audit of the MoPH, inclusive of all USAID-specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of MoPH and the Ministry of Finance under a separate Capacity Development initiative and initiate internal control and financial reviews of the MoPH-managed activities.

The Office of Social Sector Development (OSSD) technical office and the full PCS team are responsible for monitoring risk mitigation steps, including whether conditions precedent are met prior to funds disbursement and whether other ongoing covenants continue to be met. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID direct assistance to the GIRoA will be provided through existing legally binding bilateral assistance agreements, which include USAID audit, investigation and evaluation rights on behalf of itself and other *U.S.* Government agencies; refund, termination and suspension provisions; and provisions requiring the submission to USAID of plans, specifications, procurement or construction schedules, contracts, or other documentation between GIRoA and third parties relating to goods or services to be financed under these bilateral assistance agreements, including documentation relating to the prequalification and selection of contractors and the solicitation of bids and proposals.

Responsibilities

The Mission's Partner Country System (PCS) team is composed of the following individuals:

(b)(6)

(b)(6)

The Mission's Technical Office Team, Office of Social Sector Development (OSSD) staff members are expanded PCS team members for G2G activities related to the MoPH. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the December 15, 2012 assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement.

The risk mitigation assessment and strategy was reviewed by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written Approval of Use of Partner Country Systems for the Ministry of Public Health.

Approved: ____________ Date: 1/14/13

Disapproved: ____________ Date: ____________

Attachment: Stage II Risk Assessment Report

Appendix No. 1

Stage II Risk Assessment Report

[redacted]

USAID
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USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF PUBLIC HEALTH

STAGE II RISK ASSESSMENT REPORT

December 15, 2012

~~SBU – May Not be Copied or Distributed~~

CONTENTS

Background

Founded in 1747, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, the Afghanistan economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure.

According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved. The internal audit function in line ministries does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2008, USAID/Afghanistan entered into an agreement with the Ministry of Public Health (MoPH) to manage U.S. Government funds for implementing health services through nongovernmental organizations (NGOs) under host country contracting mechanisms and signed an implementation letter to provide the MoPH with up to $236 million over five years to support the delivery of standardized health services in 13 target provinces in support of the Partnership Contracts for Health Services (PCH) Program. The program was expected to improve access, quality, and use of services to improve health status and contribute to meeting Afghanistan's national health objectives. Over the life of the program, activities contributed to:

- Increasing Basic Package of Health Services (BPHS) coverage to more than 90 percent
- Reducing the maternal mortality ratio to 1,360 deaths per 100,000 live births per year
- Reducing the mortality rate for children under 5 to 168 deaths per 1,000 live births per year
- Reducing the infant mortality rate to 104 deaths per 1,000 live births per year

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work

[1] London Conference, January 2010 and the Kabul International Conference of Afghanistan, July 2010.

with GIRoA to undertake entity level risk assessments of GIRoA line Ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of the Ministry of Public Health (MoPH) was issued in April, 2012.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development strategy. With that transition to a more robust traditional development strategy will likely result in substantive changes in Government to Government (G2G) assistance.

The G2G commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and the need to address fiduciary risk in the Partner Country PFM system being considered for direct Government to Government assistance. For that reason the Agency developed the Public Financial Management Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a USAID/W team, is undertaken prior to or in conjunction with the Mission-led Stage I Rapid Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other insurmountable barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment – which is an entity level assessment – may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.[3]

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessments upon GIRoA as required under currently issued Agency Policy–ADS Chapter 220 issued in draft in August 2011 and substantially updated in

[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 - pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012, where risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

[3] According to USAID/Afghanistan's Office Social Sector Development MOPH has given it evidence of effort to respond to the identified risks and began to address the identified weaknesses. The outcomes of that effort remain to be assessed during a later review and are not reflected in this Stage II report.

March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy–the enhanced DRG review and the PFMRAF Stage I assessment.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PRMRAF Stage II guidance as currently revised in July 2012, however the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012, USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and financial accountability (PEFA) reports, assessments undertaken by the CPA firms to date, and other informal information available to Mission staff. Using that informal process and the MoPH independent CPA firm assessment report issued in April 2012, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this Stage II assessment is to determine whether the U.S. government can rely on the Ministry of Public Health's (MoPH) systems operation and internal controls to manage donors' funds. Specifically the assessment will:

- Determine whether MoPH's financial management/accounting system is adequate to properly manage and account for donors' funds.
- Determine whether MoPH's internal controls are adequate to manage donors' funds.
- Determine whether MoPH's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- Determine whether MoPH complied in all material respects with applicable laws and regulations.

Executive Summary

The United States committed to improving the quality of its aid in order to maximize development benefits in Afghanistan pledged to channel at least 50 percent of its development assistance through the national budget of the Afghan Government[4]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) systems being considered for direct implementation of USAID-funded assistance. For that reason USAID developed the Public Financial Management Risk Assessment Stage II to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This assessment was performed to determine whether USAID can rely on the Ministry of Public Health's (MoPH) systems operation and internal controls to manage donors' funds. The assessment found that USAID cannot rely on the Ministry of Public Health's (MoPH) current systems operation and internal controls to manage donor funds without substantive mitigation measures being incorporated into G2G agreements negotiated with MoPH. The assessment found significant internal control weaknesses in the PFM systems. Examples of weaknesses detected include, lack of reliable payroll systems, lack of access control and management review over financial systems and transactions, and the hiring of unqualified financial management staff. The pervasive nature of the internal control weaknesses implies that the MoPH cannot adequately manage and safeguard donors' funds against loss and or misappropriation.

MoPH senior management officials have made some strategic decisions and have provided to some extent structure within the ministry. In spite of the notable efforts, considerable governance challenges remain unaddressed, especially in the area of personnel policies and procedures where the MoPH HR directorate has an opportunity to improve current practices. As an example, employees' annually required code of conduct and conflict of interest forms are not documented, and employees' job descriptions are not acknowledged and documented. In addition to the governance challenges, the MoPH faces difficulties in many other areas as well. For instance, the procurement department does not have specific mechanisms to prevent collusion between suppliers and procurement agents. Other examples of these difficulties are, management does not consistently use feedback and observations from its monitoring professionals to manage for results, and there are potential conflict interest issues between the provincial offices and the monitoring and evaluation division.

Under normal circumstances, the results of this assessment would lead USAID not to engage in Government to Government (G2G) assistance with the Ministry. Since the determination has already been made to engage in G2G activity with the Ministry, approaching assistance with precaution and conditions, USAID, working closely with GIRoA and the MoPH, can reasonably mitigate the identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

[4] London Conference on Afghanistan, January 2010 and the Kabul International Conference on Afghanistan, July 2010.

Assessment Conclusion & Results

The assessment found that the U.S. government cannot rely on the Ministry of Public Health's (MoPH) systems operation and internal controls to manage donors' funds.

- MoPH's financial management/accounting system is not adequate to properly manage and account for donors' funds. See page 9
- MoPH's internal controls are not adequate to manage donors' funds. See pages 8 and 9
- MoPH's procurement management units do not have sufficient systems and management capacity to implement activities and manage donors' funds. See page 10
- MoPH did not fully comply with GIRoA procurement laws and regulations. See page 10

In addition, the internal control environment is not adequate to mitigate risk of corruption as several key controls are not implemented, and it is unclear if GIRoA, including the Ministry, has the capacity to combat corruption effectively. Nonetheless, with technical assistance and other support and clear commitment to change on the part of GIRoA and the MoPH, USAID believes the identified risks can nonetheless reasonably be mitigated. See pages 8-11 and Appendix 1.

Management and governance structure

Governance is a process by which decisions are made and implemented. Management, be it corporate managers or government officials, sets the tone regarding the importance of standards of conduct; and management controls and business practices. Management provides, structure, discipline and a sense of purpose, and communicates these actions by their attitude toward internal controls. The assessment found that MoPH senior management officials have made some strategic decisions and concerted efforts to operate within GIRoA's guidelines, and has provided to some extent structure and discipline within the Ministry. For example, management has developed a five years strategic plan and has demonstrated a certain degree of leadership by updating the plan for another five years (2011 to 2015). In addition, senior management committees meet regularly, and the minutes of these meetings are documented, and action plans are often prepared at the end of the meetings.

In spite of these notable efforts, considerable governance challenges remain unaddressed. The Ministry has devoted considerable resources to develop and update its strategic plan, but there is no mechanism in place to monitor the effectiveness of the plan. Furthermore, the Ministry created an Internal Audit Division (IAD), but did not invest in the development of the division. The IAD does not have a charter, there is no audit committee, and the staff working in the division lacks the professional qualifications to be auditors. The internal auditors perform mainly transaction based audits instead of risks based audits due to the lack of professional expertise. Although the MoPH is operating in a volatile environment, management has not prioritized the development of business continuity and disaster recovery plans. In addition, the lack of physical and access controls over the information technology apparatus is a common threat however it does not get the required attention from senior management. Management has made some visible effort to demonstrate a commitment to good governance; however, because of its failure to implement sufficient internal controls, it is unclear to what degree has management communicated that commitment to staff. According to other public financial management reports,[5] MoPH employees are not adequately or consistently aware of their internal control responsibilities. Currently, individual elements of internal control procedures are understood by staff members who execute them, but there is little awareness across the Ministry of risks and controls for the whole internal control system. The same report noted a lack *of internal code* of ethics to help foster a clear internal control philosophy across the Ministry. The inconsistencies in management behavior raise concerns regarding the Ministry's long term commitment to standards of conduct and discipline toward internal control activities. These concerns highlight significant risk implications and raise doubt as to whether the Ministry has the capacity to manage donors' funds without donors' continued involvement to assist the Ministry in mitigating risks.

Financial Management and Accounting Systems
To achieve success in program implementation a reliable public financial management system is vital. The implementation of internal control activities reduces the likelihood of waste and improves program success. In most cases good internal control activities help identify weaknesses in a system, and prompt early corrective actions. Admitted that some organizations may not always have the necessary resources to implement effective internal controls, nonetheless key controls performed by management personnel can overcome the lack of segregation of duties and other control activities. At a minimum, management should review accounting systems reports, inspect supporting documents for selected transactions, and oversee periodic counts of inventories and review bank statements and other reconciliations.

The assessment found no documented evidence of these internal control functions. With only basic controls like comparing expenses to allotted budget, the MoPH public financial management system is weak and is highly vulnerable to errors and misconduct. According to the auditors, the financial management system is not integrated and lacks access controls. For example, there is no mechanism in place to prevent the alteration of payment request documentation after they have been approved by Ministry of Finance. These are significant internal controls weaknesses with obvious opportunities for wrongdoing. More importantly, the assessment discovered that several employees including some of the highest paid officials on the super salary scale received their salaries in cash. To accommodate this practice, the MoPH payroll officer goes to Da Afghanistan Bank every pay period and withdraws enough cash to pay these officials and staff in cash. It is unclear how and if this risky disbursement and receipt of cash for work practice is documented. This practice raises concerns considering that the payroll office does not perform reconciliations of payroll discrepancies. Also, the payroll system is vulnerable to unauthorized changes as there is no mechanism to record, generate and review payroll exceptions. Additionally, there is a systemic lack of internal control practices including accountability. For example, cash collected from blood banks are not regularly and promptly deposited in the bank. Furthermore, fixed assets are not registered, tagged and tracked, and periodic physical verification of fixed assets is not conducted. Lastly, the authorization and approval functions are concentrated with upper management and is not delegated, causing excessive delays and inefficiencies in the system. Because of the pervasive nature of the internal control weaknesses, *the MoPH*

5 Ministry of Public Health Public Finance Management and Public Internal Financial Control Review for Key Line Ministry, GIRoA, December 2011, [illegible] Chartered Accountants, UK

is unable to adequately manage and safeguard donors' funds against loss and or misappropriation.

Personnel Policies and Procedures

Human Resource functions are essential to organizational success, as they ensure employees are treated fairly and equitably. These functions also ensure that qualified employees are recruited and retained. The recruitment process at the MoPH is vulnerable to manipulation and unfair practices as the recruitment committee does not have documented recruitment guidelines and recruitment proceedings are not documented. In addition, there is no evidence that HR conducts reference checks on non Tashkeel[6] employees (e.g., consultants, advisors), and staff development including continuing professional education for medical doctors are not prioritized. Another critical HR function is to ensure the integrity of payroll data, and safeguard of employee personal data. The assessment noted among other things that the payroll database is vulnerable to unauthorized access and modification, as the HR does not perform monthly payroll reconciliations to document variances and discrepancies. In addition to this vulnerability, the MoPH runs the risk of paying ghost employees and making improper payments to employees, because the HR system does not maintain and track employees' leave, and employees' attendance records are not reviewed and approved. Similarly, personnel records including files with bank account information are not protected and are easily accessed by unauthorized personnel. Finally, the MoPH HR directorate lacks the basic understanding of HR functions. As an example, employees annual code of conduct and conflict of interest forms are not documented, and employees' job descriptions are not acknowledged and documented. We recognized the MoPH is operating in a challenging environment; nonetheless, the lack of attention to basic employment documentation and practices exposes the entity's and donors' funds to risks.

Procurement and Purchasing system

According to GIRoA's Procurement Law, the procurement regulation was enacted to ensure transparency in the procurement processes and to ensure effective control of financial affairs and public expenditures. Review of the MoPH's procurement processes revealed that the current process is not transparent and is susceptible to manipulations. Assessors found that the procurement department maintains a list of areas where certain items may be purchased, but does not have an approved list of suppliers for these areas. When the Ministry needs to acquire goods and services, procurement agents go to these predetermined areas and distribute requests for quotation. Then bids are submitted with suppliers' business information. However, there is no control in place to prevent collusion between suppliers and procurement agents, or the use of specific suppliers. Furthermore, there is no mechanism in place to analyze which suppliers are most commonly used by the Ministry. The lack of transparency within the system creates an opportune environment for fraud, waste and abuse. In fact the previous procurement director left the ministry on alleged issues of misappropriation of public funds and operational mismanagement. Contrary to the procurement law, there is no effective control over public expenditures. The law requires that supporting documentation should be submitted to the Control Office, where costs are recalculated, the legality of the procurement process verified, and the completeness and accuracy of the documentation

[6] Tashkeel is the organizational structure (Staffing establishment or List of sanctioned posts or Staffing structure or Organizational chart or Organ gram) in civil service system of Afghanistan including departments, positions, level of positions and number of positions in each department.

confirmed. However, there is no documented indication that these controls are being implemented by the MoPH.

In addition to an environment conducive to misuse of public funds, the procurement division is fragmented and ineffective. There are several independent procurement departments within the procurement division, as each donor supports separate procurement units within the division. This duplication of efforts and lack of coordination among the procurement management units leads to misallocation of resources. In addition, the donors' supported procurement units operate independently from the Ministry's civil servants and there is no indication of capacity building or knowledge transfer to Ministry procurement staff. In fact according to reviewers, civil servants within the construction procurement division are paid much less than their consultant counterparts supported by the donors. This practice of separate salary standards is resulting in low staff morale and affecting overall procurement efficiency. There are, however, discussions underway by GIRoA and donors, to move toward a common salary scale for tashkeel, while retaining the option of hiring and paying consultants.

The procurement directorate has taken some steps to improve the process and has recently developed procurement plans. In spite of the notable efforts, the procurement directorate is still susceptible to problems. Examples of these problems are; the directorate does not verify vendors' ability to perform until services has been rendered and goods received; while open tendering is the default procurement method, alternative methods used are not documented and justified in the files; communication between procurement and the technical assessment of the goods received is inconsistent; and sensitive procurement information is not protected from unauthorized access.

Finally, the assessment raises concerns regarding consultants' willingness to truly build the Ministry's civil servants capacity. As an example, a consultant at the Ministry developed a procurement tracking database but has limited the Ministry's involvement and access to the database under the pretext of the Ministry's lack of IT capacity. It is evident that the MoPH has some significant challenges; however, it is unclear if these problems are due to the lack of capacity, management weakness or deliberate acts to exploit the system's shortcomings. Whatever the case, procurement is a critical organizational function, as vast amounts of money are spent every year procuring goods and services. Consequently, donors must be aware of the risks, as there has been allegation of misappropriation of funds by a former senior procurement official.

Program Management and Monitoring

Monitoring and evaluation is the process of collecting and analyzing information about a project to determine whether the project is on track to reaching its objectives, and whether or not the project achieved or contributed to the desired impact. In order to know whether or not a project is on track to achieving intended objectives, management must monitor the project periodically and systematically from implementation through completion. Monitoring the progress of projects allows GIRoA and donors to adapt the project as needed to ensure that objectives are attained. Furthermore, performance management is a commitment to managing for results in order to achieve the best possible outcomes.

The MoPH performance management lacks the apparent commitment needed to manage for results. The assessment revealed that there is no link between operational plan and the annual budget and there is also no mechanism to compare operational plan and annual budget with the strategic plan. The Ministry does not use a systematic approach in the development of its monitoring plans, as several locations/facilities are not included the universe used to develop the plans. In addition, monitoring personnel at the district and provincial level report to the provincial directorate rather than the Monitoring and Evaluation directorate in Kabul, reducing transparency and resulting in potential conflict of interests, as the provincial directorate is the direct implementer of the project. Finally, there could be a lack of commitment on the part of management, as management is not consistently using feedback and observations from its monitoring and evaluations professionals to manage projects in order to ensure that objectives are attained and desired results achieved. The auditors reviewed follow-up monitoring reports from three provinces containing eighteen recommendations, and found that management has addressed only three of the eighteen recommendations in the follow-up monitoring reports. Management's lack of consistent commitment to program outcome could impact program results and put donors' funds at risk.

Risk Assessment Measurement

USAID guidance states, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as, Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as, Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact	*Catastrophic*	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted the assessment under a scope which focused on five main areas of 1) Corporate Governance Structure and Control Environment, 2) Financial management and accounting system, 3) Personnel policies and procedures, 4) Procurement, and 5) Monitoring and Evaluation. While the auditors conducted an in-depth assessment on the five areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements. However to ensure Mission compliance with the Agency's guidance on required due diligence, we reviewed the assessment report and met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We also met and discussed with our internal financial analysts who had an understanding of the Ministry's systems. Further, we conducted limited research on other work performed by PKF on the MoPH. Based on the auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and the risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they were required to define their findings in terms of risks as prescribed by the Agency in order to mitigate the identified risks. Because our review was conducted after the completion of the assessment, and could not go back to determine the impact and probability of the identified risks, we relied on our understanding gained over the years of collaboration with GIRoA. Based on that understanding we defined the potential risks and took a conservative approach and considered most risks to be serious and probable unless the contrary was clearly evident.

Appendix 1

Risk Schedule:

	Risk of	Impact	Probability	Score	Suggested Mitigation Measures
	Management and governance structure				
1	Diverting government resources for unintended purposes Waste, fraud and abuse may go undetected	Serious	Probable	Critical	1. Develop a policy which requires the Ministry to compare actual results to strategic plan 2. Prepare Management Accounts that compares periodic actual results against budget 3. Submit quarterly management accounts to USAID which compares actual results against strategic plan
2	Lack of professional skills to perform risk based audit to mitigate the occurrence of risk Waste, fraud and system abuse may go undetected	Serious	Probable	Critical	1. Establish an Audit Committee with an oversight responsibility over the Internal Audit Department 2. Convene regular audit committee meetings and document meeting minutes 3. Provide relevant training to Internal Audit personnel 4. Audit all USAID projects annually 5. Submit interim risk based audit reports to USAID
3	Losing vital data and information in the event of system failure or natural disaster Abuse of system access	Catastrophic	Occasional	Critical	1. Develop a policy to include disaster recovery plan 2. Back-up information technology systems regularly on and off site 3. Put Information Technology (IT)

	rights Lack of physical control over ICT server and equipments				server under locked doors and provide acces only to authorized personnel 4. Install fire extinguishers in the IT server room 5. Users' of the information systems should have unique user ID and password to log into the system 6. System's access should be clearly defined or restricted according to roles and functions
Financial management and accounting systems					
4	Manipulation of accounting information after approval and posting to hide illegal actions Diverting donated program funds to finance unauthorized activities Engaging in accounting irregularities to hide true financial position	Serious	Probable	Critical	1. Segregate duties among accounting staff. 2. Rotate assignments within the staff to ensure all staff know and understand different levels of responsibility 3. Install computerized financial management system with in-built controls 4. Link the computerized financial management system used by MoPH to the AFMIS maintained by MoF 5. Conduct annual financial statement audit 6. Submit audited financial

					statement to USAID
5	Misappropriation of funds when revenues collected are not recorded properly and deposited into the proper bank account on a timely manner Encouraging environment conducive to fraudulent acts	Serious	Probable	Critical	1. Develop a policy to ensure that all revenues accruing to MoPH have been properly accounted for 2. Deposit all cash receipts into the bank account without delay 3. Perform monthly reconciliation on the revenue account 4. Develop revenue projections and compare projections to actual receipts and investigate the differences 5. Submit annual audited financial statements on USAID program funds
6	Misappropriation of cash arising from payment of salaries in cash	Catastrophic	Probable	Critical	1. Pay all salaries through the banking system 2. Conduct annual payroll audits 3. Reconcile payroll for discrepancies on monthly basis 4. Modify the payroll system and include the option for reviewing the payroll exceptions and limit the rights of the users
7	Assets being used for unintended purposes	Serious	Probable	Critical	1. Tag all fixed assets with an identification number 2. Update fixed assets register on

	Diverting government property for personal use Waste, fraud and abuse may go undetected				**regular basis to reflect: date of purchase, asset type, location, serial number, tagged number** 3. **Conduct periodic inventory of fixed assets, possibly every six months** 4. Provide USAID a list of all fixed assets funded with USAID money 5. Conduct regular performance audit to include asset verification
			Personnel policies and procedures		
8	Deviation from policies, rules and poor performance	Catastrophic	Probable	Critical	1. Develop clear organizational policies, mission and vision statements 2. Distribute copies of the policies to all employees
9	Improper payments to employees Funds being used for unintended purposes Lack of accountability of public officials	Serious	Probable	Critical	1. Develop a plan to automate attendance system 2. Document time and attendance for all employees 3. Link employees pay benefits to the time and attendance register and reconcile regularly 4. Supervisors approval required for all time and attendance before salaries are paid to employees

					5. Conduct compliance audit
10	Employees engaging in conflict of interest activities Nepotism and cronyism	Serious	Probable	Critical	1. Update employees' code of conduct forms annually 2. Conduct ethics training for all employees
11	Inconsistent system and no improvement Employees leaving the organization without returning all assets in their custody and fulfilling their obligations	Marginal	Occasional	Medium	1. Develop procedures for conducting exit interviews 2. Supervisors and employees clear on exit interview clearance forms 3. Retrieve all assets in the custody of the employees
12	Employees not knowing their responsibilities	Serious	Probable	Critical	1. Develop annual work objectives for all staff 2. Perform personal needs assessment to determine the areas of improvement. 3. Conduct ethics training for all staff

	Procurement and purchasing systems				
13	Procurement system not being transparent and exposed to conflict of interests Kickbacks and bribery Resulting in inconsistent practices and operational inefficiencies.	Serious	Probable	Critical	1. Develop written policies and procedures for the procurement processes 2. Request OAA's involvement in all critical procurements 3 Obtain signed conflict of interest from personnel who are involved in the procurement processes 4. Develop a plan to introduce procurement reforms
	Program management and monitoring				
14	Concealing vital monitoring and evaluation information	Serious	Probable	Critical	1. Develop written policies and procedures for monitoring and evaluation 2. Send monitoring and evaluation reports to the M&E Directorate at the head office and copies to the provincial offices 3. Submit copies of M&E reports to USAID

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

TO:	Partner Country Systems' Team
FROM:	(b)(6)
THROUGH:	
DATE:	December 16, 2012
SUBJECT:	Stage II equivalent risk assessment report and prioritization of risk mitigation measures and recommended benchmarks for the Ministry of Public Health (MoPH)

REFERENCE: USAID/Afghanistan's Stage II equivalent risk assessment report on the (MoPH)

This memorandum communicates the result of our Stage II equivalent risk assessment report and our recommended risk mitigation measures and benchmarks for the MoPH.

The result of this Stage II equivalent risk assessment report is based on our examination of the CPA firm's finalized assessment report of the MoPH issued in April 2012, and our review of other published assessments on the Government of the Islamic Republic of Afghanistan (GIRoA).

The overall objective of this Stage II equivalent risk assessment was to determine whether the U.S. government can rely on the MoPH's systems, operation and internal controls to manage donors' funds. Specifically the assessment was designed to determine whether:

- MoPH's financial management/accounting system is adequate to properly manage and account for donors' funds.
- MoPH's internal controls are adequate to manage donors' funds.
- MoPH's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- MoPH complied, in all material respects, with applicable laws and regulations.

The assessment found significant risks in the MoPH's systems, operation and internal controls. The identified risks and suggested risk mitigation measures and benchmarks are documented in the accompanied Stage II equivalent risk assessment report. To help the Mission address its fiduciary responsibility and engage in Government to Government activity with the MoPH responsibly, we've prioritized the risks according to their potential impact on the Mission's investment in the MoPH's core budget. Our recommended risk mitigation measures are based on prioritization of risk levels as high and medium (please see the Risk Prioritization schedule – Appendix I of the referenced report) for the On-Budget Committee's consideration as activity project designs are contemplated and G2G agreements are negotiated. The High risks are those risks that can have a severe and detrimental impact on the MoPH's ability to achieve its goals and objectives. Medium risks are those risks that can have a negative impact on the efficiency of the MoPH's operation and performance. OFM recommends the following conditions precedent, covenants, conditionalities, and monitoring activities be considered by the PCS team as G2G agreements are designed and negotiated.

[redacted]

Recommended Conditions Precedents

Management and governance structure

1. Develop a policy which requires the Ministry to annually compare and report actual results to strategic plan by comparing the results achieved against the operational plan and the targets set at the beginning of each year
2. Establish an Audit Committee with an oversight responsibility over the Internal Audit Department and submit an approved risk based internal audit plan to USAID
3. Submit a plan approved by Senior Management to improve information and communication technology (ICT) management practices including plans to develop ICT policies and procedures and a disaster recovery plan

Procurement

1. Develop and submit an annual procurement plan which also demonstrates MoPH's procurement capacity to implement the plan
2. Develop procurement policies and procedures in compliance with the requirements of Afghanistan Procurement Law and obtain signed conflict of interest forms from personnel involved in procurement processes
3. Provide written certification to USAID that:
    a. no USAID funds will be used to purchase ineligible commodities
    b. no USAID funds will be used to finance restricted commodities
    c. no USAID funds will be used, directly or indirectly, to produce, *acquire, use,* transport, store, sell, or otherwise deal with ammonium nitrate (AN) for agricultural applications or calcium ammonium nitrate (CAN) for agricultural or construction/demolition applications
    d. MoPH will include this prohibition in all contracts awarded for the Integrated Health Services Systems Strengthening Program and require the inclusion of this prohibition in any subcontracts awarded

Monitoring and Evaluation

1. Develop written policies and procedures for monitoring, evaluation and reporting plan on key indicators including responsible individuals or offices and their authorities and further, provide an annual Monitoring and Evaluation (M&E) plan to USAID

Financial Management

1. Submit a plan approved by the MoPH Senior Management to implement improved financial management practices to strengthen internal controls, including documentation of policies and procedures for the Finance and Administration Directorate
2. Submit a plan approved by the MoPH Senior Management to implement an asset register and improve asset management practices, including development of policies and procedures
3. Provide the program specific bank account and routing number and user name and account password
4. Develop policy and procedures for revenue accruals to ensure that all revenues are accounted for, monitored, and deposited properly
5. Develop policies and procedures to ensure salaries are only paid using the banking system
6. Develop a plan to modify the payroll system to facilitate the review and reconciliation of discrepancies and enhance access controls
7. Provide plans to improve the financial management system with built-in controls and integrated with MoF's AFMIS

Human Resources

1. Provide a plan approved by Senior Management to ensure improved human resource management practices including development of clear organizational policies, mission and vision statements, and procedures including the requirement to reconcile HR and payroll databases
2. Develop a plan to improve and to strengthen access controls over the HR database of personnel records
3. Develop an annual training plan for capacity building of staff

Recommended Ongoing Covenants, Conditionalities, and Monitoring

Management and governance structure

1. Submit annual report comparing actual results to the strategic plan by comparing the results achieved against the operational plan and the targets set at the beginning of each year
2. Submit annually approved risk based internal audit plan and summary of completed prior year audits
3. Submit approved ICT policies and procedures and a disaster recovery plan

Procurement

1. Submit quarterly progress reports on status of planning, procurements, contracting, execution of works and services and achievement to date
2. Submit copy of the annual procurement plan

Monitoring and Evaluation

1. Provide copy of the annual M&E plan to USAID

Financial Management

1. Submit annual financial statement reports audited by CPA firms approved by USAID Office of Inspector General
2. Submit on a quarterly basis, a full accounting of all transactions and activities of the special U.S. Dollar Account, including a complete copy of each monthly bank *statement*
3. Develop policies and procedures related to the establishment of an asset register and asset management practices
4. Provide a copy of the asset register and actual inventory taken
5. Submit quarterly updates on plans to improve the financial management system with built-in controls and integrated with MoF's AFMIS
6. Provide evidence that planned improvement to the financial management system has been implemented

Human Resources:

1. Submit documents prepared by the MoPH reporting on progress toward achievement of human resources management practices, document including but not limited to the following particular areas: (Then provide evidence of implementation)
   a. A full staffing plan, including job descriptions for all positions
   b. A training plan for each department/ division linked to the job description needs of staff encumbering positions and including annual ethics training

   c. Documented procedures for hiring and departure, including individual employee documentation of conflict of interest forms

2. Submit quarterly updates on plans to:
   a. reconcile HR and payroll databases
   b. strengthen access controls over the HR database of personnel records

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

January 14, 2013

~~SENSITIVE BUT UNCLASSIFIED~~

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

TO: S. Ken Yamashita, Mission Director (b)(6)

FROM: (b)(6)

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) – The Ministry of Communication and Information Technology (MoCIT) under ADS Chapter 220

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Ministry of Communication and Information Technology (MoCIT). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the MoCIT through FYE 2015.

The initial proposed G2G direct assistance activities include:

- E-Governance Resource Center (EGRC) – USAID total contribution estimated at $ 4 million.

BACKGROUND:

The mandate of MoCIT is to ensure the provision of quality and affordable communication, information technology (IT), and postal services to the citizens of Afghanistan. The current vision of MoCIT is to transform Afghanistan into an information society through the delivery of telecom and IT services to rural areas, increase access to high speed internet, extend fiber optic networks, expand utilization of telecommunication satellites, convert analogue television to digital television, and the introduce e-government services throughout the Ministries and agencies of GIRoA. MoCIT is the key Ministry tasked with implementing GIRoA's National Priority Program "E-Afghanistan", which outlines GIRoA's approach and priorities related to promoting access to information and communications systems for Afghan citizens and introducing e-governance within public institutions.

Direct government to government (G2G) assistance to MoCIT will strengthen the Ministry's internal capacity to procure essential services in an efficient and transparent manner and to competently manage government-wide staff training programs. Through the implementation of G2G activities with MoCIT, USAID adheres to a number of principles articulated in the Tokyo Mutual Accountability Framework, such as: improving GIRoA institutional capacities, aligning international assistance with national priority programs, and encouraging GIROA's ownership of the development process. USAID had a previous assistance e-governance project with MoCIT that ended in 2011 and focused on improving government websites and inter-ministerial communications systems.

Since 2002, USAID support to MoCIT has dropped significantly as other donors have stepped in to provide support. Currently, key donors include the International Telecommunications Union (ITU), the United Nations Development Program (UNDP), the Asian Development Bank (ADB) and the Government of India. The World Bank is the prime donor building the capacity of MoCIT and supporting the Ministry to fulfill its mandate. USAID was instrumental early on in standing up Afghanistan's District Communication Network and providing technical assistance on policy and regulatory reform and governance issues, but in terms of new MoCIT programs, the World Bank funds upwards of 90 % of the activities.

Complying with USAID Policy

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and to maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risks and may contain risk-mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the appropriate fiduciary relationship with the institution can exist.

Due to the formal date of issuance of ADS 220 (March 2012) and previous on-budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements was initiated for USAID/Afghanistan in August 2012. The waiver was approved by the USAID Administrator on November 20, 2012. The waiver focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro-level assessments, which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the Stage I assessments upon GIRoA, as required under currently issued ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the USG to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the MoCIT which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA, contracted a third-party to carry out the Stage II equivalent Risk Assessment of the MoCIT. The report was issued in July 2012.

DISCUSSION:

Fiduciary Risk

The mission recognizes that Afghanistan is a high-risk environment, but is both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The Mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursement of US government funds to assure maximum protection of U.S. taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The Mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The Mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through the application of the ADS 201 and other guidance to project design. This AUPCS, therefore, focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

Managing Risk

On January 8, 2013, the Mission Partner Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II assessment report was prepared to determine whether USAID could rely upon the MoCIT systems operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon the MoCIT current systems operation and internal controls to manage donors' funds without *substantive* mitigation measures being incorporated into G2G agreements negotiated with the MoCIT. The complete Stage II Risk Assessment Report, including the Risk Schedule with identified risks and suggested mitigation measures, is attached in Appendix Number 1.

USAID's initial activity to be implemented through direct on-budget assistance with the MoCIT is the E-Government Resource Center (EGRC). The programmatic objectives are described below.

E-Government Resource Center (EGRC)

The objective of EGRC is to introduce streamlined, modern, and effective e-governance platforms throughout GIRoA in order to improve government operations, increase transparency and accountability of government transactions, and promote efficiencies in the provision of government services. This purpose will be realized through the establishment of an Information and Communications Technology (ICT) center of excellence (E-government Resource Center) within MoCIT to serve as the central source of technical expertise, skills, and guidance on the further development and deployment of E-government programs throughout the Ministries and agencies of GIRoA. EGRC will be implemented as a G2G activity in order to maximize the capacity building opportunities within MoCIT throughout the various stages of project implementation – procurement of technical assistance, IT platform and policy development, awareness raising campaigns, training of GIRoA officials, etc. The EGRC project fully aligns with GIRoA's stated objective under the National Priority Program "E-Afghanistan" and ensures the sustainability of project results through the institutionalization of the E-Governance Resource Center with MoCIT.

Although EGRC involves certain risks, the Mission is structuring the program to include a number of measures that will mitigate the dangers and ensure the successful implementation of the program.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement. The IL may specifically include USAID prior-consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and other conditionalities required throughout the activity period. The conditionalities also will require MoCIT to plan and begin to address some of the general weaknesses identified in the July 2012 contracted PFM assessment report. Details reflecting interventions to address the findings of the Stage II Risk Assessment Report will be included in designs under EGRC. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreement will require an annual audit of the MoCIT, inclusive of all USAID-specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of MoCIT and the Ministry of Finance under a separate Capacity Development initiative and initiate internal control and financial reviews of the MoCIT-managed activities.

The Office of Economic Growth and Infrastructure (OEGI) technical office and the full PCS team are responsible for monitoring risk mitigation steps, including whether conditions precedent are met prior to funds disbursement and whether other ongoing covenants continue to be met. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID direct assistance to the GIRoA will be provided through existing legally binding bilateral assistance agreements, which include USAID audit, investigation and evaluation rights on behalf of itself and other U.S. Government agencies; refund, termination and suspension provisions; and might include provisions requiring the submission to USAID of plans, specifications, procurement or construction schedules, contracts, or other documentation between GIRoA and third parties relating to goods or services to be financed under these bilateral assistance agreements, including documentation relating to the prequalification and selection of contractors and the solicitation of bids and proposals.

Responsibilities

The Mission's Partner Country System (PCS) team is composed of the following individuals:

(b)(6)

[redacted]

The Mission's OEGI Technical Office staff are expanded PCS team members for G2G activities related to the MoCIT. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the January 2012 assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement.

The risk mitigation assessment and strategy was reviewed by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written Approval of Use of Partner Country Systems for the Ministry of Communication and Information Technology.

Approved: ______________ Date: 1/14/13

Disapproved: ______________ Date: ______________

Attachment: Stage II Risk Assessment Report

[redacted]

Appendix No. I

Stage II Risk Assessment Report

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

TO:	Partner Country Systems' Team
FROM:	(b)(6)
DATE:	January 8, 2013
SUBJECT:	Stage II equivalent risk assessment report and prioritization of risk mitigation measures and recommended covenants for Ministry of Communication and Information Technology (MoCIT)

REFERENCE: USAID/Afghanistan's Stage II equivalent risk assessment report on the (MoCIT)

This memorandum communicates the result of our Stage II equivalent risk assessment report and our recommended risk mitigation measures and benchmarks for MoCIT.

The result of this Stage II equivalent risk assessment report is based on our examination of the CPA firm's finalized assessment report of MoCIT issued in July 2012, and our review of other published assessments on the Government of the Islamic Republic of Afghanistan (GIRoA).

The overall objective of this Stage II equivalent risk assessment was to determine whether the U.S. government can rely on MoCIT's systems, operation and internal controls to manage donors' funds. Specifically the assessment was designed to determine whether:

- MoCIT's financial management/accounting system is adequate to properly manage and account for donors' funds.
- MoCIT's internal controls are adequate to manage donors' funds.
- MoCIT's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- MoCIT complied, in all material respects, with applicable laws and regulations.

The assessment found significant risks in the MoCIT's systems, operation and internal controls. The identified risks and suggested risk mitigation measures and benchmarks are documented in the accompanied Stage II equivalent risk assessment report. To help the Mission address its fiduciary responsibility and engage in Government to Government activity with the MoCIT responsibly, we've prioritized the risks according to their potential impact on the Mission's investment in the MoCIT's core budget. Our recommended risk mitigation measures are based on prioritization of risk levels as high and medium (please see the Risk Prioritization schedule — Appendix I of the referenced report) for the On-Budget Committee's consideration as project activity designs are contemplated and G2G agreements are negotiated. The high risks are those risks that can have a severe and detrimental impact on the MoCIT's ability to achieve its goals and objectives. Medium risks are those risks that can have a negative impact on the efficiency of the MoCIT's operation and performance. OFM recommends the following conditions precedent, covenants, conditionalities, and monitoring activities be considered by the PCS Team as G2G agreements are designed and negotiated.

[illegible]

Recommended Conditions Precedents

Management and governance structure

1. Develop terms of reference for the inter-ministerial and project steering committees and have it distributed to all members
2. Establish an Audit Committee with an oversight responsibility over the Internal Audit Department
3. Develop plans to conduct annual risk assessments with specific responsibility assigned over key processes to address identified internal control weaknesses
4. Develop plans to improve transparency at various levels of the organization including the availability of the annual budget, related budget execution reports and the annual report on the MoCIT's website

Procurement

1. Develop and submit a detailed annual procurement plan which is aligned with the approved budget and also demonstrates MoCIT's procurement capacity to implement the plan
2. Develop plans for implementing procurement procedures in compliance with the requirements of Afghanistan Procurement Law including the requirement to document procurement committee meetings, and to obtain signed conflict of interest forms from personnel involved in procurement processes
3. Provide written certification to USAID that:
   a. no USAID funds will be used to purchase ineligible commodities
   b. no USAID funds will be used to finance restricted commodities
   c. no USAID funds will be used, directly or indirectly, to produce, acquire, use, transport, store, sell, or otherwise deal with ammonium nitrate (AN) for agricultural applications or calcium ammonium nitrate (CAN) for agricultural or construction/demolition applications
   d. no USAID funds will be used to finance goods or services from a prohibited source, which is defined to mean any country to which assistance is prohibited by the annual appropriations acts of the United States Congress or other U.S. statues, or those subject to U.S. Executive Branch restrictions, such as applicable sanctions administered by the U.S. Treasury Department's Office of Foreign Assets Control
   e. MoCIT will include these prohibitions in all contracts awarded for the MoCIT programs and require the inclusion of these prohibitions in any subcontracts awarded

Monitoring and Evaluation

1. Develop a plan to establish a Monitoring and Evaluation department with clearly defined roles and responsibilities

Financial Management

1. Submit a plan approved by the MoCIT Senior Management to implement improved financial management practices to strengthen internal controls, including documentation of key processes and procedures for the Finance and Administration Directorate
2. Submit a plan approved by the MoCIT Senior Management to implement an asset register and improve asset management practices, including development of policies and procedures
3. Develop procedures for cash operations to ensure that all revenues, expenditures, and advances are accounted for, monitored, and properly reported
4. Provide plans to improve the financial management system with built-in controls and integrated with MoF's AFMIS

5. Develop a plan to establish an internal budget committee to coordinate the budgetary formulation processes and make the process more inclusive by including active participation by the provincial offices

Human Resources

1. Develop a plan to automate the time and attendance system, including processing of overtime and eliminating cash payments and to strengthen access controls over the HR database of personnel records
2. Develop a plan to document internal policies and procedures for the HR directorate
3. Develop an annual training plan to build staff capacity
4. Develop plans to improve documentation of personnel files including the documentation of reference checks of all new hires

Recommended Ongoing Covenants, Conditionalities, and Monitoring

Management and governance structure

1. Provide quarterly documentation of leadership committee meeting minutes to USAID
2. Provide copies of internal annual risk assessments with identified internal controls weaknesses and documented management corrective actions to USAID
3. Provide evidence of a functional legal department which includes an internal legal counsel with the capacity to meet the entity's legal and contractual requirements, or provide evidence of access to competent legal counsel
4. Submit annually approved risk based internal audit plan for the Internal Audit Department and summary of completed prior year audits to USAID
5. Provide evidence of regular audit committee meetings and document meeting minutes to USAID
6. Provide documentation to USAID on ongoing training for the internal audit department staff
7. Provide evidence of progress toward increased transparency, including the availability of the annual budget, related budget execution reports and the annual report on the MoCIT's website and sharing of approved procurement budget with respective departments and directorates

Procurement

1. Submit to USAID quarterly progress reports on status of planning, procurements, contracting, execution of works and services and achievement to date
2. Submit to USAID copy of the detailed annual procurement plan which is aligned with the procurement budget
3. Quarterly external evaluation reports of procurement capacity provided to USAID
4. On a quarterly basis, provide evidence of documented procurement committee meetings, receipt of signed conflict of interest forms from personnel involved in procurement processes, and implemented training plan to improve procurement capacity

Monitoring and Evaluation

1. Develop written policies and procedures for monitoring, evaluation and reporting on key indicators including responsible individuals or offices and their authorities
2. Provide copy of annual M&E plan

Financial management & reporting

1. Provide to USAID annual audited financial statements by USAID Office of Inspector General approved CPA firms
2. On a quarterly basis submit to USAID a fund accountability statement fully reconciled to the special U.S. Dollar Account, including a complete copy of each monthly bank statement (format for the fund accountability statement to be provided by USAID/OFM)
3. Provide to USAID quarterly minutes of budget committee meetings, demonstrating participation by the provinces and discussions over budget approval, budget variance and other significant budgetary issues
4. Provide to USAID periodic inventory and fixed assets verification reports
5. Submit to USAID quarterly reports demonstrating progress to improve financial management practices by strengthening internal controls, including documentation of internal risk assessments, key processes and procedures

Human Resources:

1. Provide quarterly evidence of progress toward achievement of improved human resources management practices including but not limited to:
    a. automate the time and attendance system, including processing of overtime and eliminating cash payments and to strengthen access controls over the HR database of personnel records
    b. document internal policies and procedures for the HR directorate
    c. develop a full staffing plan, including job descriptions for all positions
    d. develop a training plan for each department/division linked to the job description, needs of staff encumbering positions and including annual ethics training
    e. develop procedures for hiring and departure, including individual employee documentation of conflict of interest forms
2. Submit to USAID quarterly updates on plans to:
    a. reconcile HR and payroll databases
    b. improve documentation of centrally maintained personnel records by developing and using a checklist

USAID
FROM THE AMERICAN PEOPLE

USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF COMMUNICATION AND INFORMATION TECHNOLOGY (MoCIT)

STAGE II RISK ASSESSMENT REPORT

January 08, 2013

CONTENTS

Background

Founded in 1747, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, Afghanistan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved and their internal audit function does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work with GIRoA to undertake entity level risk assessments of GIRoA line Ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of the Ministry of Communication and Information Technology (MoCIT) was issued in July 2012.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development strategy. With that transition to a more robust traditional development strategy will likely result in substantive changes in Government to Government (G2G) assistance.

The G2G commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and the need to address fiduciary risk in the Partner Country PFM system being considered for direct G2G assistance. For that reason the Agency developed the Public Financial Management

[1] London Conference, January 2010 and the Kabul International Conference of Afghanistan, July 2010.

Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a USAID/W team, is undertaken prior to or in conjunction with the mission-led Stage I Rapid Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other insurmountable barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment–which is an entity level assessment–may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessment upon GIRoA as required under currently issued Agency Policy–ADS Chapter 220 issued in draft in August 2011 and substantially updated in March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy–the enhanced DRG review and the PFMRAF Stage I assessment.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PFMRAF Stage II guidance as currently revised in July 2012, however the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012, USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and

[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 - pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012, where risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

financial accountability (PEFA) reports, assessments undertaken by the CPA firms to date, and other informal information available to Mission staff. Using that informal process and the MoCIT independent CPA firm assessment report issued in July 2012, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this Stage II risk assessment is to determine whether the U.S. Government can rely on the Ministry of Communication Information Technology's (MoCIT) systems operation and internal controls to manage donors' funds. Specifically the assessment will:

- Determine whether the MoCIT's financial management/accounting system is adequate to properly manage and account for donors' funds.
- Determine whether the MoCIT's internal controls are adequate to manage donors' funds.
- Determine whether the MoCIT's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- Determine whether the MoCIT complied, in all material respects, with applicable laws and regulations.

Executive Summary

The United States Government committed to channeling at least 50 percent of its development assistance through the national budget of the GIRoA[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) systems at the entity level being considered for direct implementation of USAID-funded assistance. For that reason USAID developed the Stage II Public Financial Management Risk Assessment to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This Stage II assessment was prepared to determine whether USAID can rely on the Ministry of Communication & Information Technology (MoCIT) systems operation and internal controls to manage donors' funds. The assessment determined that USAID cannot rely on the Ministry of Communication & Information Technology (MoCIT) current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into Government to Government (G2G) agreements negotiated with MoCIT.

The assessment revealed several managerial and operational gaps including: weak governance structure, weak internal control environment, inadequate financial management and budgeting and accounting systems, lack of personnel policies and procedures, and the lack of a distinct Monitoring and Evaluation (M&E) Department for programmatic management and monitoring. These gaps are evidence of weak accountability and commitment to enforce best practices.

The assessment also indicated that there is the need to strengthen the capacity of the Internal Audit Department and to document the Terms of Reference (ToR) for senior management committee meetings. Furthermore, the budget formulation process at the Ministry lacks transparency; neither is there adequate controls related to fixed assets management. In addition, the codes of conduct and statements of conflict of interest forms need to be signed off by all employees, and there is no tool for conducting employee reference checks at the time of recruitment. Under normal circumstances, the results of this assessment would lead USAID not to engage in G2G assistance with the Ministry. Since the determination has already been made to engage in G2G activity with the Ministry, approaching assistance with precaution and conditions, USAID can reasonably mitigate the identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

[3] London conference on Afghanistan, January 2010 and the Kabul International conference on Afghanistan, July 2010.

Assessment Conclusion & Results

USAID cannot rely on the Ministry of Communication & Information Technology (MoCIT) systems operation and internal controls to manage donors' funds.

- MoCIT's financial management/accounting system is not adequate to properly manage and account for donors' funds.
- MoCIT's internal controls are not adequate to manage donors' funds.
- MoCIT's procurement management units do not have sufficient systems and management capacity to implement activities and manage donors' funds.
- MoCIT did not fully comply with GIRoA procurement laws and regulations.

The internal control environment is not adequate to ensure effective and efficient operations and compliance with applicable laws and regulations, safeguard assets against theft and unauthorized use, nor mitigate the risk of corruption. Nonetheless, we believe the identified risks can be reasonably mitigated. (See Appendix 1)

Management and governance structure
One of management's responsibilities is to create a solid foundation that will ensure the effective and efficient development of an organization. Also, accountable management needs to insure appropriate policies are developed and applied, talents that are needed to enhance organizational growth are identified, and procurement integrity observed. Governance structure should be designed to monitor operations of an entity to achieve long term strategic goals aimed at satisfying stakeholders and ensure compliance with the legal and regulatory requirements. The assessment found a weak governance structure, as terms of reference for the Inter-ministerial and Project Steering Committees were not established, and meeting minutes were not maintained even though these committees form an integral part of the overall governance structure of the MoCIT. In the absence of detailed terms of reference, rights and responsibilities of these bodies cannot be established. In addition, the MoCIT has not conducted risk assessments, and has not developed specific internal control procedures assigning responsibility for its processes to address internal control weaknesses on a continuous basis. The lack of specific procedures to address these internal control weaknesses can create potential conflicts of interest and increase the risk of misappropriation of resources. According to the auditors, the position of the legal advisor is currently vacant and legal services are obtained on a contractual basis from an external consultant. However, the contract with the consultant was not available for review. The absence of relevant and expert legal advice and a well functioning legal department may not be in the best interest of the Ministry, as it may undermine the Ministry's legal interest and potentially exposes it to undue legal and litigation risks. Further, the internal audit department of the MoCIT lacked an internal audit manual along with a clear risk based methodology for performing audits. This is mainly due to staff's low technical capacity and inadequate basic auditing qualifications. In addition, the process of following up on prior audit recommendations was found to be weak. An ineffective Internal Audit Department diminishes deterrence and increases the risk of fraud, waste and abuse going undetected. Moreover, transparency at various levels at the MoCIT needs to be improved. For example, the

annual budget and related budget execution reports along with reports of provincial allocation of development projects and annual reports are not published on the MoCIT's website. Similarly, the approved budget for goods and services are not shared with the respective and concerned departments or directorates. The organizational risks identified above raise concerns regarding the Ministry's long term commitment to standards of conduct and discipline towards internal control activities. These concerns highlight significant risk implications requiring constant management diligence and raise doubt as to whether the Ministry has the capacity to manage donors' funds without donors' involvement.

Financial Management and Accounting Systems

To achieve success in program implementation, reliable financial management and accounting systems are vital, and such systems at the MoCIT are inadequate. For example, MoCIT did not have documented internal financial procedures, and funds availability is not always verified prior to incurring expenditures. In addition, the budgeting system is not transparent, as provincial offices are not involved in the preparation of the Ministry's budget. This is a significant weakness in the budget formulation process, as it affects transparency, commitment and ownership of the entire budget. In fact, supporting documentation for budgets and subsequent budgetary revisions were not available for the auditors' review. Also, there is weak internal control over cash management. The cashier has the sole responsibility over petty cash operations, but does not maintain a cash receipt and disbursement book, and there are no independent periodic surprise cash counts. In addition, the Ministry permits salary advances in the form of cash to staff, however there are no internal controls to monitor and track the cash advances and a separate ledger to record the cash advances is not maintained. Also, formal procedures to ensure timely liquidation of the cash advances do not exist. This lack of commitment from management to monitor cashier operations, and account for the Ministry's assets exposes the Ministry to increased risk of misappropriation and fraud. In fact, MoCIT's internal auditors identified and reported issues regarding outstanding recoverable advances, but it is not clear if any actions were taken to address the identified deficiency. There is also a lack of management accountability, discipline and good business practices. For example, fixed assets register is not maintained and assets are not coded to reflect their location and condition. According to management, most of the financial staff does not have the required educational background specific to finance and accounting. Because of the weaknesses identified in the financial management system, the MoCIT cannot ensure that donors' funds will be utilized effectively or safeguarded against loss and misappropriation.

Personnel Policies and Procedures

Human Resources (HR) function should ensure that qualified employees are recruited, trained and retained. The assessment found the recruitment process at the MoCIT is vulnerable to manipulation and unfair practices. For example, job announcements, employment contracts, and promotion records are not documented in the personnel files. There is also no evidence that the HR conducts reference checks on new employees at the point of recruitment. In addition, the payroll system is not interfaced with the attendance registers which are maintained manually by the Human Resource Department attendance unit. Furthermore, overtime is paid in cash instead of being paid through the banking system. It is also calculated manually and is not verified for accuracy, thus increasing the risk of errors, miscalculations and misappropriation of funds. The assessment also noted among other things, that the payroll database is vulnerable to unauthorized access and modification, as the HR does not perform monthly payroll reconciliations to document variances and discrepancies. In conclusion, the overall lack of attention to basic employment documentation and practices increases the Ministry's operational and programmatic risk and exposes donors' fund to potential waste and abuse.

Procurement and Purchasing system

Procurement is a critical organizational function, as the MoCIT spends significant amount of money annually on procurement of goods and services. The assessment revealed that the MoCIT procurement system is weak and vulnerable to significant risks, as there is a lack of transparency in the process and controls to prevent procurement staff from circumventing policies and procedures. For example, physical assets are not tagged, and staff are able disaggregate large procurement to bypass the Procurement Law thresholds. In addition, there is no evidence that declaration of conflict of interest forms are signed by procurement staff prior to commencing or approving procurement activities, thus impeding the transparency of the procurement process. The Ministry has developed a procurement plan but the auditors noted that the plan was not in line with the approved budget. The lack of alignment between the procurement budget and the plan can have an adverse affect on operational and programmatic results. One of the other key deficiencies noted during the assessment included the lack of *budget details* for procurement of goods and services. MoCIT does not maintain a procurement database allowing analysis and monitoring of procurement methods and suppliers to ensure transparency, compliance, and competitiveness. In addition, Procurement Committee meetings are not documented, and the current procurement staff does not have procurement related educational backgrounds to perform procurement related functions. Ultimately, the identified deficiencies result in increased operational and programmatic risk for GIRoA and the donors.

Program Management and Monitoring

Monitoring reveals whether desired results are occurring and whether outcomes are on track. Performance management is a commitment to managing for results in order to achieve the best possible outcome. According to the auditors, MoCIT does not have an independent department responsible for monitoring and evaluating activities and projects, and does not have a documented M&E plan. Currently, M&E function is performed by the Project Management Office which is also responsible for project implementation, thus creating a potential conflict interest and transparency concerns. The inability of the Ministry to effectively develop and implement an M&E plan is a risk that could lead to programmatic inefficiencies causing goals and objectives not to be met.

Risk Assessment Measurement

USAID guidance states, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as, Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as, Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact	*Catastrophic*	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted the 2012 assessment under a scope of work which focused on four main areas of 1) Procurement, 2) Accounting and internal controls, 3) Audit arrangement, and 4) Human resources. While the auditors conducted an in-depth assessment on the four areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements as that guidance (ADS Chapter 220) was issued subsequent to the negotiation of the scopes of work with GIRoA. However, to ensure the Mission complies with the Agency's guidance and performs required due diligence, we reviewed the auditors' report and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts whom had an understanding of the ministry's systems. Based on auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they had to define their findings in terms of risks so appropriate risk mitigation measures could be developed to address the identified risks. Because our review was conducted after the auditors had completed the assessment, and could not go back to determine the impact and probability, we relied on the understanding we've gained over the years of collaboration with the government. Based on that understanding we defined the potential risks and we took a conservative approach and considered most risks to be serious and probable unless the contrary was clearly evident.

Appendix 1

Risk Schedule:

	Risks of	Impact	Probality	Score	Suggested Benchmark Mitigation Measures
Management and governance structure					
1.	Senior officials not held accountable for fraud, waste and abuse going undetected	Serious	Probable	High	1. Develop clear terms of reference for the leadership committees 2. Distribute copies of the terms of reference to each member of the leadership committee 3. Document leadership committee meeting minutes
2.	Interests of the entity may not be safeguarded Increase in legal claims and litigation Program funds being used for unintended purposes	Serious	Probable	High	1. Hire external legal advisor 2. Involve the legal department in all procurement contracts and agreements 3. Perform annual audit of all USAID projects
3.	Non-compliance with rules and regulations not being detected Operational and programmatic inefficiencies going	Marginal	Probable	Medium	1. Establish an Audit Committee with an oversight responsibility for the Internal Audit Department 2. Convene regular audit committee meetings and document meeting minutes. 3. Develop an internal audit manual 4. Provide training for personnel at the Internal

	Risks of	Impact	Probality	Score	Suggested Benchmark Mitigation Measures
	undetected				Audit Department and document those trainings 5. Develop a plan for Internal Audit to perform risk base audits at HQ and hubs 6. Conduct annual financial and programmatic audits on all USAID projects
4.	Risk not considered in decision making, leading to internal procedures not being developed for key processes Specific procedures not being available to address internal control weaknesses based on identified risk can create potential conflicts of interest and increase the risk of misappropriation of resources	Serious	Probable	High	1. Conduct annual risk assessments and develop specific internal procedures with specific responsibilities
	Financial Management and Accounting Systems				
5.	Inadequate practices and controls over key processes	Serious	Probable	High	1. Develop a MoCIT specific finance manual to address key policies and procedures including checking for funds availability prior to incurring expenditures

	Risks of	Impact	Probality	Score	Suggested Benchmark Mitigation Measures
6.	Management not being committed to sound budgetary formulation and execution practices Inaccurate reporting Lack of transparency in utilization of funds	Serious	Probable	High	1. Develop a policy on budget formulation process 2. Establish an internal budget committee 3. Define the basis of budgeted amounts and document the basis 4. Budget committee approve and discuss the budget and document meeting minutes 5. Include provincial offices in the budgetary formulation process 6. Compare actual results with budget and investigate variances 7. Budget Committee meets quarterly to review variance report
7.	Diverting government property for personal use Waste fraud and abuse may go undetected Assets not being used for intended purposes	Marginal	Probable	Medium	1. Develop and approve a fixed asset management policy 2. Tag all fixed assets with an identification number. 3. Update fixed assets register on regular basis to reflect: date of purchase, asset type, location, serial number, tagged number. 4. Conduct periodic inventory of fixed assets, possibly every six months. 5. Provide USAID a list of all fixed or long term depreciable assets funded with USAID funds 6. Conduct periodic inventory of all fixed or long-term depreciable assets purchased with USAID funds and send the inventory confirmation to USAID 7. Conduct regular performance audit to include asset verification

	Risks of	Impact	Probality	Score	Suggested Benchmark Mitigation Measures
8.	Misappropriation of cash for personal use Fostering an environment conducive to fraudulent acts	Serious	Probable	High	1. Develop an internal cash management policy 2. Establish a reporting line for the cashier 3. Develop a petty cash register to record all cash transactions 4. Conduct surprise cash count and document the result 5. During financial audit, have auditors verify cash management processes
9.	Fraud, waste and abuse may go undetected	Serious	Probable	High	1. Develop an internal management policy for staff advances 2. Develop a register to record staff advances 3. Perform advance ageing analysis for tracking overdue advances
	Personnel Policies and Procedures				
10	Improper payments to employees	Serious	Probable	High	1. Develop a plan to automate attendance system at HQ and at the hubs. 2. Document time and attendance for all employees. 3. Link employees pay benefits to the time and attendance register and reconcile regularly and use banking system for all salary payments 4. Involve Finance Department in payroll reconciliation 5. Conduct compliance audit

	Risks of	Impact	Probality	Score	Suggested Benchmark Mitigation Measures
11	Hiring unqualified staff Creating unintended condition of conflict of interest Nepotism and cronyism	Serious	Probable	Critical	1. Perform and document reference checks of all new hires 2. Obtain signed conflict of interest forms from all staff. 3. Conduct annual ethics training for staff 4. Prepare job descriptions for all key positions.
	Procurement and Purchasing system				
12	Lack of transparency in the procurement system Conflict of interest Inconsistent practices over vendor selection, resulting in fraud, waste or abuse Acquiring sub-standard goods, resulting in inefficiencies and failure to meet operational and programmatic goals Engaging in off balance sheet financing for resources diversion	Serious	Probable	Critical	1. Develop written policies and procedures for the procurement processes 2. Request OAA's involvement in all critical procurements. 3. Obtain signed conflict of interest from personnel who are involved in the procurement processes 4. Document procurement committee meeting 5. Develop a plan to introduce procurement reforms. 6. Involve the legal department in all procurement contracts 7. Develop a procurement specific database allowing monitoring and analysis of procurement data

	Risks of	Impact	Probality	Score	Suggested Benchmark Mitigation Measures
Program Management and Monitoring					
13	Not meeting programmatic and operational goals Mismanagement and misconduct going undetected Performance outcome will be lower than expected standards	Serious	Probable	Critical	1. Create a Monitoring and Evaluation Department with clearly defined roles and responsibilities 2. Develop written policies and procedures for monitoring and evaluation 3. Send monitoring and evaluation reports to the M&E Department at the head office and copies to the provincial offices 4. Submit copies of M&E reports to USAID

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

February 11, 2013

~~SENSITIVE BUT UNCLASSIFIED~~

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

TO: S. Ken Yamashita, Mission Director (b)(6)

FROM: (b)(6)

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) – The Ministry of Education (MoE) under ADS Chapter 220

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Ministry of Education (MoE). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the MoE through FYE 2015.

The initial proposed G2G direct assistance activities include:

- Basic Education, Literacy and Technical Vocational Education and Training (BELT) – USAID total contribution estimated at $158.5 million
- Afghanistan Workforce Development Program (AWDP) – USAID total contribution estimated at $47.6 million.

BACKGROUND:

The MoE is the steward of the Afghan education sector and in collaboration with the Provincial Education Departments (PEDs) and District Education Offices (DEOs) aims to provide basic education throughout the entire country.

to thwart poverty, frustrate attempts to give voice to extremism, and develop the country's human capital. The MoE is responsible for policy formulation, curriculum and teacher development, and monitoring and evaluation of education in Afghanistan. The Ministry is led by Minister Ghulam Farooq Wardak, who has served in the position since October 2008 and has overseen significant progress in the area of education. Minister Wardak, who reports directly to the President, is supported by a Leadership Committee consisting of the Deputy Minister and Directors of all the Directorates. Under ADS 220, the MoE, as a GIRoA Ministry, constitutes a partner-government entity.

Under the current service delivery model, the MoE serves as the primary manager of education services, but also engages various other actors, such as non-governmental organizations (NGOs), the private sector, and donors, in providing many education services, including community-based education (CBE), teacher training, and technical and vocational education.

Consistent with the 2010 Kabul Conference commitment to move 50% of all USG development assistance on-budget, the Mission gradually has been transitioning its educational activities to on-budget programming. The BELT Program aims to increase access to quality education by supporting in-service and pre-service teacher training, textbook printing and distribution, community-based education to improve early grade reading, and literacy and technical skills development for youth. The AWDP Program aims to contribute to economic growth by addressing high unemployment and the scarcity of technically skilled Afghan labor and trained business managers through labor market focused training programs. The AWDP will improve the quality of technical and business management training programs and professional development through partnerships with NGOs, private and public sector business training institutes and universities.

USAID, the largest bilateral donor in education, coordinates closely with other donors which are also active in the sector. Nations such as Canada, Australia, Germany, Norway and Sweden implement off-budget programs ranging from teacher training to community-based education and vocational training. USAID is the largest donor to the Education Quality Improvement Program (EQUIP), a $ 250 million project in basic education financed by 32 donors and managed by the World Bank through funds received in the Afghanistan Reconstruction Trust Fund. GIRoA considers the EQUIP project to be on budget assistance as funding is incorporated in the MoE budget, and the staff responsible for its deliverables work within MoE departments and report to respective department heads.

USAID will provide off-budget technical assistance to systematically accelerate the continued transfer of technical capacity to, and improve program management by, the MoE; promote greater Afghan leadership in the public, private and non-governmental education sectors; ensure appropriate USAID oversight of the on-budget initiatives; and further empower the MoE to effectively deliver education services and manage programs in a transparent manner.

Complying with USAID Policy

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and to maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risks and may contain risk-mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the appropriate fiduciary relationship with the institution can exist.

Due to the formal date of issuance of ADS 220 (March 2012) and previous on-budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements was initiated for USAID/Afghanistan in August 2012. The waiver was approved by the USAID Administrator on November 20, 2012. The waiver focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro-level assessments, which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the Stage I assessments upon GIRoA, as required under currently issued ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the USG to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the MoE which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA, contracted a third-party to carry out the Stage II-equivalent Risk Assessment of the MoE. The report was issued in December 2011.

DISCUSSION:

Fiduciary Risk

The Mission recognizes that Afghanistan is a high-risk environment, but represents both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The Mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursement of U.S. Government funds to assure maximum protection of U.S. taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The Mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The Mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through the application of the ADS 201 and other guidance to project design. This AUPCS, therefore, focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

Managing Risk

On January 28, 2013, the Mission Partner Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II Assessment Report was prepared to determine whether USAID could rely upon the MoE system's operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon the MoE current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with the MoE. The complete Stage II Risk Assessment Report, including the Risk Schedule with identified risks and suggested mitigation measures, is attached in Appendix Number 1.

USAID's initial activities to be implemented through direct on-budget assistance with the MoE are the Basic Education, Literacy and Technical Vocational Education and Training (BELT) Program , and the Afghanistan Workforce Development Program (AWDP). The programmatic objectives are described below.

Basic Education, Literacy and Technical-Vocational Education and Training (BELT)

The overall objective of the BELT project is to improve access to quality basic education, literacy, and technical-vocational education and training, with a focus on girls and other marginalized populations. Through mainly on-budget funding, complemented by targeted off-budget assistance, BELT seeks to improve the MoE's ability to responsibly manage donor resources and direct the growth of the education sector, improve educational attainment, increase literacy and numeracy among Afghan youth, and increase the number of Afghans with marketable, productive skills. To achieve these results, BELT will:

- Strengthen MoE's management capacity including its ability to measure student learning outcomes;

- Improve the skills and performance of teachers and school administrators through in-service and pre-service training;
- Expand primary and lower secondary education through community-based schools;
- Enhance the school learning environment, through printing of additional textbooks and learning materials; and
- Improve the employability of youth through literacy and technical skills development

USAID designed BELT to advance Afghan and U.S. objectives to improve quality basic education consistent with Afghanistan's National Development Strategy (ANDS), the National Education Strategic Plan (NESP, 2010-2014), U.S. strategic plans and policy governing USG educational programs in Afghanistan, and the President's Afghanistan and Pakistan Regional Stabilization Strategy.

Afghanistan Workforce Development Program (AWDP)

The objective of the AWDP is to increase job placements and provide self-employment opportunities to Afghan men and women by improving the skills of workers and linking them to credit and business development opportunities. The AWDP will achieve this objective by improving the quality and accessibility of business training programs at the non-degree level through partnerships with the private and public sector business training institutes and universities. This project is implemented in close coordination with the Ministry of Education, Ministry of Higher Education, and the Ministry of Labor, Social Affairs, Martyrs and Disabled. AWDP key deliverables include:

- Training and/or placement for 25,000 people, a quarter of whom are women;
- Improved teaching standards and skills of vocational trainers;
- Enhanced technical, vocational and business management courses;
- Established linkages between training providers and employers.

Although BELT and AWDP involve certain risks, the Mission is structuring the programs to include a number of measures that will mitigate the dangers and ensure successful implementation. Most significantly, USAID is providing on- and off-budget technical assistance to the MoE to:

- Strengthen MoE functions in key areas, including service delivery; administration; financing and procurement; strategic planning; monitoring; and coordination among directorates and provinces, ministries and donors;

- Foster provincial- and district-level MoE and community working relationships in identifying and addressing local constraints and problems, and in holding the MoE accountable for results and high-quality service delivery that addresses community needs;

- Build the capacity of the MoE to monitor and assess student improvements in reading and numeracy.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement. The IL, when negotiated, might include USAID prior-consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and other conditionalities required throughout the activity period. The conditionalities also will require the MoE to plan and begin to address some of the general weaknesses identified in the December 2011-contracted PFM assessment report. In particular, the off-budget assistance may work explicitly with the MoE to develop controls and procedures to mitigate identified risks. Details reflecting interventions to address the findings of the Stage II Risk Assessment Report will be included in designs under BELT and AWDP. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreement will require an annual audit of the MoE, inclusive of all USAID-specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of MoE and the Ministry of Finance under a separate Capacity Development initiative and initiate internal control and financial reviews of the MoE-managed activities.

The Office of Social Sector Development (OSSD), the Office of Economic Growth and Infrastructure (OEGI) and the full PCS team, are responsible for monitoring risk mitigation steps, including whether conditions precedent are met prior to funds disbursement and whether other ongoing covenants continue to be met. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID direct assistance to the GIRoA will be provided through existing legally binding bilateral assistance agreements, which include USAID audit, investigation and evaluation rights on behalf of itself and other U.S. Government agencies; refund, termination and suspension provisions; and provisions requiring the submission to USAID of plans, specifications, procurement or construction schedules, contracts, or other documentation between GIRoA and third parties relating to goods or services to be financed under these bilateral assistance agreements, including documentation relating to the prequalification and selection of contractors and the solicitation of bids and proposals.

<u>Responsibilities</u>

The Mission's Partner Country System (PCS) team is composed of the following individuals:

(b)(6)

The Mission's Technical Offices, Office of Social Sector Development (OSSD) and Office of Economic Growth and Infrastructure (OEGI) staff members are expanded PCS team members for G2G activities related to the MoE. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the January 28, 2013 assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement.

The risk mitigation assessment and strategy was reviewed by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written Approval of Use of Partner Country Systems for the Ministry of Education.

Approved: ______________ Date: 2/14/13

Disapproved: ______________ Date: ______________

Attachment: Stage II Risk Assessment Report

Appendix No. 1

Stage II Risk Assessment Report

~~SBU – May Not be Copied or Distributed~~

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USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF EDUCATION

STAGE II RISK ASSESSMENT REPORT

January 28, 2013

[redacted]

CONTENTS

Background

Founded in 1747, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, Afghanistan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved and the internal audit function does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work with GIRoA to undertake entity level risk assessments of GIRoA line ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of the Ministry of Education (MoE) was issued in December 2011.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan, including USAID's support of the USG counterinsurgency strategy is expected to come to an end around December 2014. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer-term development strategy. That transition to a more robust, traditional development strategy, will likely result in substantive changes in Government to Government (G2G) assistance.

The G2G commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and the need to address fiduciary risk in the Partner Country PFM system being considered for direct G2G

[1] London Conference, January 2010 and the Kabul International Conference on Afghanistan, July 2010.

assistance. For that reason, the Agency developed the Public Financial Management Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage, risk-based methodology, through which USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a USAID/W team, is undertaken prior to or in conjunction with the Mission-led Stage I Rapid Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other insurmountable barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment – which is an entity-level assessment – may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessment upon GIRoA as required under currently issued Agency Policy – ADS Chapter 220 issued in draft in August 2011 and substantially updated in March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments serve to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy – the enhanced DRG review and the PFMRAF Stage I assessment.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PFMRAF Stage II guidance as currently revised in July 2012, however, the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012,

[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 - pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012 when risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and financial accountability (PEFA) reports, assessments undertaken by the CPA firms to date, and other informal information available to Mission staff. Using that informal process and the independent CPA firm assessment report of the MoE issued in December 2011, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this assessment is to determine whether the U.S. Government can rely on the Ministry of Education (MoE) systems operation and internal controls to manage donor funds. Specifically, the assessment will:

- Determine whether the MoE's financial management/accounting system is adequate to properly manage and account for donors' funds.
- Determine whether the MoE has the financial management capacity to manage the proposed activity.
- Determine whether the MoE's internal controls are adequate to manage donors' funding.
- Determine whether the MoE's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- Determine whether the MoE complies, in all material respects, with applicable laws and regulations.

Executive Summary

The United States committed to improving the quality of its aid in order to maximize development benefits in Afghanistan and pledged to channel at least 50 percent of its development assistance through the national budget of the GIRoA[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) systems being considered for direct implementation of USAID-funded assistance. For that reason, USAID developed the Public Financial Management Risk Assessment Stage II risk assessment to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage, risk-based methodology, through which USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This Stage II assessment was conducted to determine whether USAID can rely on the Ministry of Education (MoE) system's operation and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely on the Ministry of Education (MoE) current system's operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with MoE.

The assessment revealed several managerial and operational gaps including: 1) weak governance structure, mainly due to the lack of a comprehensive risk strategy requiring key processes and internal controls to be identified and documented, 2) inadequate financial management practices resulting from budgetary and financial system weaknesses, 3) deficiencies in personnel policies and procedures due to lack of procedures and inadequate payroll system, and 4) weakness in the procurement and purchasing system due mainly to lack of formal procedures. The assessment also found that the MoE lacked an effective mechanism for monitoring and evaluation. With respect to the governance structure, the assessment identified the need to strengthen the capacity of the Internal Audit Department, and to document the Terms of Reference (ToR) for senior management committees. These weaknesses are indication of weak accountability and commitment to enforce best practices.

Comparing with normal circumstances, the results of this assessment would *lead USAID* not to engage in Government to Government (G2G) assistance with the Ministry. Since the determination has already been made to engage in G2G activity with the Ministry, approaching assistance with precaution and conditions, USAID can reasonably mitigate the identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

[3] London Conference on Afghanistan, January 2010 and the Kabul International Conference on Afghanistan, July 2010.

Assessment Conclusion & Results

The assessment found that the U.S. government cannot rely on the Ministry of Education's (MoE) systems of operation and internal controls to manage donors' funds.

- MoE's financial management/accounting system is not adequate to properly manage and account for donors' funds.
- MoE does not have the financial management capacity to manage proposed activities.
- MoE's internal controls are not adequate to manage donors' funding.
- MoE's procurement management units do not have sufficient systems and management capacity to implement activities and manage donors' funds.
- MoE did not fully comply with GIRoA procurement laws and regulations.

In addition, the internal control environment is not adequate to mitigate risk of fraud, waste, and abuse, as several key controls are not implemented and it is unclear if GIRoA, including the Ministry, has the capacity to combat corruption effectively. Nonetheless, with clear commitment to change on the part of GIRoA and the MoE, we believe the identified risks can reasonably be mitigated. (See Appendix 1)

Management and Governance Structure
One of management's responsibilities is to incorporate policies and procedures in mechanisms for implementation to ensure the effective and efficient development of the organization, and the achievement of organizational strategic goals. Accountable management ensures that appropriate policies are developed and applied, code of government ethics are enforced, procurement integrity observed, and robust financial controls are in place. The assessment found a lack of management accountability as there was no formal mechanism in place to monitor the strategic plan formulated by senior management, and there was a lack of comprehensive risk strategy requiring key processes and controls to be identified and documented. Management's inability to focus and effectively guide the organization, may lead to the MoE not achieving its long term operational objectives. Furthermore, without formalized mapping of all key processes and associated controls, an effective risk profile cannot be established and therefore monitoring is not readily feasible or effective. Also, MoE governance structure is weak, as the leadership committee tasked with the responsibility of implementing the strategic plan did not have documented terms of reference defining its specific roles and responsibilities. Similarly, the internal audit department does not have a documented internal audit charter and conducts transaction and compliance-based audits without utilizing a risk-based audit plan. Weak governance structure impacts the organization's effectiveness to deter corruption and properly account for donors' funds. In addition, the assessment revealed that the internal audit staff did not systematically monitor and follow-up on recommendations, and lacked capacity and the required qualifications to perform their function effectively. The audit department was also functioning without a

formalized annual audit plan. Overall, the absence of basic internal audit practices renders the internal audit department ineffective.

Moreover, the MoE does not have the capacity to encourage and enforce code of government ethics, and/or to discourage potential corrupt acts. As an example, the Ministry does not have access to formal and reliable legal representation, it has instead a designated staff acting as a legal advisor. The absence of a formal legal department and inadequate legal capacity may not be in the best interest of the Ministry since it could undermine timely compliance with the applicable laws and regulations and potentially expose the MoE to undue legal and litigation risk. There is also a lack of effective leadership at the Ministry, as attention is not given to basic management controls. While the Ministry has a newly established Information and Communication Technology (ICT) department, the department is currently responsible for providing basic IT services only, and does not have any role in the management and maintenance of IT systems (including financial management and reporting system) being used by the MoE. The systems' administration rights or the ability to modify and override stored data are with the management of each department. Unrestricted access to the Ministry's data and line manager's ability to override system's information is a serious internal controls weakness which questions the reliability and integrity of the Ministry's data. In fact, unlicensed and pirated software were detected on the Ministry's operating systems. The overall lack of capacity of the ICT department and the lack of basic IT controls as demonstrated by the use of unlicensed software for the Ministry's operations exposes MoE to operational and programmatic risks as well as possible litigation. The identified weaknesses raise concerns regarding the Ministry's long term commitment to effective governance, standards of conduct and discipline towards internal control activities. These concerns highlight significant risk implications and raise doubt as to whether the Ministry has the capacity to manage donor's funds without substantial involvement by the donors.

Financial Management and Accounting Systems

To achieve success in program or project implementation, reliable financial management and accounting systems are vital. While the MoE has a financial management and accounting system, the systems need improvement. The Ministry has developed a Budget Program and Expenditure Tracking database (BPET) to record and track both operational and programmatic budgets, but the system is not being fully utilized. For example, revenue transactions remain a manual process and transactions from the provinces are not updated in a timely manner because the provinces submit their information late, resulting in unreliable BPET reports. Further, data maintained in the BPET database does not match the data in the Afghanistan Management Information System (AFMIS) which is updated regularly and is utilized by the Ministry of Finance (MoF) for the national budget formulation. The assessment indicates other financial management weaknesses as well. For instance, M-3 requisition request forms used for small procurement payments are not sequentially numbered to ensure completeness of records, and to prevent duplicate payments. These internal control weaknesses undermine the reliability of financial information and diminish the effectiveness of existing policies and procedures, resulting in increased operational and programmatic risk as well as risk associated with misappropriation of resources. Also, these weaknesses inhibit the MoE from adequately managing and safeguarding donors' funds against potential loss and/or misappropriation.

Personnel Policies and Procedures
Recruiting, training and retaining qualified staff is a vital part of any organization's going concern. Management's attitude toward recruitment, human resources (HR) policy development, and investment in staff affects all level of an organization. The auditor's assessment found the HR function at MoE is susceptible to manipulation and unfair practices. For example, there is no formal employment agreement documented in the employees' files, and job descriptions are not acknowledged by MoE and the employees. The lack of a formal work agreement with specific terms of employment can create operational vulnerability and increase the Ministry legal risk. Also, personnel files are maintained in different departments within the HR Directorate and are not centralized. There is no standard checklist for maintaining the personnel files nor is there a log maintained for tracking the movement of employee's documents. These weaknesses can lead to access control issues as well as operational inefficiencies, and ultimately result in unauthorized changes to personnel records, payroll irregularities, and or errors. In addition, management's attitude toward recruitment and human resources policy development needs to be improved. The MoE HR has no method for recording and monitoring of staff attendances, code of conduct and conflict of interest forms are not read and signed by all MoE employees and there are no procedures in place to help improve staff capacity building and staff retention. Also, the assessment found a lack of notable investment in staff development. For example, employee performance is not considered in the preparation of training and development plans, and there is no procedure or a checklist for formally conducting and documenting exit interviews. MoE's HR department needs fundamental improvements to address the above identified weaknesses, reduce operational vulnerabilities and the risks of nepotism and cronyism. The implementation of fundamental changes will lessen the risk of hiring unqualified staff, reduce the risk conflicts of interest occurrences, and improve management accountability. In conclusion, the overall lack of attention to basic employment documentation and practices undermines operational and programmatic goals and puts donors' fund at risk.

Procurement and Purchasing System
Procurement is a critical organizational function, as the MoE spends a significant amount of money annually on procurement of goods and services. Procurement irregularities and fraud wastes scarce resources and can detrimentally impact operational and programmatic goals. The assessment found that the MoE had a well-defined procurement process based on the Afghanistan Procurement Law, but the Procurement Directorate lacked a formal procurement manual documenting actual internal procedures and processes. The lack of a documented internal procurement procedures and processes exposes the Ministry to inconsistent procurement practices as well as operational vulnerabilities and inefficiencies. Although MoE complied with the spirit of the Afghanistan Procurement Law, the assessment raises concerns regarding current procurement management practices. Current procurement practices at MoE is that management does not have a documented, pre-approved list of vendors for small procurements below AFS 500,000 ($10,000), and management approves vendors at its discretion without properly documenting the basis for the vendor selection. In addition, the Procurement Directorate does not have a formal and independent complaint process, and vendor evaluation and approval criteria are not documented. These inconsistent and inefficient practices could result in unintended consequences or irregularities, and could put both GIRoA and donors' fund at risk. Considering the low qualification of the procurement department's staff, the risks to donors' funds are probable. Ultimately, the lack of documented procurement procedures and the

procurement weaknesses identified above hinders compliance with intended procurement policies, resulting in increased operational and programmatic risk for the entity and donors' funds.

Program Management and Monitoring

Monitoring and evaluation (M&E) are essential and distinct management tools for ensuring program success throughout implementation. Proper program management and monitoring reveals whether the desired results are occurring and whether outcomes are on track. At the MoE, the M&E function is under the General Directorate of Planning and Evaluation which is also responsible for the preparation of the five-year strategic plan, along with the annual and operational plans. The assessment found that, in spite of this enormous responsibility, the Directorate is not fully operational due to lack of capacity. Consequently, the Budget Execution Committee is performing the M&E function and is monitoring the progress of the projects, but only in terms of its budget utilization under each program. While programmatic progress and budget utilization data are captured in the Directorate of Planning and Evaluation database, financial progress data are captured in the BPET database maintained by the Finance and Accounting Directorate. Although data for critical decision making are kept in the two separate databases, the assessment found that there is no process to link the programmatic and financial progress of the projects. While there is ongoing, discrete programmatic and financial monitoring of projects, there is no systematic and independent mechanism in place to conduct overall M&E of the projects under each program within the Ministry. The inability to develop and implement an independent and systematic M&E plan is a risk that could lead to funds being used for unintended purposes and lead to programmatic inefficiencies, causing goals and objectives not to be met.

Risk Assessment Measurement
USAID guidance states that, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact	*Catastrophic*	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted the 2011 assessment under a scope of work which focused on five main areas. 1) Governance 2) Accounting and Internal Controls, 3) Human Resources, 4) Procurement, and 5) Program Management and Monitoring. While the auditors conducted an in-depth assessment on the five areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements as that guidance (ADS Chapter 220) was issued subsequent to the negotiation of the scopes of work with GIRoA. However, to ensure the Mission complies with the Agency's guidance and performs required due diligence, we reviewed the auditors' report and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts, who had an understanding of the Ministry's systems. Based on the auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they had to define their findings in terms of risks so that appropriate risk mitigation measures could be developed to address the identified risks. Because our review was conducted after the auditors had completed the assessment, and we could not go back to determine the impact and probability, we relied on the understanding that we have gained over the years of collaboration with the government. Based on that understanding, we defined the potential risks. We took a conservative approach and considered most risks to be serious and probable unless the contrary was clearly evident.

Appendix 1

Risk Schedule:

	Risk of	Impact	Probality	Score	Suggested Mitigation Measures
			Management and governance structure		
1.	Diverting government resources for unintended purposes Public officials are not accountable	Serious	Probable	High	1. Develop policy and procedures or mechanisms which require the Ministry to monitor its strategic plan and compare the actual results to strategic plan 2. Set terms of reference for leadership committee 3. Submit quarterly reports to the Senior Management of the Ministry to compare actual results to planned activities 4. Clearly defined policies and procedures need to be implemented to ensure effective internal controls 5. Document the control procedures implemented to enable the department to monitor its control activities and provide clear reports for reporting purposes

	Risk of	Impact	Probality	Score	Suggested Mitigation Measures
2.	Fraud, waste, and system abuse going undetected due to lack of a viable internal audit function	Serious	Probable	High	1. Establish an Audit Committee with oversight responsibility over the Internal Audit Department 2. Clearly define key performance indicators to assess the Internal Audit department's effectiveness 3. Conduct risk-based audits on various divisions with the Ministry 4. Audit all USAID on-budget projects annually 5. Monitor and follow- up on the implementation of prior year recommendations given by auditors in their assessment report 6. Submit interim risk-based audit reports to USAID
3.	Violations of laws and regulations going undetected	Serious	Probable	High	1. Establish a formal Legal Department and allocate appropriate qualified staff to the Department 2. Document the roles and responsibilities of the legal advisor and legal department, including a thorough review of ministerial procurement of goods and services 3. Review of all contracts entered into with the Ministry to safeguard the MoE against any potential legal risk

	Risk of	Impact	Probality	Score	Suggested Mitigation Measures
4.	Manipulation of data due to weak information technology controls	Serious	Probable	High	1. Clearly define system access and implement controls to restrict access to key functions 2. Segregate the management and maintenance of all the systems from the system users and transfer to the Information Technology division
	Financial management and accounting systems				
5.	Misappropriation / misuse of cash resulting in fraud, waste or abuse of resources	Serious	Probable	High	1. Use bank accounts for the collection of revenues 2. Implement policies and procedures to limit the amount of cash being utilized by the Ministry 3. Implement proper reconciliation mechanisms to control cash operations
6.	Inconsistent and inaccurate reporting	Serious	Probable	High	1. Provide Budget Program and Expenditure Tracking (BPET) system input access at the provincial level to remain consistent with information in the Afghanistan Management Information System (AFMIS) 2. Reconcile the BPET system with the data available in AFMIS system on monthly basis 3. Develop a proper procedure for numbering and recording of all M-3 forms in order to ensure the completeness of record and to prevent duplicate payments

	Risk of	Impact	Probality	Score	Suggested Mitigation Measures
			Personnel policies and procedures		
7.	Nepotism and cronyism Hiring of unqualified staff	Marginal	Probable	Medium	1. Request signed statements from management certifying that USAID funds will not be used for supporting nepotism and cronyism 2. Prepare formal agreements between the Ministry and its employees which must be signed and kept in the employee files
8.	Employees engaging in activities resulting in conflict of interest Nepotism and cronyism	Serious	Probable	High	1. Update employees' code of conduct and distribute it to all staff 2. Conduct ethics training for all employees
9.	Ineffective or poor performance and lack of accountability of public officials	Serious	Probable	High	1. Ensure newly hired staff signs his/her job description and deliver the copy of all policies, procedures and job description to the new employee 2. Develop annual work objectives for all employees and conduct performance evaluations on all employees on an annual basis 3. Conduct trainings for all staff for necessary skills development and productivity enhancement
			Procurement and purchasing systems		
10.	Procurement process not being transparent	Serious	Probable	High	1. Develop written policies and procedures for the procurement processes

	Risk of	Impact	Probabilty	Score	Suggested Mitigation Measures
	Kickback and bribery resulting from inconsistent practices and operational inefficiencies				2. Request USAID/Afghanistan OAA's involvement in all critical USAID-funded procurements 3. Obtain signed conflict of interest forms from personnel who are involved in the procurement processes 4. Develop a plan to introduce procurement reforms within the Ministry
11.	Kickback and bribery Preferential treatment due to lack of transparency and procurement standards	Serious	Probable	High	1. Develop procedures for all procurements, including procurements below AFS 500,000 2. Develop written approval thresholds for clear identification for approval authority and disseminate these thresholds to all procurement personnel 3. Develop formal procedures to handle Procurement-related disputes
	Program management and monitoring				
12.	Inadequate monitoring and evaluation information for proper management decision making	Serious	Probable	High	1. Develop written policies and procedures for Monitoring and Evaluation 2. Disseminate submission of Monitoring and Evaluation reports to senior ministerial officials for approval and corrective actions 3. Submit quarterly Monitoring and Evaluation reports to USAID

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

MEMORANDUM

TO: Partner Country Systems' Team

FROM: (b)(6) (b)(6)

DATE: January 28, 2013

SUBJECT: Stage II equivalent risk assessment report and prioritization of risk mitigation measures and recommended covenants for Ministry of Education (MoE)

REFERENCE: USAID/Afghanistan's Stage II equivalent risk assessment report on the Ministry of Education (MoE)

This memorandum communicates the result of our Stage II equivalent risk assessment report and our recommended risk mitigation measures and benchmarks for Ministry of Education (MoE).

The result of this Stage II equivalent risk assessment report is based on our examination of the CPA firm finalized assessment reports of MoE issued in Dec 2011, and our review of other *published* assessments on the Government of the Islamic Republic of Afghanistan (GIRoA).

The overall objective of this Stage II equivalent risk assessment was to determine whether the U.S. government can rely on MoE's systems, operation and internal controls to manage donors' funds. Specifically the assessment was designed to determine whether:

- MoE's financial management/accounting system is adequate to properly manage and account for donors' funds.
- MoE has the financial management capacity to manage proposed activities.
- MoE's internal controls are adequate to manage donors' funds.
- MoE's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- MoE complied, in all material respects, with applicable laws and regulations.

The assessment found significant risks in MoE's systems, operation and internal controls. The identified risks and suggested risk mitigation measures and benchmarks are documented in the accompanied Stage II equivalent risk assessment report. To help the Mission address its fiduciary responsibility and engage in Government to Government activity with MoE responsibly, we've prioritized the risks according to their potential impact on the Mission's investment in MoE's core budget. Our recommended risk mitigation measures are based on prioritization of risk levels as high and medium (see the Risk Prioritization schedule – Attachment I) for the On-Budget Committee's consideration as project activity designs are contemplated and G2G agreements are negotiated. The high risks are those risks that can have a severe and detrimental impact on the MoE's ability to achieve its goals and objectives. Medium risks are those risks that can have a negative impact on the efficiency of the MoE's operation and performance. OFM recommends the following conditions precedent, covenants, conditionalities, and monitoring activities be considered by the On-Budget Committee as G2G agreements are designed and negotiated.

Recommended Conditions Precedents

Management and Governance Structure

1. Develop a plan for incorporating policy and procedures which require updating and comparing actual programmatic results to the strategic plan.
2. Develop a policy which requires the Ministry to develop the terms of reference for the leadership committee and have it distributed to all members of the committee.
3. Develop a plan to establish an Audit Committee with an oversight responsibility over the Internal Audit department.
4. Submit a plan approved by Senior Management to ensure improved information and communication technology management practices including improved IT controls and ownership of key applications.
5. Develop plans to conduct annual risk assessments with specific responsibility assigned over key processes to address identified internal control weaknesses.

Financial Management

1. Submit a plan approved by the MoE Senior Management to implement improved financial management practices to strengthen internal controls; including plans to improve reporting on the budget and expenditures, and plans to develop procedures to strengthen controls over revenue, cash collection and deposits.

Human Resources

1. Provide a plan approved by Senior Management to ensure improved human resources management practices, including the requirement for documented work objectives and performance evaluations of all employees on an annual basis.
2. Provide a plan to improve the storage of personnel files, and develop a checklist to monitor the whereabouts of the files.
3. Develop a plan to automate time and attendance and to reconcile HR and payroll databases.
4. Develop a full staffing plan, including job descriptions for all positions.
5. Develop an annual training plan for each department/ division linked to the job description.
6. Develop a plan to introduce procedures for hiring and dismissing employees, and documenting signed conflict of interest and code of conduct forms.
7. Develop a plan to introduce procedures requiring formal agreements between the Ministry and its employees which must be signed and kept in the employee files.

Procurement

1. Submit a plan to improve procurement practices through development of internal procurement procedures; including those related to procurement approval authority, vendor selection criteria and obtaining signed conflict of interest disclosure forms.
2. Develop and submit an annual procurement plan aligned with the approved budget
3. Provide written certification to USAID that:

    a) no USAID funds will be used to purchase ineligible commodities.
    b) no USAID funds will be used to finance restricted commodities.
    c) no USAID funds will be used, directly or indirectly, to produce, acquire, use, transport, store, sell, or otherwise deal with ammonium nitrate (AN) for agricultural applications or calcium ammonium nitrate (CAN) for agricultural or construction/demolition applications.
    d) MoE will include this prohibition in all contracts awarded by it for MoE project and require the inclusion of this prohibition in any subcontracts awarded.

Monitoring and Evaluation

1. Develop a plan to establish an independent Monitoring and Evaluation department with clearly defined roles and responsibilities.
2. Develop written policies and procedures for Monitoring and Evaluation.
3. Develop an annual Monitoring and Evaluation plan.

Recommended Conditions Requiring Covenants and Ongoing Monitoring

Management and Governance Structure

1. Submit quarterly reports comparing programmatic results to planned activities in the strategic plan.
2. Provide annually minutes of the Internal Audit Department Audit Committee meetings and the copy of the risk based internal audit plan.
3. Conduct risk based audits on various divisions and projects (especially USAID funded projects) within the ministry.
4. Provide a quarterly progress report on the approved plan to improve information and communication technology management practices including procedures for improved IT controls and ownership of key applications.
5. Provide evidence of follow- up activities on prior year audit recommendations.
6. Provide annual risk assessment results identifying key processes and internal control weaknesses and the mitigation plan to address identified weaknesses.
7. Provide plans to improve the capacity of the Ministry's legal department by considering an internal legal counsel to meet the entity's legal and contractual requirements.

Financial Management

1. Provide copies of annually audited financial statements by USAID Office of Inspector General approved CPA firms.
2. On a quarterly basis, submit a fund accountability statement fully reconciled to the special U.S. Dollar Account, including a complete copy of each monthly bank statement (format for the fund accountability statement to be provided by USAID/OFM).
3. Provide quarterly progress reports on development of procedures for automating transactions related to revenue and collections using banking channels.
4. Provide quarterly updates on progress related to provincial level input access for the Budget Program and Expenditure Tracking (BPET) system and reconciliation of the BPET and AFMIS systems on a monthly basis.
5. Provide quarterly updates on plans to improve financial management practices to strengthen internal controls; including plans to improve reporting on the budget and expenditures, and plans to develop procedures to strengthen controls over revenue, cash collection and deposits.

Human Resources

Documents prepared by the MoE reporting on quarterly progress toward achievement of human resources management plans including but not limited to the following areas:

1. Progress on plan to improve human resources management practices, including the requirement for documented work objectives and performance evaluations of all employees on an annual basis.

2. Progress on plans to improve central personnel files and introduction of checklists to monitor the status of personnel files.
3. Progress on plans to automate time and attendance and reconciliation of HR and payroll databases.
4. Progress on plans to develop a full staffing plan, including job descriptions for all positions.
5. Progress on the development of an annual training plan for each department/ division linked to the job description needs of staff encumbering positions and including annual ethics training.
6. Progress on development of procedures for hiring and dismissing employees, and documenting signed conflict of interest and code of conduct forms.
7. Progress on development of procedures requiring formal agreements between the Ministry and its employees which must be signed and kept in the employee files.

Procurement

1. On a quarterly basis, provide progress reports on the status of the planning and execution of the procurement plan.
2. On a quarterly basis, provide evidence of progress toward development of internal procurement procedures including those related to procurement approval authority, vendor selection criteria and obtaining signed conflict of interest disclosure forms.

Monitoring and Evaluation

1. On a quarterly basis, provide progress toward development of written policies and procedures for monitoring, evaluation and reporting on key indicators of USAID activities, including responsible individuals or offices and their authorities.
2. Provide quarterly updates on the implementation on the M&E plan

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

July 10,2013

~~SENSITIVE BUT UNCLASSIFIED~~

ACTION MEMORANDUM FOR THE ACTING MISSION DIRECTOR

TO: Sarah Wines, Acting Mission Director (b)(6)

FROM: (b)(6) (b)(6)

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) – The Ministry of Finance (MoF) under ADS Chapter 220

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Ministry of Finance (MoF). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the MoF through FYE 2015.

The initial proposed G2G direct assistance activities include:

- Civilian Technical Assistance Program (CTAP) – USAID total contribution estimated at $ 36.3 million
- CARAVAN project – USAID total direct assistance contribution estimated at $ 30 million

BACKGROUND:

The MoF is a GIRoA line ministry headed by the Minister of Finance, reporting to the President. The MoF is responsible for budget formulation and execution, collection of taxes, organization and control of public expenditure and payments to or from the Government and the management of customs. The major portion of the Afghan budget is financed by international assistance. As a central player in financial sector reform, the MoF is working with the Central Bank of Afghanistan (Da Afghanistan Bank) to ensure that the country's economic infrastructure is working properly.

The MoF has the additional responsibility of improving alignment of government programs and budgets to better support national development priorities. The ministry is also increasing its influence on coordination and management of international development assistance to Afghanistan, particularly through the implementation of the Aid Management Policy. Key aspects of the AMP include channeling more assistance through partner country systems, building sustainable and effective GIRoA capacity, improving monitoring and evaluation of international assistance, and reducing 'parallel' aid delivery mechanisms.

The MoF has developed a 5 year strategic plan for the year 2009 – 2014, covering its long term objectives.

The MoF's broad goals, as stated in this strategic plan, are to:

1. Mobilize revenues and manage the Afghan Government finances
2. Support economic management and promote economic growth
3. Promote good governance and accountability across GIRoA
4. Manage public wealth
5. Promote best practice within the Afghan public sector

Under ADS 220, the MoF, as a GIRoA ministry constitutes a partner-government entity.

USAID's G2G assistance to MoF will focus on supporting the Afghan Government efforts to improve the capacity and performance of core line ministries responsible for national priority programs. The proposed direct assistance to MoF would help finance the costs associated with: (1) international technical assistance for development and implementation of human and institutional capacity building activities; (2) training, coaching and mentoring of GIRoA civil servants; (3) strengthening the business climate of Afghanistan to enable private investment, enhance trade, and promote fiscal sustainability; (4) strengthening revenue generation and improving budget management processes and, (5) improving project management, monitoring and evaluation.

Complying with USAID Policy

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and to maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risks and may contain risk-mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the appropriate fiduciary relationship with the institution can exist.

Due to the formal date of issuance of ADS 220 (March 2012) and previous on-budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements was initiated for USAID/Afghanistan in August 2012. The waiver was approved by the USAID Administrator on November 20, 2012. The waiver focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro-level assessments, which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the Stage I assessments upon GIRoA, as required under currently issued ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the USG to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the MoF which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA, contracted a third-party to carry out the Stage II equivalent Risk Assessment of the MoF. The report was issued in January 2013.

DISCUSSION:

Fiduciary Risk

The mission recognizes that Afghanistan is a high-risk environment, but is both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The Mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursement of US government funds to assure maximum protection of U.S. taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The Mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The Mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through the application of the ADS 201 and other guidance to project design. This AUPCS, therefore, focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

Managing Risk

On March 19,2013, the Mission Parmer Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II assessment report was prepared to determine whether USAID could rely upon the MoF systems operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon the MoF current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with the MoF. The complete Stage II Risk Assessment Report, including the Risk Schedule with identified risks and suggested mitigation measures, is attached in Appendix Number 1.

USAID's projected activities to be implemented through direct on-budget assistance with the MoF are the Civilian Technical Assistance Program (CTAP) and the CARAVAN project. The programmatic objectives are described below.

Civilian Technical Assistance Program (CTAP)

Following the Kabul Process, the government formally launched the Civilian Technical Assistance Program in July 2010 as an on-budget national program to strengthen capacity development in Afghanistan. The program focuses on human and institutional capacity development. GIRoA controls the recruitment, hiring and placement of international and Afghan-expatriate technical advisors who are paired with government counterparts to transfer skills, knowledge and best international practices and experience.

The MoF manages the program and reports to donors through a quarterly forum called the Advisory Board meeting, chaired by the Deputy Finance Minister for Policy, who is the CTAP senior executive. The role of the senior executive is to approve specific requests for assistance from GIRoA ministries, and to provide high level strategic guidance to the CTAP Secretariat. Day-to-day management is provided by the CTAP Program Director.

On September 30, 2009, USAID signed an initial $30 million grant agreement with the MoF for direct assistance to support CTAP. Since then, the agreement was amended to extend the termination date for disbursements through September 30, 2014 and increase USAID total estimated contribution (TEC) to

$36,250,560. On February 14, 2011, USAID signed a MOU with UK's development agency, DFID, expressing common interest and encouraging other donors in supporting the implementation of CTAP. On June 7, 2011, USAID and the Australian development agency, AusAID, signed a Collaboration Agreement to work together to harmonize and align aid delivery, utilizing GIRoA's CTAP as the means to achieve this goal. Pursuant to the MOU and the Collaboration Agreement, USAID received $9,189,887 from DFID and $2,120,800 from AusAID as conditional gifts for CTAP.

USAID/Afghanistan has prioritized the need to improve performance and accountability of governance and increase management effectiveness of GIRoA institutions. Achieving this will require strengthened governance and service delivery at the national and sub-national levels, improved core functions of selected ministries, and increased utilization of on-budget development assistance.

In July 2012, the Tokyo Framework acknowledged the critical importance of good governance for strong and sustainable economic development and improved livelihoods of the Afghan people. Through CTAP, USAID intends to help build capacity of the civil service, the backbone of public administration in areas such as finance, procurement, and project management.

CARAVAN PROJECT

The purpose of CARAVAN project is to strengthen the business climate of Afghanistan to enable private investment, enhance trade, and promote fiscal sustainability.

CARAVAN seeks to achieve the project purpose through a range of interventions aimed at (1) improving GIRoA capacity to formulate a liberal policy framework for trade and investment in accordance with international standards; (2) strengthening revenue generation through reforms and anti-corruption measures in customs and taxation; (3) enabling more efficient, effective, and accountable service delivery for all Afghan citizens through improved budget management processes, and (4) enhancing integration in the regional and world economy through the promotion of trade and transit agreements, enhanced economic corridor governance, and private sector linkages throughout South and Central Asia.

Major inputs include: technical assistance on trade agreements, WTO accession, and rules compliance; capacity building for the implementation of reforms in customs (Border Management Model, Risk Modeling) and tax operations (VAT implementation, tax administration and enforcement); capacity building for program budget reform and sub-national budgeting; and the organization of regional trade fairs and private sector matchmaking events.

CARAVAN also supports GIRoA's commitments under the Tokyo Mutual Accountability Framework and fully aligns with the Afghanistan National Development Strategy and National Priority Programs.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement under both projects. The IL might include USAID prior-consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and other conditionalities required throughout the activity period. The conditionalities might also require MoF to plan and begin to address some of the general weaknesses identified in the January 2013 contracted PFM assessment report. Details reflecting interventions to address the findings of the Stage II Risk Assessment Report will be included in design discussions under the CARAVAN project. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreements will require an annual audit of the MoF, inclusive of all USAID-specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of MoF under a separate Capacity Development initiative and initiate internal control and financial reviews of the MoF managed activities as determined appropriate.

The Office of Program and Project Development (OPPD), the Office of Economic Growth and Infrastructure (OEGI), and the full PCS team are responsible for monitoring risk mitigation steps, including whether conditions precedent are met prior to funds disbursement and whether other ongoing covenants continue to be met. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID direct assistance to the GIRoA will be provided through existing legally binding bilateral assistance agreements, which include USAID audit, investigation and evaluation rights on behalf of itself and other U.S. Government agencies; refund, termination and suspension provisions; and provisions requiring the submission to USAID of plans, specifications, procurement or construction schedules, contracts, or other documentation between GIRoA and third parties relating to goods or services to be financed under these bilateral assistance agreements, including documentation relating to the prequalification and selection of contractors and the solicitation of bids and proposals.

Responsibilities

The Mission's Partner Country System (PCS) team is composed of the following individuals:

(b)(6)

The Mission's Office of Program and Project Development (OPPD) and Office of Economic Growth and Infrastructure (OEGI) are expanded PCS team members for G2G activities related to the above MoF activities. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the March 19, 2013 Stage II assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement.

Normally, a review of the risk mitigation assessment and strategy is to be conducted by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process. Since USAID/Afghanistan is operating under a waiver of ADS Chapter 220 policy issued on November 20, 2012, the GPCSRMT has determined that in order to not undermine the intent of the waiver, nor unreasonably impose quality control against procedures that are not applicable to the Mission process, nor delay project design/implementation, the GPCSRMT will not conduct quality control reviews of the USAID/Afghanistan entity-level PFMRAF assessments during the period that the ADS Chapter 220 waiver is in effect.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written Approval of Use of Partner Country Systems for the Ministry of Finance.

Approved: ________________ Date: ____________

Disapproved: ________________ Date: ____________

Appendix No. 1

Stage II Risk Assessment Report

USAID
FROM THE AMERICAN PEOPLE

USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF FINANCE

STAGE II RISK ASSESSMENT REPORT

March 19, 2013

CONTENTS

Background

Founded in 1747, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, Afghanistan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved and the internal audit function does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work with GIRoA to undertake entity level risk assessments of GIRoA line Ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of the Ministry of Finance was issued in January 2013.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development strategy. With that transition to a more robust traditional development strategy will likely result in substantive changes in Government to Government (G2G) assistance.

The G2G commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and the need to address fiduciary risk in the Partner Country PFM system being considered for direct G2G assistance. For that reason the Agency developed the Public Financial Management Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the

[1] London Conference, January 2010 and the Kabul International Conference of Afghanistan, July 2010.

Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a USAID/W team, is undertaken prior to or in conjunction with the Mission-led Stage I Rapid Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other insurmountable barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment – which is an entity level assessment – may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessment upon GIRoA as required under currently issued Agency Policy – ADS Chapter 220 issued in draft in August 2011 and substantially updated in March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments serve to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy – the enhanced DRG review and the PFMRAF Stage I assessment.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PFMRAF Stage II guidance as currently revised in July 2012, however the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012, USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and financial accountability (PEFA) reports, assessments undertaken by the CPA firms to

[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 - pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012, where risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

date, and other informal information available to Mission staff. Using that informal process and the independent CPA firm assessment report issued in January 2013, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this Stage II risk assessment is to determine whether the U.S. Government can rely on the Ministry of Finance (MoF) systems operation and internal controls to manage donors' funds. Specifically the assessment will:

I. Determine whether the MoF's financial management/accounting system is adequate to properly manage and account for donors' funds.

II. Determine whether the MoF has the financial management capacity to manage proposed activities.

III. Determine whether the MoF's internal controls are adequate to manage donors' funds.

IV. Determine whether the MoF's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.

V. Determine whether the MoF complied, in all material respects, with applicable laws and regulations.

Executive Summary

The United States Government committed to channeling at least 50 percent of its development assistance through the national budget of the GIRoA[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) systems at the entity level being considered for direct implementation of USAID-funded assistance. For that reason, USAID developed the Stage II Public Financial Management Risk Assessment to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This Stage II assessment was performed to determine whether USAID can rely on the Ministry of Finance (MoF) systems operation and internal controls to manage donors' funds. The assessment determined that USAID cannot rely completely on the MoF current systems, operation and internal controls to manage donors' funds.

The independent auditors' assessment revealed that while the MoF's current policies, procedures and internal controls framework are generally sufficient to properly manage and account for donors' funds, there are control weaknesses deemed to be material which can have adverse impact on MoF's capacity.

The assessment indicated that government guarantees and other contingent liabilities are not accounted for while preparing national budgets, which can result in a liquidity gap if these liabilities are realized. In addition, the Treasury Department at the Ministry of Finance does not have a formal liquidity contingency strategy to cover unexpected fluctuations with respect to revenue, expenditure, debt retirement, or aid receipt. The current debt strategy is incomplete because it does not address certain key aspects such as, evaluation of risk associated with debt levels, and a medium term debt strategy aligned with the medium term fiscal framework, which are typically included in a national level debt management strategy. Furthermore, there is no mechanism in place to independently verify reported impact included in the line ministries' budget execution reports.

The assessment also found that the MoF needs to perform comprehensive reference checks of new employees hired from nongovernmental entities, and should enhance its controls over fixed assets/property management and reporting. Lastly, a standard set of legal terms and conditions should be drafted and every contract above a certain defined threshold should be formally vetted by the legal advisor.

The results of this assessment would not preclude USAID from engaging in measured G2G assistance with the Ministry. In fact, a policy decision has been made already to engage in

[3] London conference on Afghanistan, January 2010 and the Kabul International conference on Afghanistan, July 2010.

G2G assistance in Afghanistan, so by approaching G2G assistance with precautions and conditions, USAID can reasonably mitigate the identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

Assessment Conclusion & Results

USAID cannot fully rely on the Ministry of Finance (MoF) systems operation and internal controls to manage donors' funds.

I. MoF financial management/accounting system is adequate to properly manage and account for donors' funds, except for the conditions detailed below (page 7) to enhance its financial management / accounting system.
II. MoF internal controls are adequate to properly manage and account for donors' funds, except for some conditions as detailed below (page 9) to enhance its internal controls.
III. MoF procurement management units have sufficient systems and management capacity, except for some weaknesses as detailed below (page 10)
IV. MoF has adequately designed controls to comply, in all material respects, with applicable laws and regulations and no material exception thereto has been observed.

The MoF's current policies, procedures and internal controls framework are generally sufficient to adequately safeguard and account for donors' funds. However, there are material control weaknesses that can have adverse impact on the MoF's capacity in regards to managing donors' funds. The overall level of risk identified by the assessment is considered to be medium. Nonetheless, we believe the identified risks can be reasonably mitigated. (See Appendix 1)

Management and governance structure

One of management's responsibilities is to create a solid foundation that will ensure the effective and efficient development of an organization. Also, accountable management needs to insure appropriate policies are developed and applied, talents that are needed to enhance organizational growth are identified, and procurement integrity observed. Governance structure should be designed to monitor operations of an entity to achieve long term strategic goals aimed at satisfying stakeholders and ensure compliance with the legal and regulatory requirements. The MoF has a solid organizational structure evidenced by a management committee that meets on a weekly basis. That committee is responsible for strategic management decisions and manages governance and operational issues of the Ministry. However, the terms of reference (ToR) specifying the scope of work along with the roles and responsibilities of the committee are not yet documented. Without documented ToRs, the committee cannot carry out its duties and responsibilities in an efficient and effective manner and decisions taken by the committee may not be enforced properly.

The assessment also found that the MoF relied heavily on technical assistance from the international community to strengthen internal control processes; this has however, made the improvements vulnerable to the continued presence of external technical assistance and has undermined the development of a sustainable and long-term capacity of the ministry. Further, there is evidence of institutional reluctance to the formalization of the internal control policies and procedures. Knowledge and skills with respect to internal controls remain with a few experienced staff, which is non civil servant. With high staff-turnover, this poses a major risk for the institutional knowledge and practice of internal controls within the MoF. This is a hindrance to Afghan ownership of systems and controls, and inhibits the development of a long-term exit strategy for the international donor community.

The MoF has an independent Internal Audit Investigation and Evaluation General Directorate (IAED) headed by a Director General IAED. Currently, the IAED performs transaction based audits, where it reviews financial and compliance transactions of the respective directorates. However, risk based process level internal controls assessments are not incorporated into the audit process. Without risk assessments at the process level which considers internal controls design assessments, underlying controls gaps within the processes may remain undetected and impair the effectiveness of the internal controls framework. Furthermore, the AIED do not use standard checklists to facilitate audits and there is no testing/sampling strategy in place. The lack of standard audit checklists or a sampling strategy may lead to inconsistent audit practices which may impair the quality and efficiency of the audits.

Finalized audit reports are discussed in the quarterly meetings of the Audit Committee. Follow up audits are also conducted by IAED but separate reports documenting improvement made or highlighting unaddressed recommendations are not prepared. Follow up reports should be prepared by the internal audit team, detailing the recommendations given in the previous audit reports and their status of implementation. The follow up reports should be also discussed in the Audit Committee meeting and appropriate actions should be taken accordingly. Without formal follow up reports there is no evidence relating to the resolution of previously identified weaknesses and issues.

A strategic plan has been prepared by the Information and Communication Technology (ICT) Directorate detailing the future development of ICT functions in the Ministry. However, the Ministry does not have a mechanism in place for the monitoring the plan. Lack of monitoring of the strategic plan can lead to a deviation from intended objectives and long term goals not being achieved.

In general, the assessment found that licensed software is installed in the Ministry's computers but there were exceptions. Further, there is no policy for maintaining off site backups of critical data, and a disaster recovery plan is not available. It is essential that only licensed software is used, as the use of unlicensed software exposes the MoF to undue legal risk. Also, inadequate back up of critical data and the lack of a disaster recovery plan may lead to loss of important data and impede the MoF's ability to resume normal operations after manmade or natural disaster.

The identified weaknesses raise concerns regarding the Ministry's approach to long term commitment and success in achieving an effective governance structure to pursue its strategy in an effective way and offers safeguards against misuse of resources, physical or intellectual. These concerns highlight serious risk implications and raise doubt as to whether the Ministry has the capacity to provide adequate financial oversight to line ministries and manage donor's funds without substantial involvement by the donors.

Financial Management and Accounting Systems

To achieve success in program implementation and to maintain operational integrity, reliable financial management and accounting systems are vital. The MoF follows a program based budgeting process, whereby development and operational budgets are prepared and approved separately. The annual budgets development and operational are prepared and forwarded to the cabinet and to the parliament for approval, and lastly to the president for final sign off. Allotments for the operational budget are requested on a quarterly basis, however for the development budget, allotments are requested based on the activities planned for programs / projects and the budget ceilings. Allotments and payments related to operational and development expenditure of the MoF is processed by the internal Finance Directorate. In addition, the MoF has a Receipt Processing Unit designated for the management of revenue collected by the Mustofiats. A bank account with Da Afghanistan Bank (DAB) is established for depositing the revenue collected.

The MoF manages its petty cash expenses separately for the operational and development expenditures. While there are established policies for reconciling petty cash registers with cash counts, no formal reconciliations are performed. Also there is no policy whereby surprise cash counts are conducted. Furthermore, petty cash registers are not reviewed by anyone in the Finance Directorate. The lack of periodic surprise cash counts and reconciliations may lead to misappropriation of assets going undetected.

All salaries paid to the MoF civil servant employees and project supported employees are transferred to their respective bank accounts. However, MoF Finance Directorate does not prepare formal payroll reconciliation of MoF's and project supported employee salaries prior to submitting the payroll to the Treasury Directorate for disbursement. Without such reconciliation, errors or unauthorized changes to the payroll may remain undetected, leading to improper payments.

The MoF has an Asset Management Directorate responsible for the Ministry's fixed assets and consumable inventories. Upon procurement, fixed assets and consumables are stored in the central store. The assessment found overall lack of management accountability related to fixed and consumable assets. While, the Ministry's fixed asset verification is carried out on an annual basis for the assets maintained at the warehouses, those assets maintained by the users at the head office / provincial offices and the facilities are not verified. Further, there is no process for tagging fixed assets. To strengthen controls related to fixed assets, a formal plan should be prepared for carrying out physical verification of fixed assets located at all of the MoF locations and the results should be compiled in a formal report and presented periodically to the Steering Committee. To further strengthen internal controls, such physical verification should be monitored by the representative of the IAED. Without adequate internal controls related to fixed assets and consumable inventories, instances of lost or damaged assets will remain undetected and asset valuation reports to the management will may not be accurate.

While the MoF has adequate financial management and accounting systems in place, the identified internal control weaknesses undermine the effectiveness of these financial and internal control systems. Also, these weaknesses can hinder the Minister's ability to achieve operational and programmatic goals and prevent timely detection of fraud and error, therefore impacting the accuracy and completeness of the accounting records and financial reports.

Personnel Policies and Procedures

Human Resources function should ensure that qualified employees are recruited, trained and retained. Human Resource (HR) Directorate has been established at the MoF to manage the human resource related functions of the Ministry. The policies and procedures for HR at MOF are governed by the Civil Service Commission and a detailed procedure manual is maintained by the HR Directorate. However, the MoF is exposed to unnecessary financial and operational risks as there is no evidence that reference checks on non Tashkeel[4] employees (e.g., consultants, advisors) are conducted during the hiring process. Furthermore, the MoF HR Directorate lacks other basic HR procedures. For example, job descriptions are not acknowledged by the new employees and documented accordingly. It would be a prudent practice for the respective employee to sign off on the job description as well as the head of the HR Directorate to demonstrate evidence of concurrence with the job responsibilities. Without such an acknowledgement, the employee may not be fully aware of assigned roles and responsibilities which can result in essential duties going unfulfilled and also lead to unanticipated performance issues. In addition, there is no checklist to facilitate formal documentation of the exit interviews and official employee files are not centrally maintained. The lack of formal exit interviews facilitated and documented by checklists can lead to inconsistent practices and deviation from procedures resulting in degradation of internal controls. Without central employee files, access control issues as well as operational inefficiencies can arise, and ultimately result in unauthorized changes, lost documents, payroll irregularities, and or errors.

A training plan is prepared by Training and Capacity Building Department in the HR Directorate at the start of the year and the plan includes the details of trainings to be conducted along with the resources needed for those trainings. However, the prepared training plan does not take into consideration the annual appraisals. The training plan would be more effective, if it is also linked with the results of the employee appraisals. Additionally, the training plan should be monitored against implementation in order to be an effective monitoring tool.

The above identified HR related weaknesses and the overall lack of attention to basic employment documentation and practices undermines the operational and programmatic goals of the Ministry and also needs to be addressed or mitigated by the donors.

Procurement and Purchasing system

Procurement is a critical organizational function and the Procurement Directorate purchases goods, works and services required to implement the development and the operational budget requirements. Procurements carried out at the MoF are regulated by the Procurement Law of Islamic Republic of Afghanistan, issued in 2008. An annual procurement plan is prepared at the start of each year based on the procurement needs of all of the MoF directorates. A Procurement Committee has been established to oversee the procurement process at the MoF, and it ensures that procurement proceedings are conducted in accordance with the approved procurement plan.

[4] Tashkeel is the organizational structure (Staffing establishment or List of sanctioned posts or Staffing structure or Organizational chart) in civil service system of Afghanistan including departments, positions, level of positions and number of positions in each department.

However, the assessment found that the actual procurements executed are not monitored and compared against the established procurement plan. In addition, a Procurement Management Information System (PMIS) has been established by the Procurement Policy Unit of the Ministry to provide an electronic solution for public procurement in Afghanistan. The PMIS enables the Procurement Directorate to upload and publish procurement data through its website. Auditors found that the data regarding registered list of bidders and vendors are not uploaded on the website. The lack of registered bidders / vendors on the website diminishes transparency and may also result in operational inefficiencies. Further, the data related to actual procurements performed by the Ministry in the provinces is not entered in the PMIS. Ultimately, it is essential that the procurement plan is monitored against its implementation. Without such monitoring, the Ministry is not effectively able to evaluate whether there is progress toward achieving programmatic and operational targets. Additionally, there was no documentary evidence of a policy, or regular practice whereby legal documents related to procurement contracts are sent to the legal advisor for vetting before they are signed. The current practice exposes the entity to unnecessary legal risk and litigation. Therefore, a standard set of legal terms and conditions should be drafted and every contract above certain defined threshold should be formally vetted by the legal advisor.

Procurement records are maintained by the relevant section within the Procurement Directorate. All required documentation from the initiation of the solicitation onward is required to be maintained in the procurement files. However, the procurement contract files prepared by the procurement officers are not reviewed by supervisors and a standard documentation checklist is not used. The lack of a formal process for the review and maintenance of procurement documentation can lead to errors in documentation and the required documentation may not be included in the procurement files.

The procurement weaknesses identified above, including the lack of legal vetting of procurement contracts can lead to inconsistent practices and hinder compliance with intended procurement policies and procedures. As a result, the Ministry is faced with increased legal and operational risks for the Ministry's and donors' funds.

Program Management and Monitoring

Monitoring reveals whether desired results are occurring and whether expected outcomes are on track. Effective program management is a commitment to managing for results in order to achieve the best possible outcome. At the MoF, the Reform Implementation and Management Unit (RIMU) is responsible for assisting in the development and monitoring of the strategic plan. A strategic plan was developed for the years 2009 to 2014 and should be updated on a yearly basis. However, at the time of the assessment the strategic plan was not updated for the current year. The strategic plan should be updated on an annual basis to incorporate new objectives considering the impact of the dynamic economic environment in Afghanistan. Relying on an outdated strategic plan could lead to undesired results, and goals and objectives may not be achieved. Moreover, monitoring of the strategic plan is carried out on a quarterly basis against the development and operational plans developed for the year. The Project Implementation Unit (PIU) has been established in the past year for the monitoring and evaluation of development projects / programs being undertaken by the MoF. However, the focal points in the provincial offices, from where PIU collects data regarding the progress and the expenditure incurred on the projects/programs are not independent. To minimize impairment of independence, the focal points reporting to the PIU should be independent of the directorate and/or the Mustofiat. In addition, to prevent possible conflict of interest, the reporting line of the PIU should be to the Minister directly rather than the Deputy Minister for Administration who is responsible for the implementation of the projects / programs in the respective directorates. An annual plan for monitoring against the strategy is in place, and the PIU submits on a monthly basis a report to the senior staff on the progress of the development projects/programs being implemented. However, the Ministry does not have in place an interfaced system which can provide information relating to both financial and programmatic progress of projects and programs.

Further, the assessment found that specialized trainings are not provided to the personnel involved in technical evaluation of on-going projects/programs. A training plan should be established and linked with the annual staff appraisals to better identify training requirements to build capacity of the monitoring and evaluation function.

Without regularly updated strategic plans which are monitored independently and pro-actively with relevant and accurate information, the Ministry is exposed to increased programmatic risk. The increased risk can results in strategic objectives not being met and inefficient and ineffective use of donors' funds.

Other Matters

National Budget

The key responsibilities of the Directorate General for Budget include implementing the overall budget framework at the national level by setting overall budget reform policies and undertaking actual activities on budget formulation, implementation and reporting. The Directorate General for Budget and its various functions are further delegated to three key officials; Director of Budget Policy and Reform, Director of Budget Execution and Director of Aid Management. The assessment found that there is no process leading to an independent survey to assess the effectiveness and efficiency of services provided by the line ministries as a result of allotted budget expenditures. The lack of an independent survey assessing the impact of executed budgets can undermine transparency and lead to expenditure inefficiencies. Furthermore, government guarantees and other contingent liabilities are not considered in the national budget formulation. As a result, the government's cash outflows cannot be estimated accurately. In addition, the MoF provides budget execution reports to various stake holders including the Parliament and makes such reports available on the MoF website. However, these reports lack details on the largest vendors / suppliers with respect to each line ministry. Without such disclosure, a comparison cannot be made readily between the largest vendors (with respect to each line ministry). The lack of detailed reports result in reduced level of transparency and accountability that can be exercised by various oversight bodies such as the Parliament, the Cabinet of Ministers, donors and the public at large.

Another significant budgetary concern raised in the assessment report is low execution rates of Ministry's development budget. Many factors including limited implementing capacity and changing donor agendas and priorities make it difficult to produce consistent estimates of available development funds, dependable forecasting and ultimately implementing development programs accordingly. The execution rates for the Ministry during FY 1388 (2009) and FY 1389 (2010) was 20%, and 27%, respectively.

Overall, the weaknesses identified in the national budgeting process places both public and donor resources at risk of not being optimally utilized. In addition, budget fluctuations resulting from inadequate consideration of contingent liabilities and the impact of erratic budget execution can further undermine donor sponsored programs and activities.

Treasury Department

The Treasury Department has defined processes for major functions including: 1) Revenue Recording/Reporting, 2) Payments for Operational and Development Expenditures, 3) Developing Finance Policy, and 4) Cash and Debt Management. The Special Disbursement Unit (SDU) is responsible for payment processing for development expenditures. Upon receiving a new grant or loan, SDU creates a special account and sets up fund and object codes. The Treasury Department also maintains the central records of the government and provides reports related to donors' funds. Vendor data comparison is not performed, although the accounting platform (AFMIS) has the requisite capability. In addition, the line ministries do not submit details of vendor performance for significant contracts as required by the contractual agreement(s) for onward submission to the cabinet of ministers. As a result, vendor performance information is not available and anomalies with respect to the procurement process may go undetected. Moreover, the liquidity management within the Treasury Department is undertaken by the Cash Management Unit which is responsible for forecasting and cash planning. However, there is no documented liquidity contingency plan to cover unexpected fluctuations with respect to revenue, expenditure, debt retirement or aid receipt. The lack of a liquidity contingency plan can hamper the capacity to address unexpected fluctuations and lead to increased cost of maintaining liquidity. Although there is a Debt Management Unit in place, the current debt management strategy is incomplete and not aligned with the medium term fiscal framework and does not consider an overall framework as to how the MoF would evaluate the risk of debt, debt sustainability, etc. The lack of a robust debt strategy can lead to liquidity issues resulting in increased costs of servicing debt.

Furthermore, the fixed assets register is not automated, including for donor funded projects. The line ministries do not provide a subsidiary record of fixed assets purchased with donor funds. Therefore, hindering donor's ability to monitor project execution. In order to improve the efficiency and reduce the risk of errors, the fixed assets register should be automated and integrated with the treasury's main financial management system (AFMIS) to prevent and, detect reporting errors.

The identified deficiencies and weaknesses related to the availability of vendor performance information and fixed assets could lead to uninformed decisions resulting in operational and programmatic inefficiencies. Without robust cash contingency and debt management plans, GIRoA is faced with unmitigated cash flow risks which can lead to unexpected fluctuations and operational and programmatic risk to both GIRoA and donors' funds.

Risk Assessment Measurement

USAID guidance states, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as, Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as, Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact					
	Catastrophic	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted the 2012 assessment under a scope of work which focused on seven main areas of 1) Governance structure and control environment,2) Financial management, budgeting and accounting systems, 3) Personnel policies and procedures, 4) Procurement and purchasing systems, 5) Programmatic management and monitoring. 6) National Budget, and 7) Treasury Department. While the auditors conducted an in-depth assessment on the seven areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements as that guidance (ADS Chapter 220) was issued subsequent to the negotiation of the scopes of work with GIRoA. However, to ensure the Mission complies with the Agency's guidance and performs required due diligence, we reviewed the auditors' report and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts whom had an understanding of the ministry's systems. Based on auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they had to define their findings in terms of risks so appropriate risk mitigation measures could be developed to address the identified risks. Because our review was conducted after the auditors had completed the assessment, and could not go back to determine the impact and probability, we relied on the understanding we've gained over the years of collaboration with the government. Based on that understanding we defined the potential risks and we took a conservative approach and considered most risks to be serious and probable unless the contrary was clearly evident.

Appendix 1: Risk Schedule

	Risks	Impact	Probability	Score	Mitigating Measures
	Governance Structure and Control Environment				
1	Lack of accountability of public officials Not being able to fulfill its mandate and carry out its operation	Serious	Probable	Critical	Define and document terms of reference for its Board Management Committee that specify their scope of work, roles and responsibilities.
2	Inconsistencies in audit practices and approach. Unresolved recommendation The underlying controls gaps/shortcoming within the processes may remain undetected and impair the effectiveness of internal controls framework.	Serious	Probable	Critical	Devise standard audit program and a checklist to serve as a guide for all audit engagements and training of IAED staff on such standardized checklists. The high risk issues requiring immediate attention should be covered in separate follow up audits The follow up report should be discussed in the Audit Committee meeting and appropriate actions should be taken accordingly. Include risk base audit approach in the annual audit program.
3	The performance outcome will be lower than expected standards or long term goals will not be achieved.	Serious	Probable	Critical	MoF should develop a policy which requires the Ministry periodically review actual performance against its strategic plan, document same and be presented to the Strategic Committee.
4	Non-retrieval of important data or loss of data. May result in penalties and legal proceedings against the ministry.	Catastrophic	Probable	Critical	A clear and robust Business Continuity and Disaster Recovery plan should be developed and backup information on regular basis Only licensed software should be used for the IT systems at the Ministry.

5	The improvements are vulnerable to the continued presence of external technical assistances Limitation of the development of sustainable and long-term capacity of the ministry	Serious	Probable	Critical	MoF should assess the sustainability of the capacity of departments and consider ways in which knowledge and skills could be passed on to Afghan staff
6	In case of high staff-turnover, this poses a risk for the institutional knowledge of internal controls within the MoF. long-term reliance on international donors community	Serious	Probable	Critical	Internal control written procedures should be comprehensively documented and communicated across the organization, Management should monitor the understanding of those procedures by operational employees.
	Financial management budgeting and accounting systems				
7	Risk of unauthorized / inappropriate practices and undetection of differences between the amount of cash recorded and actual amount of cash held Lack of accountability	Catastrophic	Frequent	Critical	Petty cash should be counted and reconciled by the designated personnel (who is independent of custodian) with petty cash register on at least weekly basis. Use impress system of cash in hand Monthly reconciliation should be made between current and last month payroll.
8	Fixed assets misappropriation and loss and theft of property. Unauthorized use of Government property Fixed asset may not be traceable	Serious	Probable	Critical	All fixed asset should be tagged with unique fixed asset identification number and the existence be verified during yearly audits. Fixed assets register should be updated on regular basis to reflect: date of purchase, asset type, location, serial number, tagged number, respective

					user etc. Conduct periodic inventory of fixed assets, possibly every six months and the results should be presented to the Steering Committee. Reconcile inventory record with financial record
9	Difficult to produce consistent estimates of available development funds, dependable forecasting and execute the development programs accordingly.	Serious	Probable	Critical	MoF should establish a committee to closely monitor the execution of its budget and development programs and provide feedbacks to the management on regular basis.
	Personnel policies and procedures				
10	Manual systems are prone to human errors and manipulation. Errors and omissions may remain undetected. Lack of formal process for maintenance of employee documentation can lead to documentation being misplaced or lost.	Marginal	Probable	High	Develop a plan to automate attendance system at the provincial, revenue and custom offices which should then be used by the Finance Directorate to process the payroll of staff to ensure accuracy. All the documents involved in the recruitment process should be filed at a single location in the employee permanent files. A senior person in the Record Keeping section should review the employee permanent file after it has been prepared by Record Keeping Officer for ensuring that all required documents have been filed.
11	Employee may remain unaware of the assigned responsibilities. Ineffective or poor performance and lack of accountability of public officials	Serious	Probable	Critical	The job description of the employee should be signed off by the respective employee as well as the Head of Directorate, as an evidence of concurrence with the job responsibilities and should be documented in employees' personal files.

12	Lead to inefficiencies in the operations	Marginal	Probable	High	The training need assessment should be carried out at the time of annual appraisals. On a quarterly basis, a comparison should be prepared between the planned and actual trainings, in order to identify the progress. HR Directorate should develop a format for the exit interview and conduct discussion with the staff and document the reasons on the exit interview form. The form should be signed off by the employee and the HR Director and maintained in the employee file.
13	Nepotism and cronyism Exposure of MoF to financial and operational risk.	Serious	Probable	Critical	A formal process for reference checks should be put in place. The reference checks should be maintained in the permanent file of the employee.
	Procurement and purchasing systems				
14	Interests of the entity may not be safeguarded Will expose the entity to unnecessary legal risk / complications. Violation of laws and regulations may go undetected.	Serious	Probable	Critical	A standard set of legal terms and conditions should be drafted and every contract above certain defined threshold should be formally vetted by the legal advisory. A standard checklist should be developed for documents to be maintained in the file.

15	Procurement plans may not be followed fully leading to undesired procurement activities. Deviations from the procurement plan may not be identified at all or on a timely basis. Actual progress of procurements cannot be measured against the plan. Resources may be wasted.	Serious	Probable	Critical	Should set a frequency at which it should generate the monitoring reports using the MIS. Monitoring reports should be reviewed by the Procurement Director and the variances should also be documented. A threshold may be determined (such as +/- 10%), and if there is any variance above the threshold, the reasons should be documented and investigated in detail.
16	May result in operational inefficiencies in the procurement process of MoF. Kickback and bribery.	Serious	Probable	Critical	Procurement Directorate should enter the list of registered bidders in PMIS. The vendors list should be periodically evaluated for their performance and updated accordingly.
	Programmatic management and monitoring				
17	Performance outcome will be lower than expected standards Not meeting programmatic and operational objectives and goals	Serious	Probable	Critical	The strategic plan should be updated on an annual basis to incorporate the impact of the dynamic economic environment
18	Inconsistent and inaccurate reporting Will lead to segregation of duties issues. Will cause conflict of interest. Will cause inefficiency and ineffectiveness at time of technical evaluation.	Serious	Frequent	Critical	The reporting line of PIU should be to the Minister directly to minimize any conflict of interest or segregation of duties. The focal points reporting to the PIU should be independent of the directorate and / or mustofiat. A training plan should be established and be linked with the annual staff appraisals.

19	Will cause ineffective monitoring of the programs / projects.	Serious	Probable	Critical	A system based technical monitoring system should be implemented by PIU. The technical monitoring system should be interlinked with AFMIS to generate reports which link financial and physical progress of the projects.
	National Budget				
20	In the absence of the independent survey the government achievement will be undermined	Serious	Probable	Critical	Independent third parties surveys should be carried out / to ascertain the effectiveness/ efficiency of services provided by the line ministries and reported to the Ministry of Finance.
21	Negative public opinion	Serious	Probable	Critical	Since the Information is readily available with the Ministry of Finance, this information can be disclosed.
22	Will lead to ineffective planning Will result in contingency changes in the project expenditures	Serious	Probable	Critical	Arrangements be made to incorporate contingent liabilities in budget planning process
	Treasury Department				
23	Potential anomalies as regards to the procurement process may go unnoticed.	Serious	Probable	Critical	Vendor analysis should be undertaken to assess the volume of contracts granted to particular vendors.
24	Effective safeguard of physical assets may be compromised. In effective fixed asset management may lead to fixed assets misappropriation and loss to the ministry.	Serious	Probable	Critical	The system / IT platform be enabled so as to keep a record of the assets acquired and the same be integrated with the AFMIS the treasury's main financial and accounting system.
25	Negative impact on the capacity to cater to stress events	Serious	Occasional	High	A formal liquidity contingency plan should be drawn up.
26	Increased risk of ineffective debt management	Serious	Probable	Critical	The debt strategy should be augmented to incorporate these aspects.

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FROM THE AMERICAN PEOPLE

October 2, 2012

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

TO: S. Ken Yamashita, Mission Director (b)(6)

FROM: (b)(6)

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) – Ministry of Mines (MoM) under ADS Chapter 220

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Ministry of Mines (MoM). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the MoM through FYE 2015.

The initial proposed G2G direct assistance activities include:

- Sheberghan Gas Development Project (SGDP) – USAID total contribution estimated at $90 million
- Mining Investment and Development for Afghanistan (MIDAS) – USAID total contribution estimated at $45 million

BACKGROUND:

The GIRoA Ministry of Mines (MoM) has the mandate to promote the development of sustainable, market-based, economically successful mineral and hydrocarbon sectors that encourages and protects private capital investments and enterprises, as set out in the Constitution of the Islamic Republic of

Afghanistan and the Afghan National Development Strategy (ANDS). Under ADS 220, the MoM constitutes a partner government entity.

USAID's extractives sector G2G assistance to the MoM will focus on three areas: reforming mining policy and regulation; strengthening capacity at the MoM; and supporting the private sector and mining project development. USAID is also providing G2G assistance to the MoM for the development of the Sheberghan gas fields.

Several multilateral and bilateral donors are actively involved in the mining sector in Afghanistan. The World Bank's (WB) proposed $52 million Sustainable Development of Natural Resources Project II will build on the work done since 2006 with a previous $40 million grant including mining policy frameworks, training through the MoM Mining Institute, project management of Aynak and Hajigak, supporting environmental compliance, and the Extractive Industries Transparency Initiative (EITI). The Asian Development Bank (ADB) is another major donor in the Afghan mining sector primarily focused on funding transportation infrastructure including road and rail networks that will support the growth of the mining sector and facilitate mineral exports. The United Kingdom's Department for International Development (DFID), the German aid agency (GIZ), and the Indian Government are also implementing or planning modest support to the MoM. USAID's G2G assistance will fill critical gaps in technical areas identified by the MoM concentrating on geo-science, investment promotion, and contract management.

Complying with USAID Policy

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risk and may contain risk mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the correct fiduciary relationship with the institution can exist.

Due to the late date of issuance of ADS 220 (March 2012) and previous on budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements has been initiated for USAID/Afghanistan in August 2012. The waiver request focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro level assessments which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID Afghanistan has never conducted the macro-level enhanced DRG review and the Stage I assessments upon GIRoA as required under currently issued Agency Policy – ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the U.S.G. to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the MoM which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government, in order to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA contracted a third-party to carry out the Stage II equivalent Risk Assessment of the MoM. The report was issued in October 2011.

DISCUSSION:

Fiduciary Risk

The mission recognizes that Afghanistan is a high risk environment, but is both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursing US government funds to assure maximum protection of US taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through application of the ADS 201, and other guidance, to project design. This AUPCS therefore focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

Managing Risk

On September 25, 2012, the Mission Partner Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II assessment report was prepared to determine whether USAID could rely upon the Ministry of Mines' (MoM) systems operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon the Ministry of Mines' (MoM) current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with the MoM. The complete Stage II Risk Assessment Report including the Risk Schedule with identified risks and suggested mitigation measures are attached in Appendix No. 1.

USAID's initial activities to be implemented through direct on-budget assistance with the Ministry of Mines are the Sheberghan Gas Development Project (SGDP) and the Mining Investment and Development for Afghanistan (MIDAS) project. The programmatic objectives are described below:

SGDP – The objective of the G2G activity is to support the MoM to increase utilization of indigenous natural resources and generate electrical energy for sustained economic and social benefits. SGDP includes two distinct components to be implemented in two phases: (1) the rehabilitation of two existing gas wells and drilling of up to two additional gas wells and (2) the construction of a gas processing plant capable of sweetening sufficient gas from the Sheberghan wells to meet the needs of the planned 200 MW Independent Power Plant, which is expected to be constructed by Industrial Promotion Services (IPS) Asia.

MIDAS – The G2G activity will focus on three areas: (1) reforming mining policy and regulation. The MoM should continue transforming itself into a regulatory body that encourages private sector activity and economic and community development; (2) strengthening human resources and institutional capacity at the MoM. These efforts will include regional MoM offices whenever appropriate; and (3) supporting the private sector and mining project development.

Although the SGDP and MIDAS programs involve certain risk, the Mission is structuring each program to include a number of measures that will mitigate the dangers and ensure the successful implementation of the programs. Most significantly:

USAID is providing off-budget technical assistance, which will provide design and engineering services, Quality Assurance and Quality Control services, Monitoring and Evaluation, and technical assistance to begin addressing Risk Assessment weaknesses.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement. The IL will specifically include USAID prior consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and a number of conditionalities required throughout the activity period. The conditionalities will also require the MoM to plan and begin to address some of the general weaknesses identified in the October 2011 contracted PFM assessment report. USAID's off-budget technical assistance contractors will work with the MoM to develop controls and procedures to mitigate identified risks. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreement will require an annual audit of the MoM inclusive of all USAID specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of MoM and the Ministry of Finance under a separate Capacity Development initiative and initiate internal control and financial reviews upon the MoM managed activities.

The Office of Economic Growth and Infrastructure (OEGI) technical office, and the full PCS team, is responsible for monitoring risk mitigation steps, including whether conditions precedent continue to be followed. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID direct assistance to the GIRoA will be through existing legally binding bilateral assistance agreements, which include USAID audit, investigation and evaluation rights on behalf of itself and other U.S. Government agencies; refund, termination and suspension provisions; and provisions requiring the submission to USAID of plans, specifications, procurement or construction schedules, contracts, or other documentation between GIRoA and third parties relating to goods or services to be financed under these bilateral assistance agreements, including documentation relating to the prequalification and selection of contractors and to the solicitation of bids and proposals.

<u>Responsibilities</u>

The Mission's Partner Country System (PCS) team is composed of the following individuals:

(b)(6)

The Mission's Technical Office Team, Office of Economic Growth and Infrastructure (OEGI) are expanded PCS team members for G2G activities related to the Ministry of Mines. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement.

The risk mitigation assessment and strategy was reviewed by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written Approval of Use of Partner Country Systems for the Ministry of Mines:

Approved: ______________ Date: 10-6-12

~~Disapproved: ______________ Date: ______________~~

Attachment: September 25, 2012 Stage II Risk Assessment Report

~~SBU – May Not be Copied or Distributed~~

Appendix No. 1

Stage II Risk Assessment Report

USAID
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USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF MINES

STAGE II RISK ASSESSMENT REPORT

September 25, 2012

CONTENTS

Background

Founded in 1947, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, the Afghan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved. The internal audit function in line ministries does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work with GIRoA to undertake entity level risk assessments of GIRoA line Ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of the Ministry of Mines (MoM) was issued in October 2011.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. This counterinsurgency commitment remains in force for an approximate three year period until FY 2015. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development strategy. With that transition to a more robust traditional development strategy will likely result in substantive changes in Government to Government (G2G) assistance.

The G2G commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and the need to address

[1] London Conference, January 2010 and the Kabul International Conference of Afghanistan, July 2010.

fiduciary risk in the Partner Country PFM system being considered for direct Government to Government assistance. For that reason the Agency developed the Public Financial Management Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a *USAID/W* team, is undertaken prior to or in conjunction with the Mission-led Stage I Rapid Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other insurmountable barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment–which is an entity level assessment–may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessments upon GIRoA as required under currently issued Agency Policy–ADS Chapter 220 issued in draft in August 2011 and substantially updated in March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy–the enhanced DRG review and the PFMRAF Stage I assessment.

[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 -pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012, where risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PRMRAF Stage II guidance as currently revised in July 2012, however the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012, USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and financial accountability (PEFA) reports, assessments undertaken by the CPA firms to date, and other informal information available to Mission staff. Using that informal process and the MoM independent CPA firm assessment report issued in October 2011, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this Stage II risk assessment is to determine whether the U.S. government can rely on the Ministry of Mines' (MoM) systems operation and internal controls to manage donors' funds. Specifically the assessment will:

- Determine whether MoM's financial management/accounting system is adequate to properly manage and account for donors' funds.
- Determine whether MoM has the financial management capacity to manage proposed activities.
- Determine whether MoM's internal controls are adequate to manage donors' funds.
- Determine whether MoM's procurement management units have sufficient systems and management capacity to implement activities and manage donors' funds.
- Determine whether MoM complied, in all material respects, with applicable laws and regulations.

Executive Summary

The United States Government committed to channeling at least 50 percent of its development assistance through the national budget of the Afghan Government[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) systems at the entity level being considered for direct implementation of USAID-funded assistance. For that reason USAID developed the Stage II Public Financial Management Risk Assessment *to enable* it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This Stage II assessment was prepared to determine whether USAID can rely on the Ministry of Mines' (MoM) systems operation and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely on the Ministry of Mines' (MoM) current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with MoM.

Management attitude has a pervasive affect on the culture and attitude of an entity. This attitude affects the integrity and ethical values of the entity, human resources policies, operating philosophy and commitment to organizational competence. Accordingly the risks identified at those levels will be difficult to mitigate. The assessment revealed the governance structure and management accountability needed to insure appropriate policies are developed and applied, code of government ethics enforced, procurement integrity observed, and robust financial controls implemented are lacking. This absence of structure is indicative of a lack of accountability, will, and commitment to enforce best practices and combat wrong doing in the civil service.

In addition to a lack of governance structure, the assessment identified several risk factors that can compromise USAID funding. Examples of these risks are; lack of accountability of public officials, financial data susceptible to manipulation, lack of standards to prevent undue preferential treatment such as nepotism and cronyism, and the likelihood for kickbacks and collusion. Under normal circumstances, the results of this assessment would lead USAID not to engage in Government to Government assistance with the Ministry. Since the U.S. Government commitment has already been made to engage in G2G activity with the Ministry, approaching assistance with precaution and conditions, USAID must reasonably mitigate the identified risks. *Appendix 1* details the identified risks and proposes possible mitigating measures to manage those risks.

[3] London conference on Afghanistan, January 2010 and the Kabul International conference on Afghanistan, July 2010.

Assessment Conclusion & Results

USAID cannot rely on the Ministry of Mines' (MoM) systems operation and internal controls to manage donors' funds.

- MoM's financial management/accounting system is not adequate to properly manage and account for donors'. funds.
- MoM's does not have the financial management capacity to manage proposed activities.
- MoM's internal controls are not adequate to manage donors' funds.
- MoM's procurement management units do not have sufficient systems and management capacity to implement activities and manage donors'. funds.
- Except in few instances where MoM did not fully comply with GIRoA procurement laws, for the most part MoM complied with applicable laws and regulations.

In addition, the internal control environment is not adequate to mitigate the risk of corruption. and it is unclear if there is the will to combat corruption. Nonetheless, we believe the identified risks can be reasonably mitigated. See appendix 1.

Management and governance structure
One of management's responsibilities is to implement a structure that will enable it to execute it responsibilities in an accountable manner. The governance structure and management accountability needed to insure appropriate policies are developed and applied , code of government ethics are enforced, and procurement integrity observed, and robust financial controls put in place is missing. This absence of structure is indicative of a lack of will and commitment to enforce best practices and combat wrong doing in the civil service.

Management attitude has a pervasive affect on the culture and attitude of the entity. This attitude affects the integrity and ethical values of the entity, human resources policies, operating philosophy and commitment to organizational competence. Accordingly the risks identified at that level will be difficult to mitigate. Because of this USAID must engage government to government (G2G) assistance with precaution, and set conditions in its agreements with the Ministry. USAID must also exercise substantial involvement in project implementation until GIRoA achieves satisfactory progress on its management and governance structure challenges.

Financial Management and Accounting Systems
To achieve success in program implementation a reliable public financial management system is vital. The PFM system at MoM is weak and is highly susceptible to fraud, waste and abuse. There is no financial management and accounting system in place to record transactions for both operational and development budget. There is no evidence of reconciliation of monthly payroll records. In fact, staff are receiving bonuses in cash which are not declared on their bank transfer. The same staff is recoding and reconciling transactions.

Personnel Policies and Procedures
Recruiting, training and retaining qualified staff is vital for any organization's going concern. Management attitude toward recruitment, human resources policy development, and investment in staff affect all level of the organization. It is recognized that MoM is operating in a challenging environment where it is very difficult to find qualify staff. Aside from this challenge it is evident from our observation that MoM has not taken its human resources responsibilities seriously. The Ministry does not have documented Human Resources policies and procedures manual. Employment agreements are not signed, annual employee code of conduct and conflict of interest forms are not documented. Management casual attitude toward recruitment and the lack of basic employment documentation could expose donors funds to cronyism and nepotism.

Procurement and Purchasing system
Procurement is a critical organizational function, as huge amounts of money are spent every year procuring goods and services. Procurement fraud wastes limited funds, and compromises safety. With the award of each contract, potential fraud exists in areas such as product substitution, cost mischarging, and progress payment. *The MoM* procurement system is vulnerable to all these risks, as the Ministry does not have basic procurement controls. The Ministry has no annual procurement plan, no mechanism to pre-qualify vendors for goods and services where no competitive bidding is required, personnel do not monitor turnaround time or the quality of goods received. The lack of accountability by public officials in the procurement process puts donors' funds at risk.

Program Management and Monitoring
According to USAID's policy, monitoring reveals whether desired results are occurring and whether outcomes are on track. Performance management is a commitment to managing for results in order to achieve the best possible outcomes. The Ministry's inability to develop a monitoring plan and conduct actual monitoring is a fiduciary risk that could lead to funds being used for unintended purposes and/or being utilized for inefficient programs, and not detected timely.

Risk Assessment Measurement

USAID guidance states, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as, Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as, Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact	*Catastrophic*	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted the 2011 assessment under a scope of work which focused on five main areas. 1) Procurement, 2) Accounting and internal controls, 3) Monitoring and Evaluation, 4) Audit arrangement, and 5) Human resources. While the auditors conducted an in-depth assessment on the five areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements as that guidance (ADS Chapter 220) was issued subsequent to the negotiation of the scopes of work with GIRoA. However, to ensure the Mission complies with the Agency's guidance and performs required due diligence, we reviewed the auditors' report and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts whom had an understanding of the ministry's systems. We conducted limited research on other work performed by DFID on MoM. Based on auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they had to define their findings in terms of risks so appropriate risk mitigation measures could be developed to address the identified risks. Because our review was conducted after the auditors had completed the assessment, and could not go back to determine the impact and probability, we relied on the understanding we've gained over the years of collaboration with the government. Based on that understanding we defined the potential risks and we took a conservative approach and considered most risks to be *serious* and probable unless the contrary was clearly evident.

Appendix 1

Risk Schedule:

	Risks Identified	Impact	Probality	Score	Suggested Mitigation Measures
1.	Public officials not being accountable.	Serious	Probable	Critical	Transfer all assistance funding in escrow bank accounts.
2.	Management not being able and competent to manage USAID's fund.	Serious	Probable	Critical	Substantial involvement of USAID's staff in the implementation of projects and/or hiring third party monitor. USAID audits all projects annually.
3.	Violating laws and regulations	Serious	Remote	High	1.Conduct periodic surprise investigations of suspicious activities. 2.Hold employees accountable to the fullest extent of law if violated.
4.	Waste, fraud and abuse may go undetected.	Serious	Probable	Critical	1.Conduct audits to prevent fraud, waste and abuse. 2.Conduct Ethics trainings as well.
5.	Financial data being manipulated	Serious	Frequent	Critical	1.Proper segregation of duties among Accounting staff. 2. Rotations of assignments within the staff to ensure all staff know and understand different levels of responsibility 3.Request the installation of computerized financial sytem with built-in controls. 4. Conduct yearly audits of financial transactions.
6.	Critical data will be lost and may be irretrievable	Castrophic	Probable	Critical	1.Encourage data storage and validation for all USAID funded activities to ensure accountibility and reliability of information. 2. Back up information on a daily basis.

	Risks Identified	Impact	Probality	Score	Suggested Mitigation Measures
7.	USAID will rely on erroneous data collected to make management decisions.	Marginal	Probable	High	1.Conduct monitoring and evaluations of all USAID-funded activities. 2.Conduct audits of the on-budget programs annually.
8.	Engaging in off balance sheet financing for resources diversion.				1.Conducting regular audits of all assets on the balance sheet. 2. Evaluating revenue generation systems within the ministry to make sure all revenues are recognized. 3- Request OAA's involvement in all critical procurement or third party monitor.
9	Funds being used for unintended purposes. Funding ghost employee Improper payments to employees.	Serious	Probable	Critical	1.Conduct employee validation surveys of payroll to ensure all employees are properly accounted for. 2-Conduct yearly payroll audits.
10	Paying higher prices for commodities and services to finance kickbacks and bribes.	Serious	Probable	Critical	1.Conducting market price analysis/surveys to ensure proper prices are being paid for goods and services. 2- Request OAA's involvement in all critical procurement or third party monitor decisions. 3-Obtain signed conflict of interest forms from senior staff.
11	Collusion to skim liquid assets such as cash.	Serious	Probable	Critical	1.Conduct Fraud Awareness Trainings and briefings to employees. 2. Conducting surprise inspections and evaluations of

	Risks Identified	Impact	Probality	Score	Suggested Mitigation Measures
					petty cash practices within the ministry for proper accountibility. 3-Perform yearly audits.
12	Unauthorized use of Government property including cash.	Serious	Probable	Critical	1.Conduct regular audits of cash and property to insure proper accountibility.
13	Diverting government property for personal use.	Serious	Probable	Critical	1.Maintain accurate asset registers within the ministry. 2. Conduct regular audits and physical inspections of all assets.
14	Not implementing standards so to facilitate illegal acts.	Serious	Probable	Critical	1. Institute more stringent accountibility standards and policies to hold individuals accountible. 2. Set individual benchmarks before any funds are disbursed for goods and services.
15	Vendor selecting scheme to defraud the government.	Serious	Probable	Critical	1.Conduct pre-selection of vendors to ensure acceptable quality standards are maintained. 2. Acquire USAID approval on major procurement of goods and services.
16	Acquiring substandard goods, to finance kickbacks and bribes.	Serious	Probable	Critical	1.Conduct physical inspections of goods at delivery to verify quality. 2.Pre-selection of vendors to ensure acceptable quality standards are maintained. 3-Request OAAs involvement in all key acquistions.

Afghanistan Stage II Risk Assessment

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

October 18, 2012

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

TO: S. Ken Yamashita, Mission Director (b)(6)

FROM: (b)(6)

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) under ADS Chapter 220 – Ministry of Agriculture, Irrigation, and Livestock (MAIL)

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Ministry of Agriculture, Irrigation, and Livestock (MAIL). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the MAIL through FYE 2015.

The initial proposed G2G direct assistance activities include:

- Agriculture Development Fund (ADF) – USAID total contribution estimated at $75 million
- Agriculture Research and Extension Development (AGRED) – USAID total contribution estimated at $40 million
- Irrigation Watershed Management Program (IWMP) – USAID total contribution estimated at $100 million
- Land Reform in Afghanistan (LARA) – USAID total contribution estimated at $9 million

BACKGROUND:

The GIRoA Ministry of Agriculture, Irrigation and Livestock (MAIL) has the mandate to restore Afghanistan's licit agricultural economy through increasing production and productivity, natural resource management, improved physical infrastructure, and market development as stated in the National Agricultural Development Framework (NADF) and other official Ministry documents. MAIL's role in the Afghan National Development Strategy (ANDS) has been further outlined in the National Priority Programs for water and natural resource management and agricultural marketing and development which will be presented to the Joint Coordination and Monitoring Board (JCMB) in November 2012 for endorsement. Under ADS 220, MAIL constitutes a partner government entity.

USAID's agriculture sector G2G assistance to MAIL will focus on three areas: strengthening agricultural extension and research systems to improve service delivery to Afghan farmers; defining the role of MAIL in water management under the Afghan water law in order to encourage more effective use of water for agricultural purposes; and improving MAIL's role as a technical and policy oversight institution in support of private sector agribusiness and economic development. USAID is also providing G2G assistance to MAIL to support credit access for farm communities and land management. USAID's support for MAIL will build on management capacity building programs currently being implemented by the U.S. Department of Agriculture in financial and personnel management as well as communication and systems management.

Several multilateral and bilateral donors are actively involved in the agriculture sector in Afghanistan. The World Bank (WB) has four activities currently supported through the Afghanistan Reconstruction Trust Fund (ARTF), the Horticulture and Livestock Program (HLP), the On Farm Water Management Program (OFWM), the Improving Agricultural Inputs Systems Delivery program (IAIDS), and the Irrigation Rehabilitation and Development program (IRDP). The four projects are valued at approximately $142 million. The Asian Development Bank (ADB) has also invested in the irrigation and water management sector with the Community Based Irrigation Rehabilitation which is designed to improve agricultural production. The United Kingdom's Department for International Development (DFID), the Japanese International Cooperation Agency (JICA), and the European Union are all also implementing programs in support of Afghan farmers and MAIL. USAID's G2G assistance will fill critical gaps in technical areas identified by MAIL concentrating on technical and management capacity to support research and extension, water policy and technical engagement, and agri-business support and policy.

Complying with USAID Policy

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risk and may contain risk mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the correct fiduciary relationship with the institution can exist.

Due to the late date of issuance of ADS 220 (March 2012) and previous on budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements has been initiated for USAID/Afghanistan in August 2012. The waiver request focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro level assessments which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID Afghanistan has never conducted the macro-level enhanced DRG review and the Stage I rapid appraisals upon GIRoA as required under currently issued Agency Policy – ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the U.S.G. to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the MAIL which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government, in order to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA contracted a third-party to carry out the Stage II equivalent Risk Assessment of the MAIL. The report was issued in April 2012.

DISCUSSION:

Fiduciary Risk

The mission recognizes that Afghanistan is a high risk environment, but is both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursement of US government funds to assure maximum protection of US taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through application of the ADS 201, and other guidance, to project design. This AUPCS therefore focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

Managing Risk

On October 10, 2012, the Mission Partner Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II assessment report was prepared to determine whether USAID could rely upon MAIL's systems operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon MAIL's current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with the MAIL. The complete Stage II Risk Assessment Report including the Risk Schedule with identified risks and suggested mitigation measures is attached in Appendix No. 1.

USAID's initial activities to be implemented through direct G2G assistance with the MAIL are the Agriculture Development Fund (ADF), the Agriculture Research and Extension Development (AGRED) project, the Irrigation Watershed Management Program (IWMP), and the Land Reform in Afghanistan (LARA) project. The programmatic objectives are described below:

Agricultural Development Fund (ADF). The objective of the G2G activity is to support MAIL to establish a credit institution designed to provide access to credit for Afghan farm communities and agribusinesses. With technical support and financing provided by USAID, the ADF loan institution will provide loans to Afghan borrowers in line with transparent credit procedures and rules agreed between MAIL and USAID. Given the constrained financial and credit environment in Afghanistan this loan fund is often the only credit available to those working in the agricultural sector.

Agricultural Research and Extension Development (AGRED). This program will focus on four areas: 1. public education and outreach; 2. improved research and extension infrastructure; 3. training for increased technical capacity of research and extension staff; and 4. research grants to increase access to improved varieties and modern agricultural technologies. These efforts will engage seven regional research stations and fifty provincial districts around the country and support private sector agri-business development.

Irrigation and Watershed Management Program (IWMP). This program will focus on three areas: 1. water governance to improve management and reduce conflict; 2. water supply side management to improve watersheds and irrigation infrastructure to reduce water loss; and 3. water demand management to improve on-farm water management.

Land Reform in Afghanistan Program (LARA). This program is focusing on the following four programmatic areas: 1. strengthen land tenure security through the formalization and upgrading of informal settlements – upgrading informal settlements, formalization of land rights, cadastral mapping, women's inheritance and land rights, community based dispute resolution, and training in planning and enforcement; 2. legal framework - providing assistance to the Afghanistan Land Office (ARAZI), the Afghanistan Geodesy and Cartography Head Office (AGCHO), and the Ministry of Urban Development (MUDA) to draft, update and amend laws for urban planning and land use regulation, land management, and cadastre; 3. capacity building - building capacity of public (AGCHO, ARAZI, the Independent Directorate of Local Governance (IDLG) , MUDA, Supreme Court) and private sector service providers to improve and streamline land tenure processes to Afghan private and public sectors; 4. on-budget assistance to MAIL/ARAZI - MAIL will procure services to improve its institutional capacity with the goal of developing ARAZI into Afghanistan's one-stop-shop for land management with specific assistance to further efforts to identify, manage, lease, and obtain revenue from Afghan government lands.

Although the ADF, AGRED, IWMP, and LARA programs involve certain risk, the Mission is structuring each program to include a number of measures that will mitigate the dangers and ensure the successful implementation of the programs. Most significantly:

USAID is providing off-budget technical assistance that will work directly with MAIL's Directorates of Irrigation, Extension, Research and Administration to provide on the job training for activity design, budgeting, monitoring and management. In addition, technical skills development through long and short term training as well as field based practice will be provided. The off-budget contractors will support MAIL to conduct quality assurance and quality control monitoring, evaluation and reporting on all USAID funded activities and also work with the departments of finance and procurement to address any weaknesses identified during the Stage II equivalent risk assessment.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement. The IL will specifically include USAID prior consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and a number of conditionalities required throughout the activity period. The conditionalities will also require the MAIL to plan and begin to address some of the general weaknesses identified in the April 2012 PFM assessment report. USAID's off-budget technical assistance contractors will work with the MAIL to develop controls and procedures to mitigate identified risks. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreement will require an annual audit of the MAIL inclusive of all USAID specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of MAIL and the Ministry of Finance under a separate Capacity Development initiative and initiate internal control and financial reviews upon the MAIL managed activities.

The Office of Agriculture (OAG) and the Office of Economic Growth and Infrastructure (OEGI) technical offices, and the full PCS team, are responsible for monitoring risk mitigation steps, including whether conditions precedent continue to be followed. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID G2G assistance to the GIRoA will be made through existing legally binding bilateral assistance agreements, which include USAID audit, investigation and evaluation rights on behalf of itself and other U.S. Government agencies; and refund, termination and suspension provisions.

Responsibilities

The Mission's PCS team is composed of the following individuals:

(b)(6)

Two of the Mission's Technical Offices, OAG and OEGI, are expanded PCS team members for G2G activities related to the MAIL. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the Stage II risk assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement with MAIL.

The risk mitigation assessment and strategy was reviewed by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written AUPCS for the Ministry of Agriculture, Irrigation, and Livestock (MAIL):

Approved: __________ Date: 10-24-12

~~Disapproved: __________ Date: __________~~

Attachment: October 10, 2012 Stage II Risk Assessment Report

Appendix No. 1

Stage II Risk Assessment Report

USAID
FROM THE AMERICAN PEOPLE

USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF AGRICULTURE, IRRIGATION AND LIVE STOCK

Stage II RISK ASSESSMENT
October 10, 2012

Afghanistan Stage II Risk Assessment

~~SBU-May Not be Copied or Distributed~~

CONTENTS

Background

Founded in 1947, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, the Afghan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved. The internal audit function in line ministries does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work with GIRoA to undertake entity level risk assessments of GIRoA line Ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of the Ministry of Agriculture, Irrigation and Live Stock s' (MAIL) was issued in April, 2012.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. This counterinsurgency commitment remains in force for an approximate three year period until FY 2015. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development

[1] London Conference, January 2010 and the Kabul International Conference of Afghanistan, July 2010.

strategy. With that transition to a more robust traditional development strategy will likely result in substantive changes in Government to Government (G2G) assistance.
The G2G commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and the need to address fiduciary risk in the Partner Country PFM system being considered for direct Government to Government assistance. For that reason the Agency developed the Public Financial Management Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a USAID/W team, is undertaken prior to or in conjunction with the Mission-led *Stage I Rapid* Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other insurmountable barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment – which is an entity level assessment – may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessments upon GIRoA as required under *currently* issued Agency Policy–ADS Chapter 220 issued in draft in August 2011 and substantially updated in March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level

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[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 -pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012, where risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy–the enhanced DRG review and the PFMRAF Stage I assessment.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PRMRAF Stage II guidance as currently revised in July 2012, however the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012, USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and financial accountability (PEFA) reports, assessments undertaken by the CPA firms to date, and other informal information available to Mission staff. Using that informal process and the MAIL independent CPA firm assessment report issued in April 2012, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this Stage II risk assessment is to determine whether the U.S. government can rely on the Ministry Agriculture, Irrigation and Live Stock s' (MAIL) systems, operation and internal controls to manage donors' funds. Specifically the assessment will:

- Determine whether MAIL's financial management/accounting system is adequate to properly manage and account for donors' funds.
- Determine whether MAIL has the financial management capacity to manage proposed activities.
- Determine whether MAIL's internal controls are adequate to manage donors' funds.
- Determine whether MAIL's procurement management units have sufficient systems and management capacity to implement USAID activities and manage donors' funds.
- Determine whether MAIL complied, in all material respects, with applicable laws and regulations.

Executive Summary

The United States Government committed to channeling at least 50 percent of its development assistance through the national budget of the Afghan Government[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) system being considered for direct implementation of USAID-funded assistance. For that reason USAID developed the Public Financial Management Risk Assessment tool stage I rapid appraisal and the stage II risk assessment to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This Stage II assessment was performed to determine whether USAID can rely on the Ministry of Agriculture, Irrigation and Live Stock (MAIL) systems operation and internal controls to manage donors' funds. The assessment found that USAID cannot fully rely on the Ministry of Agriculture, Irrigation and Live Stock current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with MAIL.

The current governing body at the Ministry does not have the required management awareness and competence to lay the foundation for a strong control environment and to motivate staff to pursue the organization's goals. Senior management is still trying to figure out their roles and responsibilities, and has not been able to respond to identified and eminent control risks. In general senior management's attitude toward good governance has been very casual.

In some respect senior management has been cooperating with the donor community to assume greater responsibility to manage aid projects. By the same token senior management has not focused seriously on strengthening the Ministry's financial systems and management controls that would give donors reasonable assurance that funds transferred into the GIRoA's core budget will be safeguarded against waste fraud and abuse. During the assessment auditors noted that, budget formulation and execution are not tracked in the Ministry's Financial Management Information System (FMIS), financial transactions are not always recorded and recognized , and physical assets are not inventoried and documented in the FMIS. The auditors also noted that, employees' time and attendance is not consistently documented, and that several employees were on

[3] London conference of Afghanistan, January 2010 and the Kabul International Conference on Afghanistan, July 2010

leave without written authorizations and the unauthorized leaves were not deducted from the employees' wage statements.

Furthermore, MAIL's existing procurement processes are not transparent and need strengthen. The assessment found evidence of conflict of interest, as staff responsible for obtaining quotations is also responsible for evaluating them. In fact, vendor selection without formal bid evaluation is a common management practice.

Lastly, the assessment identified significant deficiencies in the Ministry's information and commutations systems. Monitoring and Evaluation (M&E) staffs at the provinces are reporting their observations to project implementers, however, these observations are not shared with mid and senior level management at the central M&E Directorate.

Under normal circumstances, the results of this assessment would lead USAID not to engage in Government to Government (G2G) assistance with the Ministry. However, since the determination to engage in direct G2G assistance with the Government of the Islamic Republic of Afghanistan (GIRoA) has been made already at the highest levels of the U.S. Government, USAID needs to take reasonable precautions to mitigate all identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

Assessment Conclusion & Results

USAID cannot rely on the Ministry of Agriculture, Irrigation and Live Stocks' *(MAIL)* systems operation and internal controls to manage donors' funds.

- MAIL's financial management/accounting system is not adequate to properly manage and account for donors' funds.
- MAIL does not have the financial management capacity to manage proposed activities.
- MAIL's internal controls are not adequate to manage donors' funds.
- MAIL's procurement management unit does not have sufficient systems and management capacity to implement activities and manage donors' funds.
- Except for not complying with GIRoA's procurement laws regarding the composition of procurement committee, for the most part MAIL complied with applicable laws and regulations.

In addition, the internal controls environment is not adequate to mitigate risk of corruption, and it is unclear if there is the will to combat corruption. Nonetheless, we believe the identified risks can be reasonably mitigated. See appendix 1.

Management and governance structure
One of management's responsibilities is to implement structure that will enable it to execute its responsibilities in an accountable manner. The governance structure and management accountability needed to insure appropriate policies are developed and applied, procurement integrity observed, and robust financial controls put in place is missing. . MAIL's leadership committee and evaluation committee for land leases meet weekly to discuss strategic and policy issues; however, members from both *committees* do not understand their roles and responsibilities. Legal matters with the potential to detrimentally impact the Ministry's operations, including the use of unlicensed software are not prioritized. Management recognized the volatility of the operating environment, but has not discussed or considered business continuity and disaster recovery plans. Although management is aware of the threat of unauthorized use and access to its information systems, it has not taken action to mitigate or prevent the occurrence of that threat. Management's casual attitude toward good governance and the lack of general controls put donors' funds at risk.

Financial Management and Accounting Systems
To achieve success in program implementation a reliable public financial management system is vital. MAIL does not have sufficient financial management capacity to manage proposed activities, and its management and accounting systems are not adequate to properly manage and account for donors' funds. Accounting staffs do not record cash receipt in the MAIL's financial Management Information System (FMIS). *and they do not* prepare revenue analysis. Fixed assets are not registered, tagged and tracked, and periodic physical verification of fixed assets is not conducted. In addition, auditors noted several transactions that were not recorded and recognized in the MAIL's FMIS. Lastly, budget formulation and execution are not tracked in the FMIS. These conditions create a weak and inadequate internal controls environment, and indicate MAIL's inability to mange donors' fund without substantial involvement from donors.

Personnel Policies and Procedures
Recruiting, training and retaining qualified staff is vital for any organization's going concern. In addition, management attitude toward recruitment, human resources policy development, and investment in staff affects all levels of the organization. The assessment found that the MAIL does not properly review the history and background of employees, including employees in critical positions before they are hired. The assessment also found employee job descriptions are not signed, and annual employee code of conduct and conflict of interest forms are not documented. *Further evidence* of management's casual attitude, auditors noted during the assessment that staffs were taking leave; however, there were no records of leave of absence on file, thereby making it very difficult to track accurately employees' pay benefits. Similarly, provincial offices have difficulty tracking staff's time and attendance, because there are no basic automated attendance systems in these offices. MAIL's control environment weaknesses are systemic, as staff performance appraisals are not conducted timely, and, there is a lack of adequate training for newly hired staff. In addition to the human resources challenges, noted above, the Ministry does not have a documented

succession plan. We understand MAIL is operating in a challenging environment, but the lack of attention to basic employment procedures, and the unwillingness or inability to enforce the most ordinary ethical conducts in the organization expose donors' fund to cronyism and nepotism.

Procurement and Purchasing system

Procurement is a critical organizational function, as huge amount of money are spent every year procuring goods and services. MAIL's inability to effectively management its procurement processes could have a significant negative impact on donors' funds. Contrary to GIRoA's procurement law, MAIL has no documented and defined procurement policy for advertisement below AFS 500,000 ($10,000). Furthermore, the MAIL's procurement processes are not transparent, as request for *quotations* are sometimes issued to vendors at the discretion of management – No documented vendor evaluation processes are applied. These inadequacies in the procurement processes are systemic and prevalent, the assessment revealed evidence of conflict of interest, as personnel responsible for obtaining quotations are also responsible for evaluating the quotations. There is also no segregation of duties at the provincial levels for purchases below AFS 500,000 ($10,000). This lack of accountability by public officials in the procurement process gives rise to potential fraud and puts donors' funds at risk.

Program Management and Monitoring

Monitoring is a key component of internal controls. It assesses the adequacy and quality of the internal control activities and systems' performance over time. Opportunity for improvement identified and observations should be communicated to the appropriate level, in most cases to the senior management. The assessment found a significant weakness in the Ministry's communication and information sharing system. Staffs were preparing Monitoring and Evaluation (M&E) reports, these reports were shared with low level management, but not with senior level management. As a result, senior management (Minister and/or the Leadership Committee) did not have access to critical information on program management. The practice of provincial M&E staff reporting directly to the Provincial Directorate (project implementers) instead of the central M&E Directorate raises concern of conflict of interest which poses a risk that could lead to funds being used for unintended purposes and/or being utilized for inefficient programs.

Risk Assessment Measurement

USAID guidance states, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as, Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as, Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact	*Catastrophic*	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted the assessment under a scope which focused on five main areas. 1) Procurement, 2) Accounting and Internal Controls, 3) Monitoring and Evaluation, 4) Audit and 5) Human Resources. While the auditors conducted an in-depth assessment on the five areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements. However to ensure the Mission comply with the Agency's guidance and performs required due diligence, we reviewed the auditors' report and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts who had an understanding of the ministry's systems. We conducted limited research on other work perfomed by DFID on the MAIL. Based on auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they had to define their findings in terms of risks so appropriate risk mitigation measures could be developed to address the identified risks. Because our review was conducted after the auditors had completed the assessment, and could not go back to determine the impact and probability, we relied on the understanding we've gained over the years of collaboration with the government. Based on that understanding we defined the potential risks and we took a conservative approach and considered most risks to be serious and probable unless the contrary was clearly evident.

Appendix 1

Risk Schedule:

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
			Management and governance structure		
1.	Senior officials: Losing focus on organizational goals and objectives Not being competent to manage USAID's funds Not being accountable	Serious	Probable	Critical	1. Develop clear terms of reference for the Leadership and Evaluation committee for the land leases. 2. Distribute copies of the terms of reference to each member of the Leadership and Evaluation committee 3. Transfer all assistance funding into an escrow bank accounts.
2.	Internal controls weaknesses and gaps may go undetected Inconsistencies in audit practices and approach Waste, fraud and abuse may go undetected	Serious	Probable	Critical	1. De-emphasize Internal Audit on the payment process. 2. Develop risk base audit approach in the annual audit program. 3. Develop a standard audit program and a checklist to serve as a guide for all audit engagements. 4. Audit all USAID projects annually. 5. Submit interim risk based audit reports to USAID.
3.	Unauthorized access to the computer systems Abuse of system access rights where system's users also have administrative rights Loss of vital data and	Serious	Probable	Critical	1. Develop a ministry wide Information Communication Technology system policy to include disaster recovery plan. 2. Develop unique user ID and password for all users of the information systems. 3. Define and restrict systems access to staff according to their roles and functions. 4. Back-up information technology systems regularly on and off site. 5. Audit all USAID projects annually.

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
	Information in the event of system failure or disaster Financial data being manipulated				
4.	Penalties and legal proceedings issued against the Ministry for the use of unlicensed software Violating laws and regulations	Serious	Probable	Critical	Purchase licensed software for the Ministry's IT systems.
	Financial management and accounting systems				
5.	Public officials not being accountable for revenues that flow to the Ministry Engaging in off balance sheet financing for resources diversion	Serious	Probable	Critical	1. Develop a policy for accounting for revenue. 2. Prepare monthly reconciliations on revenue accounts. 3. Prepare monthly receivable aging analysis report. 4. Review and approve monthly receivable aging report. 5. Conduct periodic audits on revenue accounts. 6. Audit all USAID projects annually.
6.	Lack of physical control over fixed assets Diverting government property for personal use	Serious	Probable	Critical	1. Tag all fixed assets with an identification number. 2. Update fixed assets register on regular basis to reflect date of purchase, asset type, location, serial number, tagged number. 3. Conduct periodic inventory of fixed assets, possibly every six months.

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
			Personnel policies and procedures		
7.	Project not being sustainable	Marginal	Probable	High	1. Develop and document a formal succession plan for staff and projects. 2. Establish a training committee to review and plan staff training needs. 3. Develop training plan for each member of staff. 4. Submit regular project reports to USAID.
8.	Employing unqualified personnel Nepotism and cronyism may lead to collusion between related parties	Serious	Probable	Critical	1. Develop a policy for recruitment. 2. Verify that adequate reference checks have been made on every prospective employee and properly documented. 3. Update if applicable, employee security checks periodically. 4. Update employees' code of conduct regularly. 5 .Conduct annual ethics training for all employees. 7. Develop annual work objectives for all employees. 8. Document recruitment disclosure forms for senior management and HR staffs.
9.	Payments to employees for not working Funds being used for unintended purposes Improper payments to employees.	Marginal	Probable	High	1. Document time and attendance for all employees. 2. Link employees pay benefits to the time and attendance register and reconcile regularly. 3. Conduct compliance audit.
			Procurement and purchasing systems		
10.	Procurement system not being transparent Conflict of interest Not implementing	Serious	Probable	Critical	1. Develop written policies and procedures for the procurement processes. 2. Request OAA's involvement in all critical procurements. 3. Obtain signed conflict of interest from personnel who are involved in the procurement processes. 4. Develop a plan to introduce procurement reforms.

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
	standards so to facilitate illegal acts Vendor selecting scheme to defraud the government Acquiring sub-standard goods, to finance kickbacks and bribes				
	Program management and monitoring				
11.	Senior management not having access to critical programmatic information Funds being used for unintended purposes Covering-up mismanagement misconduct and abuse may go undetected	Marginal	Probable	High	1. Develop written policies and procedures for monitoring and evaluation and disseminate notices to all staff. 2. Send monitoring and evaluation reports to the M&E Directorate at the head office and copies to the provincial offices. 3. Submit copies of M&E reports to USAID.

USAID | AFGHANISTAN
FROM THE AMERICAN PEOPLE

November 4, 2012

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

(b)(6)

TO: S. Ken Yamashita, Mission Director

FROM: (b)(6)

SUBJECT: Approval of Use of Partner Country Systems (AUPCS) – Da Afghanistan Breshna Sherkat (DABS) under ADS Chapter 220

ACTION REQUESTED:

In accordance with Automated Directive System (ADS) Chapter 220, you are requested to approve the use of partner country systems in connection with USAID's assistance to the Government of the Islamic Republic of Afghanistan (GIRoA) through the Da Afghanistan Breshna Sherkat (DABS). This approval determination will remain in force for approximately a three-year period through Fiscal Year End (FYE) 2015. This approval authority will include all current and future proposed Government to Government (G2G) assistance activities between USAID and the DABS through FYE 2015.

The initial proposed G2G direct assistance activities include:

- Power Transmission Expansion and Connectivity Project (PTEC) – USAID total contribution estimated at $738 million

BACKGROUND:

The GIRoA Da Afghanistan Breshna Sherkat (DABS) is the national power utility company of Afghanistan, incorporated to operate and manage domestic electrical power generation, importation, transmission and distribution through Afghanistan on a commercial basis. DABS is a wholly owned GIRoA entity with shares held by the Ministry of Finance (MoF), the Ministry of Energy and Water (MEW), the Ministry of Economy (MoE), and the Ministry of Urban

Planning and Development (MUPD). The Board of Directors is made up entirely of Afghan government officials. Under ADS 220, DABS as a GIRoA parastatal organization, constitutes a partner-government entity.

USAID's energy sector G2G assistance to DABS will focus on expanding the national energy grid's ability to transport power from neighboring countries, as well as transporting power from domestic generating plants from the North East Power System (NEPS) to the Southern Electric Power System (SEPS). In addition, as part of Power Transmission Expansion and Connectivity project (PTEC), USAID/Afghanistan also is providing roughly $157 million in on-budget commercialization and technical-assistance capacity building support to DABS, to ensure sustainability of the national energy system.

Other donors are actively involved in the energy sector development and rehabilitation in Afghanistan. For example:

- Asian Development Bank (ADB) programs are supporting the Kunduz-Taloqan, Chimtala-Arghandi, and Naghlo-Jalalabad transmission lines at a cost of aabout $97 million;

- A World Bank (WB) $50 million program is constructing distribution systems that will serve 50,000 customers in Chahirkar; and

- The United States Army Corps of Engineers (USACE) has provide $101 million to support the Arghandi-Gardez transmission line and $94 million to rehabilitate and replace transmission lines from Kajaki to Durai Junction including improvements to three substations along the corridor.

USAID's off-budget technical assistance is providing construction quality assurance for the PTEC activities and building the capacity of the Ministry of Energy and Water to plan, manage and regulate energy systems.

<u>Complying with USAID Policy</u>

Automated Directives System (ADS) Chapter 220, "Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance," establishes the "Public Financial Management Risk Assessment Framework" (PFMRAF) as the Agency's accountability mechanism to protect U.S. taxpayer funds from unreasonable risk and to maximize the value of G2G development investments. Approval of the AUPCS by the Mission Director should be done on the basis of identified, assessed, allocated and evaluated risk and may contain risk-mitigation measures. Approval takes place after the completion of a series of macro-level and entity-level risk assessments, and at a time when the Mission Director determines the correct fiduciary relationship with the institution can exist.

Due to the late date of issuance of ADS 220 (March 2012) and previous on-budget commitments by the US Government to the GIRoA, a request for a formal Administrator waiver of application of ADS 220 requirements was initiated for USAID/Afghanistan in August 2012. The waiver request focuses primarily on compliance with guidance on Stage I PFMRAF Rapid Appraisals and Enhanced Democracy, Human Rights, and Governance (DRG) review. The Stage I Appraisal and the DRG review are macro-level assessments, which assist with understanding the risk environment in targeted countries to inform decisions whether to consider the use of a partner country's systems. USAID Afghanistan never has conducted the macro-level enhanced DRG review and the Stage I assessments upon GIRoA, as required under currently issued Agency Policy – ADS Chapter 220. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010 committed the USG to direct G2G assistance to GIRoA. This commitment was not made subject to the review of macro-level risk in Afghanistan.

Even with the waiver in place, the Mission still must ensure that USG funds are properly safeguarded and fiduciary risks are appropriately identified and mitigated. To that end, the Mission has conducted an entity-level public financial management risk assessment upon the DABS which is comparable in all material respects to those PFMRAF Stage II Risk Assessments completed by other missions and described in ADS 220, and no due diligence is compromised. The Mission's risk assessment, like the ADS 220 PFMRAF Stage II Risk Assessment for institutions, examines the capacity, control systems, and day-to-day practices used in the PFM systems in the ministries, departments or agencies that may be responsible for making and carrying out decisions and actions related to proposed G2G assistance which USAID will provide. The purpose of this risk assessment is to identify and characterize the fiduciary risks of the institution within the partner government, to inform USAID in determining whether use of partner country systems is suitable with the institution.

USAID, with the participation of GIRoA contracted a third-party to carry out the Stage II equivalent Risk Assessment of the DABS. The report was issued in October 2012.

DISCUSSION:

Fiduciary Risk

The mission recognizes that Afghanistan is a high-risk environment, but is both an "overarching foreign policy" concern and a "national security interest" within the meaning of ADS 220. G2G activities may exhibit risk factors beyond those encountered in other development environments. In any case, G2G activities are expected to show positive development outcomes, even if a manageable risk of loss exists and risk mitigation is sub-optimal. The mission assumes no acceptable level of fraud. All identified risks will be mitigated. Where risks are deemed high by USAID, mitigations will be implemented prior to or concurrent with the disbursing US government funds to assure maximum protection of U.S. taxpayer dollars. Other risk mitigation will correspond to the level of risk identified.

The mission negotiates conditions precedent, based upon risk mitigation plans developed in accordance with the process set forth in ADS 220, in all agreements where government entities have identified risks and where a condition precedent is the appropriate mitigation treatment. The conditions precedent will mitigate risks and contribute to an appropriate internal control environment. Other risk treatments will continue throughout the life of the G2G activity or until sufficient capacity is demonstrated by the partner government.

The mission will apply the ADS 220 process to management of fiduciary risk. Programmatic risk is managed through application of the ADS 201, and other guidance, to project design. This AUPCS, therefore, focuses on fiduciary risk issues. The project design documents should be consulted for information regarding programmatic risk.

Managing Risk

On October 20, 2012, the Mission Partner Country System (PCS) team documented a Stage II Risk Assessment Report. The Stage II assessment report was prepared to determine whether USAID could rely upon the DABS systems operations and internal controls to manage donors' funds. The assessment basically determined that USAID cannot rely upon the DABS current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with the DABS. The complete Stage II Risk Assessment Report including the Risk Schedule with identified risks and suggested mitigation measures are attached in Appendix Number 1.

USAID's initial activity to be implemented through direct on-budget assistance with the DABS is the Power Transmission and Connectivity Project. The programmatic objectives are described below.

Power Transmission and Connectivity Project (PTEC).

The objective of the PTEC Project is to support the GIRoA to expand and improve Afghanistan's electric transmission system in order to provide affordable, reliable and sustainable power to a greater number of Afghans. Electrification of Afghanistan will be a key driver for economic growth and modernization. Increased power availability and accessibility through *PTEC* will provide the critical backbone for Afghanistan's continued political, economic and social development. PTEC will be implemented through a broad partnership with GIRoA, to include the MoF, DABS, and MEW, and USAID.

Although the PTEC program involves certain risk, the Mission is structuring the program to include a number of measures that will mitigate the dangers and ensure the successful implementation of the programs. Most significantly:

USAID is providing on-budget technical assistance to DABS to:

- Commercialize distribution of electricity in Kabul and key load centers in Herat, Mazar-e Sharif, Jalalabad, and Kandahar, to increase cost recovery;
- Strengthen corporate management strengthened to more effectively manage, operate, and maintain the national electric system;
- Procure a management contractor to assist DABS effectively manage, operate and maintain the SEPS electric system and reduce losses while increasing cost recovery; and
- Provide key equipment to enable DABS load centers to operate and maintain their systems.

USAID also is providing off-budget technical assistance to MEW to increase its capacity for:

- Planning and implementing projects;
- Development of policy and regulatory mechanisms;
- Improving MEW's Vocational Training Center which provides technical courses for MEW and DABS staff; and
- Working with educational institutions to provide curriculum for MEW and DABS staff, and to produce qualified graduates that can be hired by both organizations.

USAID will also use off-budget funds to provide construction quality assurance oversight of PTEC activities being undertaken by DABS.

USAID will utilize an Implementation Letter (IL) as the basic activity agreement. The IL specifically will include USAID prior-consent privileges throughout the procurement cycle, conditions precedent prior to disbursement, and other conditionalities required throughout the activity period. The conditionalities also will require DABS to plan and begin to address some of the general weaknesses identified in the October 2012 contracted PFM assessment report. In particular, the on-budget assistance provided through the corporate management strengthening and commercialization activities will explicitly work with DABS to develop controls and procedures to mitigate identified risks. The method of disbursement will be on a reimbursable basis for costs incurred or specific milestones achieved.

The IL agreement will require an annual audit of the DABS inclusive of all USAID specific financed activities. The USAID Office of Financial Management will partner with the Internal Audit Departments of DABS and the Ministry of Finance under a separate Capacity Development initiative and initiate internal control and financial reviews upon the DABS managed activities.

The Office of Economic Growth and Infrastructure (OEGI) technical office, and the full PCS team, is responsible for monitoring risk mitigation steps, including whether conditions precedent continue to be followed. Determinations of what measures should be taken if mitigating steps are not implemented or effective will be made by the PCS team.

All planned USAID direct assistance to the GIRoA will be through existing legally binding bilateral assistance agreements, which include

> USAID audit, investigation and evaluation rights on behalf of itself and other U.S. Government agencies; refund, termination and suspension provisions; and provisions requiring the submission to USAID of plans, specifications, procurement or construction schedules, contracts, or other documentation between GIRoA and third parties relating to goods or services to be financed under these bilateral assistance agreements, including documentation relating to the prequalification and selection of contractors and to the solicitation of bids and proposals.

<u>Responsibilities</u>

The Mission's Partner Country System (PCS) team is composed of the following individuals:

(b)(6)

The Mission's Technical Office Team, Office of Economic Growth and Infrastructure (OEGI) are expanded PCS team members for G2G activities related to Da Afghanistan Breshna Sherkat. Those core expanded PCS team members include:

(b)(6)

The full expanded PCS team reviewed the results of the assessment and is responsible for developing and approving the risk mitigation measures negotiated into each respective G2G activity agreement.

The risk mitigation assessment and strategy was reviewed by the Global Partner Country Systems Risk Management Team (GPCSRMT) in the Office of the CFO to ensure quality control in the PFMRAF process.

AUTHORITY

According to ADS 220.3.2.2, application of the PFMRAF gives authority to the Mission Director to approve the use of partner country systems, known as the Approval of Use of Partner Country Systems (AUPCS).

RECOMMENDATION

That you approve this written Approval of Use of Partner Country Systems for the Da Afghanistan Breshna Sherkat.

Approved: ____________ Date: 11-4-12

~~Disapproved: ____________ Date: ____________~~

Attachment: October 23, 2012 Stage II Risk Assessment Report

[redacted]

Appendix No. 1

Stage II Risk Assessment Report

[redacted]

USAID
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USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN DA AFGHANISTAN BRESHNA SHERKAT

STAGE II RISK ASSESSMENT REPORT

October 23, 2012

[redacted]

CONTENTS

Background

Founded in 1747, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, the Afghan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved. The internal audit function in line ministries does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

In 2010, the Obama administration made a public strategic foreign-assistance decision announced at the January 2010 London conference and reaffirmed by Secretary of State Clinton and USAID Administrator Shah at the July 2010 Kabul conference, which committed the U.S. Government to provide at least 50 percent of U.S. Government assistance directly to GIRoA, to be channeled through GIRoA's core budget systems within two years (2012)[1]. In June 2011, USAID/Afghanistan negotiated a scope of work with GIRoA to undertake entity level risk assessments of GIRoA line Ministries. Contracts utilizing the negotiated scope of work were issued to Certified Public Accountant (CPA) firms to undertake the Ministerial engagements. The CPA firm finalized assessment report of Da Afghanistan Breshna Sherkat (DABS) was issued in August 2011. That assessment found significant weaknesses in DABS' systems and operation, so at the request of USAID the CPA firm reassessed DABS' systems and operation and issued a draft report in October 2012.

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. This counterinsurgency commitment remains in force for an approximate three year period until FY 2015. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development strategy. With that transition to a more robust traditional development strategy will likely result in substantive changes in Government to Government (G2G) assistance.

The G2G commitment comes with the responsibility to ensure effective use of funds

[1] London Conference, January 2010 and the Kabul International Conference of Afghanistan, July 2010.

provided by U. S. taxpayers and appropriated by Congress, and the need to address fiduciary risk in the Partner Country PFM system being considered for direct Government to Government assistance. For that reason the Agency developed the Public Financial Management Risk Assessment Framework (PFMRAF) Stage I Rapid Appraisal Assessment, the Democracy, Human Rights and Governance enhanced (DRG) review, and the PFMRAF Stage II Risk Assessment to enable it to meet that objective[2].

The PFMRAF is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or to increase the use of partner country public financial management systems in delivering aid assistance. The enhanced DRG review, led by a USAID/W team, is undertaken prior to or in conjunction with the Mission-led Stage I Rapid Appraisal, and seeks to determine whether a G2G investment could empower a government at the expense of its people. Unless the macro-level Stage I Rapid Appraisal and enhanced DRG review determine that there is unacceptable or unmitigated country level fiduciary risk, political constraints, or other *insurmountable* barriers to the use of partner country systems, an in-depth PFMRAF Stage II risk assessment–which is an entity level assessment–may be completed by the Mission. This Stage II assessment will establish the baseline level of Ministerial entity level risk corresponding to contemplated funding levels, and identify vulnerabilities of the partner country implementing entity. If the assessment reveals clear evidence of vulnerabilities to corruption and other high levels of control risks, and the partner country government fails to respond or agree to appropriate risk mitigation remedy measures, then the use of partner country systems must not be authorized.

USAID/Afghanistan has never conducted the macro-level enhanced DRG review and the PRMRAF Stage I assessments upon GIRoA as required under currently issued Agency Policy–ADS Chapter 220 issued in draft in August 2011 and substantially updated in March 2012. Given the history of G2G assistance in Afghanistan, this situation is understandable. The macro-level assessments are to guide the decision process about whether G2G assistance should be considered as a bilateral assistance objective. In Afghanistan, that decision was made several years ago at the highest levels of the U.S. Government. The Obama administration's foreign policy decision in January 2010, which was reaffirmed by Secretary Clinton and Administrator Shah at the Kabul conference in July 2010, strongly reiterated the U.S. commitment to direct G2G assistance to GIRoA. This commitment was not made subject to review of macro-level risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy–the enhanced DRG review and the PFMRAF Stage I assessment.

Scopes of work for the entity level Ministerial engagements undertaken by GIRoA and USAID may not have complied with every element of the detailed PRMRAF Stage *II*

[2] In August 2011, the Agency issued a new draft policy - ADS Chapter 220 -pertaining to the use of reliable partner country systems for direct G2G assistance. That policy chapter was substantially updated in late March 2012 and continues to undergo modifications - the latest in July 2012, where risk assessment questionnaire guidelines were modified. This ADS chapter with its latest modifications now requires a three-stage approach in the process leading to a decision of whether USAID should consider use of a partner country's systems to implement direct assistance programs.

guidance as currently revised in July 2012, however the Mission believes it has complied with the spirit and purpose of that guidance. In August 2012, USAID/Afghanistan addressed an unofficial Stage I review by internally summarizing responses to assessment guidelines using collective information gathered from public expenditure and financial accountability (PEFA) reports, assessments undertaken by the CPA firms to date, and other informal information available to Mission staff. Using that informal process and Da Afghanistan Breshna Sherkat (DABS) independent CPA firm assessment reports issued in July 2011 and in October 2012, the Mission is documenting through this framework a Stage II equivalent report based upon the most recently updated ADS Chapter 220 guidance.

Objectives

The overall objective of this re-assessment is to determine whether the U.S. government can rely on Da Afghanistan Breshna Sherkat (DABS) systems operation and internal controls to manage donors' funds, and to determine if the identified weaknesses in the initial assessment had been addressed. Specifically the re-assessment will:

- Determine whether DABS' financial management/accounting system is adequate to properly manage and account for donors' funds.

- Determine whether DABS has adequate internal controls to manage donors' funds.

- Determine whether DABS' procurement systems are sufficient to manage donors' funds.

- Determine whether DABS complies, in all material respects, with applicable laws and regulations.

Executive Summary

The United States committed to improving the quality of its aid in order to maximize development benefits in Afghanistan pledged to channel at least 50 percent of its development assistance through the national budget of the Afghan Government[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary risk in the Partner Country Public Financial Management (PFM) systems being considered for direct implementation of USAID-funded assistance. For that reason USAID developed the Public Financial Management Risk Assessment Stage II to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This stage II assessment was performed to determine whether USAID can rely on Da Afghanistan Breshna Sherkat (DABS) systems operation and internal controls to manage donors' funds and to determine if DABS had taken sufficient measures to address weaknesses indentified in the initial assessment. While DABS has taken some measures to address several of the weaknesses identified in the initial assessment, our review found that DABS' systems and internal controls are still not adequate to properly manage and account for donors' funds. The re-assessment noted instances of significant material control weaknesses with the potential of adverse impact on DABS' operations, notably in the area of financial management. Examples of material weaknesses detected in DABS' operations are, lack of reliable financial data, risk of off balance sheet financing, disclaimer of opinion on financial statements, and three years of unresolved financial audit engagements with potential liability implications.

DABS's leadership has taken notable measures to improve governance and provide some structure within the organization. Vacant positions in key functional areas have been filled, policies and procedures were developed, and most of the weaknesses indentified during the initial assessment were addressed. In spite of the notable improvements, DABS' leadership needs to address some major remaining weaknesses. For example, budget to expenditure reconciliation and or comparison needs to be documented, information technology access control policies need to be prioritized, as well as training for new staff.

In the areas of procurement and monitoring and evaluation, DABS has also demonstrated leadership and commitment to progress. Management has developed and implemented a detailed procurement plan which conforms to the Afghan Procurement Law. Management has also established various committees to make sure that procurement activities are in line with the Afghan Procurement Law. However, lack of transparency in the process and serious conflict of interest issues remain unresolved and it is also uncertain if DABS' procurement system is equipped to manage large

[3] London Conference on Afghanistan, January 2010 and the Kabul International Conference on Afghanistan, July 2010.

procurements. Regarding monitoring and evaluation, management has decided to use the newly created Internal Audits Division to assume that responsibility, but concerns remain as to whether the newly created Internal Audit Division has the technical capacity to conduct M&E functions.

In spite of the Director's General aggressive reforms and the corrective measures taken to strengthen DABS, donors must remain vigilant as the operating environment is volatile, and there are still significant operational risks within DABS. However, approaching assistance with precaution and conditions, USAID can reasonably mitigate the identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

Assessment Conclusion & Results

USAID cannot rely on the Da Afghanistan Breshna Sherkat (DABS) systems operation and internal controls to manage donors' funds.

- DABS financial management/accounting system is not adequate to properly manage and account for donors' funds. DABS has been struggling to implement strong financial management internal controls, and off-balance sheet financing remains a high risk.

- DABS's internal controls are not fully adequate to manage donors' funds as most of the internal controls weaknesses identified in the initial assessment remain unaddressed.

- Except for conflict of interest in the procurement process, DABS' procurement system is adequate to manage donors' funds. However, it is uncertain if DABS' procurement system is equipped to manage large procurements.

- No instances of non-compliance with applicable laws and regulations were found.

The internal controls environment is not fully adequate to mitigate risk of corruption. However, the considerable measures management has taken to address most of the governance weaknesses identified in the initial assessment demonstrate to a certain degree the will to address concerns that could lead to corrupt acts. Although considerable risks exist nonetheless we believe they can reasonably be mitigated. See appendix 1

Management and governance structure

The control environment is the pillar of the internal controls structure. It is affected by the attitude and actions of the organization's leadership and senior management. Senior management and the leadership set the tone regarding the importance of standards of conduct, management controls and business practices. In few words the control environment provides, structure, discipline and a sense of purpose. The original assessment found significant weaknesses in DABS' governing structure and a lack of prioritization of key controls. In fact, some fifteen weaknesses raging from missing policies and procedures to vacancies in key positions such as legal adviser and internal audit director were identified during the original assessment. To prove its commitment to good governance, DABS' leadership has taken considerable measures to address most of the fifteen governance weaknesses that were identified in the initial assessment. For example, it developed a business strategy covering fiscal years (FY)[4] 2010 through 2014. It established a Board of Directors and this Board of Directors is involved to a great extent in strengthening DABS' financial management and corporate structuring. In addition, the leadership has developed and approved several policies and procedures, and has recruited a number of key staffs.

[4] As per the Solar Hijri Calendar its FY1388 through FY1392. The Solar Hijri Calendar is the official calendar in Afghanistan and it begins at the start of spring in the northern hemisphere. The Solar Hijri year begins about 21 March of each Gregorian year and ends about 20 March of the next year.

In spite of the notable improvements, DABS' leadership needs to address some major remaining weaknesses. For instance, budgat to expenditure reconciliation and or comparison needs to be documented, information technology access control policies need to be prioritized, as well as training for new staff.

In addition to addressing the remaining major weaknesses, DABS' leadership needs to demonstrate strong commitment to the policies adopted and the actions taken to improve the control environment. Auditors noted that while, the internal audit division is staffed and vacancies in key positions are filled, the leadership has not taken any further active action to ensure sustainability or on-going progress on the measures implemented. According to the auditors, the Board has not yet approved training for key personnel newly hired, and the Board does not regard the internal audit function as important.

Financial Management and Accounting Systems

To achieve success in program implementation a reliable public financial management system and reasonable internal controls activities are vital. The implementation of internal controls activities reduces tne likelihood of fraud, waste and abuse. In most cases good internal controls activities help identify weaknesses in a system, and prompt early corrective actions. DABS has had a weak public financial management system and has been struggling to implement strong financial management internal controls. As in the case of the DABS' governance structure, the assessment found significant weaknesses in DABS' financial management and accounting system. Of the ten weaknesses documented in the initial assessment report, DABS has been able to address only three of the ten. In addition to the remaining seven weaknesses that DABS did not fully address, DABS is also struggling to sustain accomplishments made since the last assessment, as the current assessment detected an additional eight financial management weaknesses. Some of the internal controls weaknesses that DABS is still struggling with are, inability to prepare financial statement in accordance with Generally Accepted Accounting Standards, failure to verify the existence of acquired assets, and failure to bill some customers for their electricity consumption. These weaknesses create opportunities for fraud, including off-balance sheet financing. Evidently, DABS does not have sufficient financial management capacity to manage donors' funds, without strong mitigation measures and/or substantial involvement from donors.

Personnel Policies and Procedures:

To achieve organizational success, senior management must demonstrate a commitment to competence in the human resources processes for attracting, developing and retaining the right individual for the job. DABS' inattention and casual attitude to core human resources processes were central observations during the initial assessment. In 2011 the auditors detected twelve areas of weakness in DABS' human resources processes. Less than a year later DABS has taken action and addressed all but four of the twelve weaknesses. As indication to its commitment to strong human resources practices, DABS has recently implemented an automated attendance system which is linked to its payroll system in Kabul. Proper segregation of duties has been introduced with regards to various payroll functions and salary disbursements to mitigate any measures of misappropriation with regards to payroll. These improvements did not take place initially, but came about as a result of the initial assessment. In spite of the Director General's aggressive goal to reform personnel policies and procedures and fill key positions, capacity building within the organization remains a challenge, as Afghanistan lacks qualified and experienced staff. The lack of qualified staff will likely impact project goals, completion and program outcome, ultimately putting donors' investment at risk.

Procurement and Purchasing system

Procurement is a critical organizational function, as huge amounts of money are spent every year procuring goods and services. Procurement fraud wastes limited funds, and compromises safety. The initial assessment noted seven weaknesses in the procurement process. At the time of reassessment auditors found that DABS had resolved five of the seven weaknesses, leaving two unresolved. The unresolved weaknesses relate to lack of transparent mechanisms to pre-qualify vendors for routine procurements, and conflict of interest in the procurement process. According to the auditors, procurement officers responsible for collecting quotations by personally visiting vendors' shops are the same procurement officers approving vendors to do business with DABS. In addition, it is unclear if the legal department is involved in reviewing critical procurement and contract documents prior to execution. Management's actions to resolve most of the weaknesses are evidence of its commitment to strengthen the procurement and the purchasing system within DABS. However, critical weaknesses with the potential opportunity for fraud and wastes exist and it is uncertain if DABS' procurement system is equipped to manage large procurements. Donors must engage DABS in those areas and develop strong mitigations to overcome those risks.

Program Management and Monitoring

Monitoring is a key component of internal controls, as the flow of information is essential for an organization to execute its responsibilities and support the achievement of its objectives. In the initial assessment Monitoring and Evaluation was noted as an area of weakness in DABS' systems and operation. The monitoring and evaluation unit was understaffed and was basically functioning exclusively for the benefit of one donor. There were no links between senior management and M&E staff and senior management were oblivious to the M&E operations. DABS operating philosophy at the time was that each project and/or donor would fund discrete M&E units for the benefit of a project and/or donor. The auditors, recommended against this approach, as it was redundant, costly, and was detrimental to DABS' internal technical capacity. According to the reassessment's observations, DABS is not planning on organizing a central M&E unit; it plans instead to rely upon its newly established Internal Audit Department to conduct monitoring and evaluation. DABS is definitely responsive to the auditors recommendations, however, there remains concerns as to whether the newly created Internal Audit Division has the technical capacity to conduct M&E functions. Because of these concerns it is uncertain if the DABS can support the achievement of its objectives and safeguard donors' funds against waste and fraud.

Laws, Regulations and Other Matters:

According to DABS's by-laws, its financial statements must be audited within four months after the end of the fiscal year (FY), or by July of each year. In addition, Afghanistan income tax law requires entities such as DABS to file their tax returns at the Tax Authority by the end of the third month following the fiscal year. Moreover, entities cannot file their tax returns without completed financial statements, and DABS in addition to having a disclaimer on its FY2010 financial statements it has not prepared audited financial statements for the last two fiscal years, 2011 and 2012. We followed up with the auditor who conducted the assessments to verify if DABS had filed tax returns for the last three years and if DABS was up to date with its tax liabilities. According to the auditor, DABS has filed tax returns for the last three *years and it* is losing money therefore, not liable for taxes. Furthermore, in 2009 DABS acquired or merged with two local energy firms Da Afghanistan Breshna Mousasa (DABM) and Power Construction Entity (PCE), and as part of the acquisition or merger DABS assumed the liabilities of those companies. The amount of the liabilities is still unclear, but DABS Chief Financial Officer (CFO) identified at least $7 million of outstanding debt to date and the final figure may not be known until March, 2013 when a task force created by DABS appraises the value of assets and liabilities acquired and makes a final determination. As a government entity there was an expectation that GIRoA would guarantee DABS' financial exposure, but DABS' CFO confirmed that DABS is *solely* responsible for all its liabilities and GIRoA does not guarantee DABS' liabilities. The uncertainties regarding DABS' long term viability, legal status, and its financial problems have significant risk implications for donors. One, donors may be funding an entity that is not viable in its current structure, and also donated funds for specific projects could be diverted to pay off loans and liabilities acquired as a results of the acquisitions, thus reducing the likelihood of programs meeting goals and objectives. Donors planning on supporting DABS are highly encouraged to verify the resolution of these matters and get express confirmation from DABS that these issues have been resolved and/or does not put donors' fund at risk.

Risk Assessment Measurement

USAID guidance states, once a risk has been identified, the impact and probability of that risk must be determined. The impact measures the severity of an adverse event associated with the risk and is measured as, Negligible, Marginal, Serious, and Catastrophic. Conversely, probability measures the likelihood of the occurrence of the adverse event associated with the risk and is expressed as, Remote, Occasional, Probable, and Frequent. Combining impact and probability factors categorize risks in clusters of Critical, High, Medium and Low categories. Although subjective, it is nonetheless the basis for the Risk Mitigation plan in USAID.

USAID's PFM Risk Matrix

Impact	*Catastrophic*	High	Critical	Critical	Critical
	Serious	High	High	Critical	Critical
	Marginal	Medium	Medium	High	High
	Negligible	Low	Low	Medium	Medium
		Remote	*Occasional*	*Probable*	*Frequent*
		Probability			

Scope and Methodology

The independently contracted auditors conducted an initial assessment under a scope which focused on five main areas. 1) Financial management/accounting system, 2) Accounting and Internal Controls, 3) Procurement 4) Human Resources and 5) Monitoring and Evaluation. Then a re-assessment was conducted to ascertain if DABS has taken measures to address the weaknesses noted in the initial assessment. While the auditors conducted in-depth assessments on the five areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements. However to ensure the Mission comply with the Agency's guidance and performs required due diligence, we reviewed the auditors' reports and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts who had an understanding of the ministry's systems. We conducted limited research on other work performed on the DABS. Based on auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

Appendix 1

Risk Schedule:

	Risk of	Impact	Probality	Score	Suggested Mitigation Measures
			Management and governance structure		
1.	Not being accountable Management not being committed to sound organizational structure and competence	Serious	Remote	High	1. Approve and circulate the five years strategic plan to key management personnel. 2. Prepare annual budgets using the strategic plan. 3. Compare annual budget to actual results. 4. Prioritize financial management, accounting and internal control issues on agenda items at BOD meetings. 5. Transfer all assistance funding into an escrow bank account.
2.	Waste, fraud and abuse may go undetected Lack of management commitment may create opportunity for fraud to occur	Serious	Oassional	High	1. Convene reguler audit committee meetings and document meeting minutes. 2. Provide training for key personnel including Internal Audit personnel and document those trainings 3. Develop a plan for Internal Audit to perform risk base audit at HQ and hubs 4. Implement basic internal controls in the financial management system. 5. Conduct annual financial and programmatic audits on all USAID projects
3.	Losing vital data and information in the event of system failure or natural disaster	Serious	Ocassional	High	1. Back-up information technology systems regularly on and off site. 2. Complete and approve draft Business Continuity and Disaster Recovery Plans

Financial management and accounting systems					
4.	Stakeholders being misled Making decision based on erroneous financial data Financial data being manipulated to hide illegal actions Diverting donated program funds to pay for penalties Diverting donated program funds to finance unauthorized activities. Engaging in accounting irregularities to hide true financial position.	Serious	Probable	Critical	1. Finalize all outstanding financial statement (2008 to date) 2. Close all open audit recommendations since 2008 3. Introduce General Ledger preparation in the accounting processes. 4. Prepare Trial Balance for all the sub offices. 5. Submit quarterly consolidated financial statements to USAID. 6. Automate the accounting system for HQ and the hubs. 7. Train Financial Management staff on the use of the new accounting software. 8. Prepare financial statement in accordance with International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP). 9. Provide signed statement to USAID that funds provided will not be used to pay fines or liabilities associated with Da Afghanistan Breshna Mousasa (DABM) and Power Construction Entity (PCE) merger. 10. Provide copies of audited financial statements to USAID for the years 2010, 2011, and 2012 11. Develop a chart of accounts that clearly accounts for USAID funds. 12. USAID to conduct: a) Periodic financial review on DABS together with DABS Internal Audit Department. b) Train DABS Internal Audit Department on how to perform a risk base audit.

5.	Diverting government property for personal use Waste fraud and abuse may go undetected Assets not being used for intended purposes	Serious	Ocassional	High	1. Tag all fixed assets with an identification number. - 2. Update fixed assets register on regular basis to reflect: date of purchase, asset type, location, serial number, tagged number. 3. Conduct periodic inventory of fixed assets, possibly every six months. 4. Define the process for inter departmental transfer of assets. 5. Have an approved fixed assets (capitalization) policy 6. Develop a fixed asset management policy. 7. Provide USAID a list of all fixed or long term depreciable assets funded with USAID funds 8. Conduct periodic inventory of all fixed or long-term depreciable assets purchased with USAID funds and send the inventory confirmation to USAID 9. Conduct regular performance audit to include asset verification.
6.	Meter readers conniving with customers to defraud DABS Lost revenues Under reporting of revenues Collecting and unrecorded revenues for personal and illegal use	Catastrophic	Probable	Critical	1. Implement a computerized billing system in all the hubs. 2. Reconcile voltage consumption to receivable account. 3. Categorize customers according to consumption pattern. 4. Conduct comprehensive and nationwide survey on all electricity users and develop and roster. 5. Develop a billing system based on that roster 6. During financial audit have auditors verify the meter readers data 7. Develop revenue projections and compare projections to actual receipts and analyze

	Fostering an environment conducive to fraudulent acts Engaging in off balance sheet financing for resources diversion				differences. 8. Submit annual audited financial statements to USAID.
7.	Misappropriation of petty cash Erroneous posting of financial data	Serious	Ocassional	High	1. Perform monthly surprise cash count. 2. Stamp all invoices received with "Received stamp" and all payment vouchers with "Paid" stamp. 3. Obtain monthly expenditures from all the hubs, using the 'monthly expenditure standard form'.
	Personnel policies and procedures				
8.	Payments to employees for work not done Improper payments to employees.	Serious	Probable	Critical	1. Develop a plan to automat attendance system at the hubs. 2. Document time and attendance for all employees. 3. Link employees pay benefits to the time and attendance register and reconcile regularly. 4. Conduct compliance audit.
9.	Creating unintended conflict of interest conditions Hiring unqualified staff	Serious	Probable	Critical	1. Obtain signed conflict of interest forms from all staff. 2. Conduct annual ethics training for staff. 3. Prepare job descriptions for all key positions.