

# SIGAR

**Special Inspector General for  
Afghanistan Reconstruction**

**OFFICE OF SPECIAL PROJECTS**

## **DIRECT ASSISTANCE: REVIEW OF PROCESSES AND CONTROLS USED BY CSTC-A, STATE, AND USAID**

This product was completed under SIGAR's Office of Special Projects, the Special Inspector General's response team created to examine emerging issues in prompt, actionable reports to federal agencies and the Congress. The work was conducted pursuant to the Special Inspector General's authorities and responsibilities under the National Defense Authorization Act for FY 2008 (P.L. 110-181).



# OCTOBER 2014

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**SIGAR**

Office of the Special Inspector General  
for Afghanistan Reconstruction

October 23, 2014

The Honorable James B. Cunningham  
U.S. Ambassador to Afghanistan

General Lloyd J. Austin III  
Commander, U.S. Central Command

General John F. Campbell  
Commander, U.S. Forces-Afghanistan and  
Commander, International Security Assistance Force

Major General Kevin R. Wendel  
Commanding General, Combined Security Transition Command-Afghanistan

Mr. William Hammink  
USAID Mission Director for Afghanistan

Dear Gentlemen:

I am writing to inform you about the results of SIGAR's review of the systems used by the Department of Defense (DOD), the Department of State (State), and the U.S. Agency for International Development (USAID) for providing direct assistance to the Afghan government.<sup>1</sup> This review focused on the processes and controls used by each agency to ensure the proper use of direct assistance funds.

To fulfill its commitments under the London Conference, the Tokyo Mutual Accountability Framework, and other international conferences of donors supporting the reconstruction of Afghanistan, the U.S. government pledged to provide at least 50 percent of its development aid to Afghanistan in the form of on-budget assistance.<sup>2</sup> On-budget assistance funds are provided by international donors and delivered through the Afghan government for specific programs and projects. Direct assistance funds, a type of on-budget assistance, are channeled through Afghan public financial management and procurement systems, including the government's budget process. The projects funded by direct assistance are managed and implemented by the Afghan government. Direct assistance is intended to provide the Afghan government with increased control over the management of its own budget, while simultaneously building capacity.

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<sup>1</sup> Direct assistance is a type of on-budget assistance that includes host country contracts and government-to-government awards. Other types of on-budget assistance include contributions to multi-donor trust funds and direct budget support. In contrast to USAID, the Department of State's Bureau of International Narcotics and Law Enforcement Affairs does not consider its funding to multilateral trust funds to be "on-budget" assistance.

<sup>2</sup> Although not bound by the commitments made at international donor conferences because their funds are not considered "development aid," DOD and State also began providing direct assistance funds to the Afghan government following these agreements.

Since the U.S. government's commitment to expand its provision of on-budget assistance, DOD has committed nearly \$6.4 billion and disbursed approximately \$3 billion, and State has obligated approximately \$140 million and disbursed nearly \$77 million.<sup>3</sup> USAID has committed and obligated approximately \$668 million and disbursed \$217 million<sup>4</sup> to its bilateral direct assistance programs in Afghanistan and an additional \$1.25 billion through the World Bank's Afghanistan Reconstruction Trust Fund (ARTF).

Our review found that DOD, State, and USAID provide direct assistance through different processes using the Afghan public financial management and procurement systems and that the agencies have instituted a number of controls to help ensure the appropriate use of those funds. More specifically, we found that:

- DOD's direct assistance funds come from the Afghanistan Security Forces Fund. Those funds are disbursed to the Afghan government and overseen by the Combined Security Transition Command–Afghanistan (CSTC-A).<sup>5</sup> CSTC-A provides direct assistance funds to Afghanistan's Ministry of the Interior (MOI) and Ministry of Defense (MOD) to directly support the personnel and mission expenses of the Afghan National Police and the Afghan National Army. CSTC-A transfers direct assistance funds to the Afghan government through a designated account established at Afghanistan's central bank by the Ministry of Finance (MOF) for MOI or MOD expenditures on a quarterly basis, or as otherwise required. To ensure the proper use of these funds, CSTC-A has instituted a number of controls, such as requiring MOI and MOD to develop spending plans, adhere to disbursement conditions contained in formal agreements, and use the Afghanistan Financial Management Information System to record financial transactions. However, CSTC-A has not instituted a number of other controls, such as completing comprehensive assessments of MOI and MOD financial management capacity and internal control systems, requiring submission and approval of invoices and supporting documentation prior to funds disbursement, and establishing a formal monitoring and evaluation plan. Appendix II contains detailed information on the CSTC-A process and associated controls for providing direct assistance.
- State, through its Bureau of International Narcotics and Law Enforcement Affairs (INL), provides direct assistance to the Ministry of Counter Narcotics for the Good Performers Initiative and Governor-Led Eradication program.<sup>6</sup> State INL uses a cost-reimbursement method to disburse its direct assistance funds—as called for in the Consolidated

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<sup>3</sup> These figures are accurate as of November 2013 for CSTC-A; State INL, as of March 2014, and; USAID, as of September 2013. DOD began providing direct assistance funding to the Afghan government in 2011 and State began providing direct assistance to the Afghan government in fiscal year 2009. DOD uses the term "commitment" for the amount of funding it agreed to provide to the Afghan government. USAID uses the term "commitment" to describe an internal control mechanism to ensure that USAID does not over-obligate funding. An "obligation" is a term of appropriations law that creates a legal liability of the government for the payment of funds for specific goods or services ordered or received. Consequently, we use different terms depending on which agency we are discussing.

<sup>4</sup> Of the \$217 million in disbursements, approximately \$208 million was disbursed for programs that were within the scope of this review. The remaining \$9 million was disbursed to programs that were no longer active, as of September 30, 2013, and not included in our scope.

<sup>5</sup> CSTC-A's standard operating procedures for providing direct assistance designate CSTC-A's CJ8 Directorate as the comptroller for the CSTC-A budget and as the unit responsible for building financial management capability in the ministries and overseeing DOD's direct assistance funding to the Afghan Ministries of the Interior and Defense.

<sup>6</sup> The Good Performers Initiative provides development assistance to provincial governors to reduce or eliminate poppy cultivation, or to maintain a poppy-free status. The Governor-Led Eradication program promotes the involvement of provincial governments in eradicating poppy crops by reimbursing expenses incurred as a result of poppy elimination efforts, including equipment and personnel costs.

Appropriations Act, 2012.<sup>7</sup> State INL’s method requires both the ministry and State INL to review and approve implementer invoices and supporting documentation prior to funds disbursement. State INL has also instituted several other controls to ensure that the direct assistance funds it provides to the Afghan government are properly used. For example, State INL requires the Ministry of Counter Narcotics to provide bank statements, monthly reports on the use of funds, and photographs of projects in various stages of completion. Although State INL has multiple controls in place to protect its direct assistance funds from misuse, they did not require the completion of a comprehensive assessment of the Ministry of Counter Narcotics’ capacity to manage and account for direct assistance funds prior to disbursement. Appendix III contains detailed information on the State INL process and associated controls for providing direct assistance.

- USAID has disbursed nearly \$208 million for the five active direct assistance programs in our review.<sup>8</sup> As called for by the Consolidated Appropriations Act, 2012, USAID uses a cost-reimbursement method of disbursement to fund its direct assistance programs.<sup>9</sup> USAID’s process requires both the ministries and USAID to review and approve implementer invoices and supporting documentation prior to funds disbursement. USAID has also instituted many other controls, including reporting/documentation requirements, audit/financial reporting and review standards, a monitoring and evaluation plan, and the establishment of a special joint bank account for disbursement. While USAID has instituted many controls to help protect its direct assistance funds, it has not ensured the appropriate implementation of all its required controls. For example, in January 2014, we reported that “conditions precedent”—actions USAID requires ministries to take prior to the initial disbursement of funds—were USAID Mission in Afghanistan’s (USAID/Afghanistan) primary method for addressing the risks it identified in its ministerial capacity assessments and internal risk reviews.<sup>10</sup> However, we found that USAID/Afghanistan only included 24 of 333—less than 8 percent—of the identified mitigation measures as conditions precedent in its implementation letters with those ministries. USAID’s low adoption rate of risk mitigation measures as conditions precedent is concerning because it allows direct assistance funds to flow to ministries that have not fixed their weaknesses—weaknesses that can expose U.S. government funds to waste, fraud, and abuse and undermine the effectiveness of other safeguards. For example, while USAID has a formal monitoring and evaluation plan in place for the Ministry of Public Health, USAID’s risk review of that ministry found there was a serious risk of the ministry “concealing vital monitoring and evaluation information.” Appendix IV provides detailed information regarding USAID’s process and associated controls for providing direct assistance.<sup>11</sup>

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<sup>7</sup> Pub. L. No. 112-74, § 7031(a), 125 Stat. 786, 1209-10 (2011). See also, Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, § 7031, 128 Stat. 5, 509-12.

<sup>8</sup> USAID has also contributed \$1.25 billion to the World Bank-administered ARTF, which is the primary mechanism by which the international community provides non-security on-budget assistance to the Afghan government. The direct assistance funds USAID provides to the Afghan government comes from its Economic Support Fund and is intended to finance numerous development and infrastructure projects and programs. For example, USAID provided direct assistance to support improvements to the national electric transmission system, provide credit to small commercial farmers and agribusinesses, deliver and expand health services, and build civil service capacity and organizational governance, among many other projects.

<sup>9</sup> Pub. L. No. 112-74, § 7031(a), 125 Stat. 786, 1209-10 (2011).

<sup>10</sup> SIGAR-14-32-AR. *Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries’ Ability to Manage Donor Funds, but Concerns Remain*, January 30, 2014.

<sup>11</sup> *Id.*

Building the Afghan government's capacity to deliver better governance, economic development, and security for the Afghan people through direct assistance has been a priority of U.S. government agencies and international donors for years. However, providing direct assistance to institutionally weak Afghan government ministries remains a concern and requires U.S. agencies to institute a comprehensive control regime and conduct robust oversight to protect those funds from waste, fraud, and abuse. While even the required use and consistent application of all of the controls identified in the appendices cannot fully prevent corrupt actors from taking advantage of U.S. government direct assistance funds, we generally believe that agencies should strive to institute and appropriately apply these controls.

In commenting on a draft of this letter, CSTC-A stated that it has taken steps to improve the Afghan government management of the Afghan Security Forces Fund to include implementing controls and adding "stronger language that close loopholes and ambiguity in the fiscal year [2015] Commitment Letters." For example, CSTC-A now requires the MOF to create a separate treasury account for CSTC-A funds, provide monthly submission of account statements, and grant CSTC-A access (read only) to this account to ensure funds are expended properly. CSTC-A also now requires the ministries to adhere to Generally Accepted Accounting Principles. We commend CSTC-A for undertaking these measures. CSTC-A's comments are reproduced in Appendix V.

In its comments, State INL said that it is taking steps to correct potential deficiencies in its controls over direct assistance funds. For example, on September 17, 2014, State INL awarded a contract to conduct a comprehensive public financial management risk assessment of the Ministry of Counter Narcotics. State INL agreed with SIGAR that the Ministry should adhere to applicable international accounting standards and is investigating adding language to its Memoranda of Agreements with the Afghan government to that effect. We commend State INL for undertaking these measures. State INL's comments are reproduced in Appendix VI.

As for USAID, officials stated that our observations contained "some significant misrepresentations." First, USAID believes that our observations did not fully reflect the agency's use of conditions precedent as a risk mitigation measure. We disagree. We describe in Appendix IV the controls that USAID has implemented in order to help safeguard its direct assistance funds to include the use of conditions precedent. We did not seek to rate them in order of importance. In fact, we acknowledge that USAID has used conditions precedent, albeit on a limited basis because of the high number of vulnerabilities within Afghan ministries identified by USAID's own assessments. We also acknowledge USAID's efforts to establish other types of controls to protect U.S. taxpayer funds from those vulnerabilities. Notwithstanding the use of conditions precedent and other controls, USAID does not require the ministries to address critical administrative, operational, and systematic weaknesses prior to receiving direct assistance funds. We maintain that requiring Afghan ministries to take the necessary corrective actions to address vulnerabilities would help them reduce the risk of waste, fraud, and abuse in the event that any of USAID's existing controls fail.

Second, USAID disagreed with our observation that the Partnership Contracts for Health Services program is more vulnerable to waste, fraud, and abuse because the program is funded with monies paid in advance of costs incurred. USAID stated that it processes payments associated with the program based on "advances and liquidations," which are in turn based on actual costs. We maintain that funds provided to the Afghan government *in advance* of costs actually incurred are at risk because the ministries do not have the systems operation or internal controls in place to appropriately manage U.S. funds.

USAID also acknowledged the need for timely third-party audits, stating that it has modified its audit requirements and is “now contracting and actively managing the required audits of the ministries.” However, USAID stated that it does not perform internal audits. Instead, it has adopted “compensating measures” such as access to disbursement bank accounts and monthly reconciliations of expenditures. As our letter states, by not conducting internal audits, USAID is limited in its ability to identify and address issues as they arise. USAID’s comments are reproduced in Appendix VII.

Sincerely,



John F. Sopko  
Special Inspector General  
for Afghanistan Reconstruction

Encl:

Appendix I: Scope and Methodology

Appendix II: Department of Defense Process and Associated Controls for the  
Provision of Direct Assistance

Appendix III: Department Of State Process and Associated Controls for the  
Provision of Direct Assistance

Appendix IV: U.S. Agency for International Development Process and  
Associated Controls for the Provision of Direct Assistance

Appendix V: DOD Comments

Appendix VI: State Comments

Appendix VII: USAID Comments

## APPENDIX I: SCOPE AND METHODOLOGY

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This report provides the results of SIGAR's review of the processes by which the Department of Defense (DOD), the Department of State (State) and the U.S. Agency for International Development (USAID), provide direct assistance funds to the Afghan government and the extent to which those agencies employ controls to protect those funds.

In order to identify a comprehensive set of controls used by the U.S. government agencies providing direct assistance funds, we interviewed Combined Security Transition Command–Afghanistan (CSTC-A), USAID, and State's Bureau of International Narcotics and Law Enforcement Affairs (INL) officials in Kabul, Afghanistan and reviewed agency operating procedures, policies, guidance, reports, and agreements with the Afghan government. Since other international donor organizations, such as the World Bank and Asian Development Bank (ADB), also provide direct assistance funds to the Afghan government, we interviewed officials from both organizations and reviewed guidance from those organizations to identify additional controls that U.S. agencies could use to better protect direct assistance funds. Based on this review, we identified a list of internal controls used by at least one of the agencies or multilateral organizations and provided this list to CSTC-A, State, and USAID. We asked each agency to (1) indicate whether each internal control is used, and (2) if used, to provide documentation to verify the use of the internal control. For CSTC-A, we assessed the process and implementation of internal controls for the provision of funds to both Ministry of Defense (MOD) and Ministry of Interior (MOI). For USAID, we assessed the process and implementation of internal controls for USAID's five active programs that had disbursements as of June 2013: (1) Agriculture Development Fund, (2) Basic Education and Literacy and Vocational Education Training, (3) Civilian Technical Assistance Program, (4) Grant Agreement to Support Civil Service Reform, and (5) Partnership Contracts for Health Services. For State INL, we assessed the direct process and implementation of internal controls for its two direct assistance funds programs: (1) Good Performers Initiative and (2) Governor Led Eradication.

As a result of this work, we found that the agencies were using the following controls to help protect direct assistance funds:

- **Ministerial capacity assessment:** The agency completes a comprehensive assessment of each ministry's financial management capacity and internal control systems prior to disbursing direct assistance.
- **Formal agreement with the Afghan government:** The agency enters into a formal agreement with the government of Afghanistan that defines funding levels and other expectations prior to fund disbursement.
- **Funds disbursement conditions:** The agency establishes conditions for the ministry to meet prior to fund disbursement.
- **Reporting/documentation requirements:** The agency requires the ministry to provide specific documentation in order to receive direct assistance.
- **Audit/financial reporting standards:** The agency requires the Afghan ministry to maintain books and records in accordance with generally accepted accounting principles prevailing in the United States or other accounting principles, such as those prescribed by the International Accounting Standards Committee or prevailing in Afghanistan.
- **Monitoring and evaluation plan:** The agency establishes a formal monitoring and evaluation plan to oversee the disbursement and implementation of direct assistance.

- **Risk mitigation strategy:** The agency establishes a risk mitigation strategy that determines how to mitigate risks associated with providing direct assistance funds to the ministries *and* lays out a plan for addressing the underlying problems within the ministries.
- **Ministerial capacity building:** Based on ministerial needs, the agency establishes a program to develop the ministry's ability to manage direct assistance.
- **Special joint bank account for disbursement:** The agency establishes a separate, non-interest bearing bank account for each direct assistance funds program.
- **Ministerial submission and agency review of invoices and supporting documentation prior to disbursement:** The agency requires the ministry to submit invoices and supporting documentation for its review and approval prior to disbursing funds.
- **Review of condition satisfaction prior to disbursement:** The agency reviews documentation to ensure that the ministry met the conditions, as detailed in the formal agreements, prior to disbursing funds.
- **Reimbursement method of disbursement:** The agency receives a payment request from the ministry, reviews the request and supporting documentation, approves or disapproves the disbursement, and, if approved, initiates payment.
- **Funds held outside of Afghan financial sector until disbursement:** The agency does not put direct assistance funds into a bank account in Afghanistan until it initiates disbursement for a specific payment request.
- **Visibility over disbursement bank account:** The agency has viewing access over the bank account to which funds are disbursed.
- **Monitor direct assistance funds implementation:** The agency monitors programmatic progress, achievements, and constraints.
- **Internal audit of funds:** The agency itself performs audits of direct assistance funds that provide findings and recommendations to mitigate risk.
- **Third-party audit of funds:** The agency contracts with a third-party organization or assists the recipient-ministry in contracting for third-party audits of direct assistance funds that provide findings and recommendations to mitigate risk. The audits are completed within 4-6 months of the end of the fiscal year.
- **Reconciliation and reduction of ineligible expenditures:** The agency reconciles funding to determine if there were any ineligible expenditures. If ineligible expenditures are found, the agency provides an invoice to the recipient ministry or reduces the level of future funding.

We reviewed documentation that covered the period from July 2008 to January 2014. We did not rely on computer-processed data for the purpose of the audit objective. With respect to assessing internal controls, we reviewed the processes and controls that each agency has in place to internally control its contribution to direct assistance. The results of our review are included in the body of this report.

We conducted our review in Kabul, Afghanistan, and Washington, D.C., from June 2013 through March 2014, in accordance with SIGAR's quality control standards. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to meet our stated objectives and to discuss any limitations in the work. We believe that the information and data obtained, and the analysis performed, provide a reasonable basis for our findings. This work was conducted under the authority of Public Law No. 110-181, as amended; the Inspector General Act of 1978, and the Inspector General Reform Act of 2008.

## APPENDIX II: DEPARTMENT OF DEFENSE PROCESS AND ASSOCIATED CONTROLS FOR THE PROVISION OF DIRECT ASSISTANCE

The Department of Defense (DOD) provides the Afghan government with direct assistance from the Afghanistan Security Forces Fund. These funds are disbursed to the Afghan government and overseen by the Combined Security Transition Command–Afghanistan (CSTC-A).<sup>12</sup> CSTC-A provides direct assistance funds to Afghanistan’s Ministry of the Interior (MOI) and Ministry of Defense (MOD) to directly support the personnel and mission expenses of the Afghan National Police and the Afghan National Army. Since March 2011, DOD has committed approximately \$6.38 billion in direct assistance to MOI and MOD, of which nearly \$3 billion has been disbursed.<sup>13</sup> In the first year, DOD committed \$1.05 billion and disbursed \$752 million. By March 2013 (or Afghanistan’s solar year 1392), commitments increased to \$2 billion with disbursements of \$1.44 billion. This represents approximately a 91 percent increase in commitments and disbursements in 2 years. Table 1 shows the amount of direct assistance CSTC-A has committed and disbursed to the Afghan government.

**Table 1 – CSTC-A Direct Assistance Provided to the Afghan Government**

Ministry	Commitments (\$)	Disbursements (\$)
Ministry of Defense	4,262,230,000	2,011,640,000
Ministry of the Interior	2,120,234,168	985,800,000
Total	6,382,464,168	2,997,440,000

Source: CSTC-A funding figures.

Note: Data as of November 2013

To provide the Afghan government with these direct assistance funds, CSTC-A transfers funds to the Afghan government—through a designated account established at Afghanistan’s central bank by the Ministry of Finance (MOF) for MOI or MOD expenditures—on a quarterly basis, or as otherwise required. The process CSTC-A uses to provide direct Afghanistan Security Forces Funds to the Afghan government begins with a request from the MOF for direct assistance contributions from CSTC-A. In this request, CSTC-A requires the MOF to include, at a minimum, the amount of the Afghan government’s planned contribution and the requested amount and primary purpose of CSTC-A direct assistance.<sup>14</sup> CSTC-A then coordinates with the MOI and MOD to develop an annual Direct Contributions Plan based on the MOF request, and, after approval from the Office of Under Secretary

<sup>12</sup> CSTC-A’s standard operating procedures for providing direct assistance designate CSTC-A’s CJ8 Directorate as the comptroller for the CSTC-A budget and as the unit responsible for building financial management capability in the ministries and overseeing DOD’s direct assistance funding to the MOI and MOD.

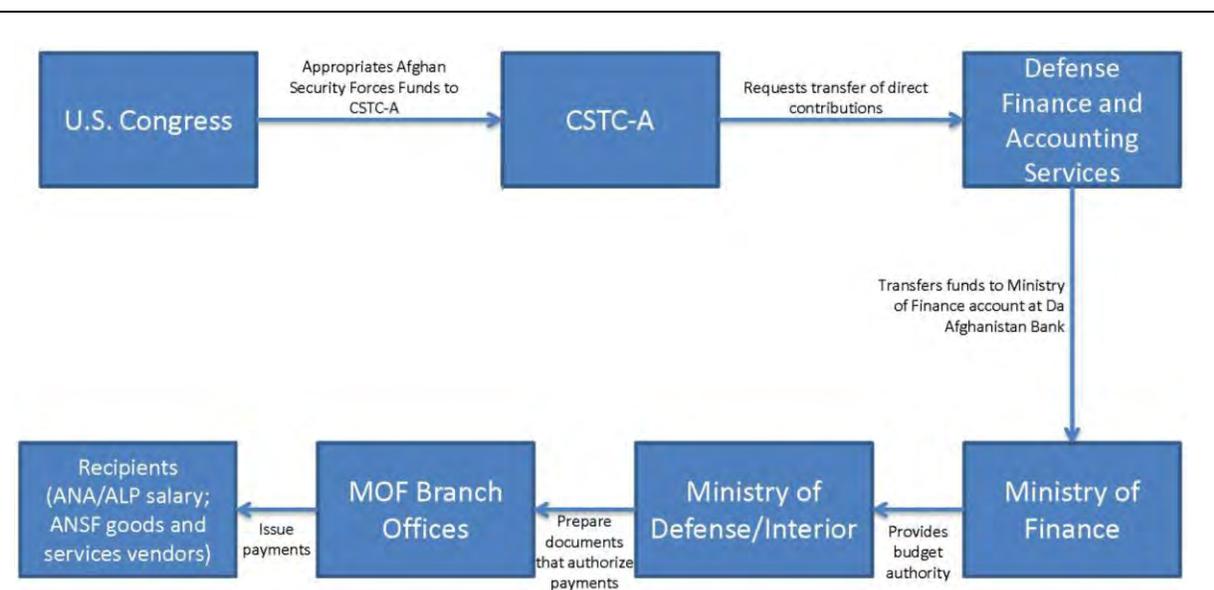
<sup>13</sup> DOD did not provide direct assistance from the Afghanistan Security Forces Fund until February 2011. DOD began providing direct assistance in March 2011 (or Afghanistan’s solar year 1390). Prior to February 2011, DOD provided on-budget assistance through contributions to the United Nations Development Program-administered Law and Order Trust Fund (LOTFA). Although DOD now provides direct assistance to MOI and MOD through CSTC-A, it still contributes to LOTFA and United Nations data show that DOD remains the largest contributor. Since the LOTFA was established, DOD has contributed approximately \$855 million.

<sup>14</sup> The MOF request letter must also identify the methodology used to derive the requested assistance and identify any previous agreements that factored into the calculations.

of Defense (Comptroller), notifies Congress. The terms of the transfer are then formalized through commitment letters signed by the CSTC-A Deputy Commanding General, the Afghan Ministers of the Interior or Defense, respectively, and the Afghan Minister of Finance. These agreements outline specific assistance amounts, a timeline for providing the funds, and the budgetary categories for which the funds may be used.

To disburse funds, CSTC-A requests a transfer of direct assistance to an MOF account at Da Afghanistan Bank—Afghanistan’s central bank—using the Defense Finance and Accounting Services. The MOF provides budget authority to the MOI and MOD. The ministries then coordinate with the MOF branch offices<sup>15</sup> to (1) make salary payments to the Afghan Local Police and the Afghan National Army<sup>16</sup> or (2) make payments to vendors for goods and services. Prior to the funds transfer from MOF to MOI and MOD, the MOF provides CSTC-A with an acceptance letter, stating that MOF accepts and confirms the purpose and amount of funds to be disbursed and the bank account to be used in facilitating the actual transfer. Figure 1 shows the basic process CSTC-A uses to provide direct assistance funds to the Afghan government.

**Figure 1 – CSTC-A Direct Assistance Process**



Source: SIGAR analysis of CSTC-A interviews and documentation.

To help protect these funds from waste, fraud, and abuse, CSTC-A has instituted several controls, including the requirement for formal agreement with the Afghan government, establishment of funds disbursement conditions and reporting requirements, and the development of a risk mitigation strategy. While CSTC-A has instituted several other controls, they have not always been effectively implemented. For example, CSTC-A relies on information entered into the Afghanistan Financial

<sup>15</sup> MOF branch offices are referred to as mustofiat. In Afghanistan, the MOF serves as the budget office to the President, the government payment service, and the treasury. Funds flow down to provinces via the MOF, and provincial government entities tap into these resources at the provincial level. Funding authority is maintained at the mustofiat with an account for each government service. When those services need funding, they visit the local mustofiat.

<sup>16</sup> The Afghan National Police personnel’s salaries are paid through the Law and Order Trust Fund for Afghanistan.

Management Information System (AFMIS) to monitor the use of its direct assistance, perform internal audits, and reconcile and reduce ineligible expenditures—three important controls. However, according to CSTC-A officials, this system is not consistently used by MOI and MOD and CSTC-A cannot verify the accuracy of the data entered into the system.

The following list describes the controls CSTC-A has implemented:

- *Formal agreement with the Afghan government:* Prior to providing any direct assistance, CSTC-A signed a memorandum of agreement with the Afghan Ministry of Finance (MOF), Ministry of Defense (MOD), and Ministry of Interior (MOI). The agreement outlined the specific amount, time period, budgetary codes eligible for funding, and purpose of the funding. The memorandum stated that at the request of the Afghan government, disbursements would be provided as necessary based on, but not limited to, actual expenditure rates and estimated expenditure forecasts. At a minimum, requests for funds were due to CSTC-A no later than 15 days prior to the beginning of each quarter.
- *Funds disbursement conditions:* In its funding commitment letter for 2013 (Afghanistan's solar year 1392), CSTC-A required the MOI and MOD to provide supporting documentation such as payroll records and electronic funds transfer reports with each quarterly funding request. In addition, CSTC-A's draft commitment letters for 2014 (Afghanistan's solar year 1393) established 27 conditions for the MOI and MOD to meet in order to receive funds. Conditions included: the prohibition of the reallocation of funds without explicit authorization from CSTC-A, mandatory use of AFMIS before contracts (to be funded with direct assistance) are awarded, and the creation of a prioritized "Spend Plan" broken out by quarters, budgetary units, and object code. If the MOI and MOD do not meet the conditions, CSTC-A may reduce the amount of funding.
- *Risk mitigation strategy:* CSTC-A identified financial management and internal control challenges at MOI and MOD and implemented measures to address those weaknesses. Measures include (1) placement of Afghans with financial management expertise within the ministries to help build capacity, (2) a proposed process to withhold direct assistance in the event that unauthorized spending is discovered, and (3) the establishment of 27 conditions in the draft fiscal year 2014 (or Afghanistan's solar year 1393) commitment letters that Afghan ministries are required to meet in order to receive full funding. CSTC-A's 27 conditions include the prohibition of reallocation of committed funds without CSTC-A's authorization, mandatory use of AFMIS, and the requirement that all miscoding errors discovered in procurement data must be corrected within 15 days of notification.
- *Reporting/documentation requirements:* CSTC-A, in its commitment letters, stipulated the documentation that it required the Afghan ministries to provide for the disbursement of funds. However, in its written response to our request for information, CSTC-A stated that documentation is sporadically received from MOI and MOD. CSTC-A officials stated that most of the invoices and other payment documentation were processed in remote areas in Afghanistan, delivered to the MOF mustofiats, and then entered into AFMIS. Further, the documents delivered to mustofiats were often incomplete and their delivery was dependent on the security situation in the area. This, in effect, reduced CSTC-A's ability to conduct robust oversight of the funds, making it reliant on the sporadic, unreliable information entered into AFMIS by the provincial mustofiat.
- *Ministerial capacity building:* CSTC-A's commitment letters required it to advise the ministries in budgeting and financial management and "direct, influence, and increase the capacity of the [ministry] personnel." One effort was a CSTC-A program to fund 50 civilian subject matter

experts within MOI to help fulfill critical functions. Our December 2013 report also found that CSTC-A deployed advisors to the MOD and MOI to work with Afghan officials in building their ministerial capability.<sup>17</sup> CSTC-A also identified the ministry offices that have financial and/or acquisition authority, including Finance, Logistics, and Procurement. The advisors used the Capabilities Milestone system to measure and track the progress made by each ministry in approving its capability to operate independently. However, CSTC-A officials stated that efforts to build ministerial capacity have been unsuccessful.

- *Reconciliation and reduction of ineligible expenditures:* CSTC-A performed annual reconciliation as a final attempt to correct improper MOI or MOD charges to the Afghanistan Security Forces Fund code. This process involved CSTC-A performing a review of the data available in AFMIS and noting the number of transactions, along with the associated amount and charged code, that were improperly paid with CSTC-A funding. Additionally, all contributions must be either obligated, on a contract, or completely disbursed by the ministries prior to the end of Afghan fiscal year in which the contribution was made. CSTC-A then documented unobligated or undisbursed amounts each fiscal year, and the MOF retained unexecuted funds in a holding account on behalf of CSTC-A. CSTC-A considers these residual amounts when developing Afghanistan Security Forces Funds contribution plans for future support. To perform the reconciliation and reduction of ineligible expenditures however, CSTC-A officials used AFMIS data, about which they expressed concerns due to their inability to verify its accuracy.

Although CSTC-A instituted the above controls, it has not instituted many others. For example, CSTC-A did not conduct a comprehensive assessment of the financial management capacity and internal controls of MOI and MOD prior to disbursing direct assistance funds, require visibility over the bank account from which the Afghan government disburses the funds it receives from CSTC-A, or conduct third-party audits. In addition, CSTC-A's process of providing direct assistance funds on a quarterly basis to the Afghan government, while in accordance with CSTC-A's standard operating procedures, limited CSTC-A's ability to implement a number of controls. For example, CSTC-A's method of disbursement limits its ability to require the establishment special joint accounts for disbursement, ministerial submission and approval of invoices and supporting documents prior to disbursement, and review of condition satisfaction prior to disbursement. The adoption and appropriate implementation of the following controls may help CSTC-A further protect its direct assistance funds from waste, fraud, and abuse:

- *Ministerial capacity assessment:* CSTC-A did not complete a comprehensive assessment of ministerial financial management capacity and internal control systems. CSTC-A has examined the capacity and controls of individual offices within the ministries and conducted financial risk assessment for some, but not all, Afghan budget requirements for direct assistance. These risk assessments are limited to financial risks associated with the procurement of a particular good or service. CSTC-A's process did not enable it to determine core functional capacity across each ministry, provide trainers and decision makers with an understanding of systemic shortcomings of each ministry's financial management capacity, or identify risk associated with capacity weaknesses.

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<sup>17</sup> SIGAR-14-12-SP, *Comprehensive Risk Assessments of MOD and MOI Financial Management Capacity Could Improve Oversight of Over \$4 Billion in Direct Assistance*, December 03, 2013.

- *Audit/financial reporting standards:* CSTC-A did not require the Afghan ministries to maintain accounting records in accordance with generally accepted accounting principles. CSTC-A officials expressed concern that it would be “impossible” for the ministries to meet this standard, given the ministerial reliance on paper documentation, and stated that the ministerial financial records are “unauditable.”
- *Monitoring and evaluation plan:* CSTC-A did not have a formal monitoring and evaluation plan for its direct assistance funds but, rather, monitored the funds it provided through its reviews of AFMIS data. In conducting the reviews, CSTC-A examined the transactional data for a certain period and identified ineligible expenditures. These ineligible transactions were for expenses that were originally paid for with CSTC-A funds. However, CSTC-A’s review of the AFMIS data determined that the transactions were associated with spend categories for which CSTC-A did not provide funding.
- *Special joint bank account for disbursement:* CSTC-A used a single Afghan Treasury account to transfer its funds to the Afghan government. This account is at Da Afghanistan Bank—Afghanistan’s central bank—and is controlled by the MOF Treasury, which disbursed funds to MOD and MOI periodically. According to CSTC-A, it has almost no control once the funds arrive in the MOF account. CSTC-A has access to AFMIS, which allows its representatives to see how much is spent and to review the purpose for which the ministries stated they intended to use the funds, but it does not have access to the bank accounts into which it disburses funds to ensure funds were properly and expediently disbursed to recipients.
- *Ministerial submission and CSTC-A review of invoices and supporting documentation prior to disbursement:* Given CSTC-A’s quarterly disbursement method, the MOI and MOD did not submit invoices and supporting documentation for review and approval by CSTC-A prior to disbursement. Rather, the funds went into the MOF bank account and MOF provided budget authority to the ministries on a periodic basis.
- *Review of condition satisfaction prior to disbursement:* As part of its conditions for the disbursement of funds, CSTC-A required the ministries to provide AFMIS data showing object codes, object descriptions, and the total amount of funds committed, disbursed, and expended. CSTC-A officials reviewed the AFMIS data to identify ineligible expenditures and required the Afghan government to document and correct the erroneous transactions identified. However, this process did not apply to the initial disbursement of funds, but, rather, only to subsequent disbursements. Therefore, while these officials’ efforts were sufficient to verify the reconciliation and reduction of ineligible expenditures, they do not constitute a review of condition satisfaction prior to disbursement. In its draft fiscal year 2014 (or Afghanistan’s solar year 1393) commitment letters, CSTC-A stated it will provide conditional funding to MOI and MOD. Since this process had not taken effect by the time we completed fieldwork, we cannot verify CSTC-A’s review of condition satisfaction prior to disbursement.
- *Funds held outside of Afghan financial sector until disbursement:* Once Congress appropriates money for the Afghanistan Security Forces Fund, CSTC-A receives and manages some of those funds for direct assistance. CSTC-A then authorizes the Defense Finance and Accounting Service to disburse the agreed-upon direct assistance. The funds are kept in CITIBANK New York and transferred to an MOF account in Da Afghanistan Bank on quarterly, or as required bases. The MOF provides allotments (budget authority) to MOI and MOD on a periodic basis. Therefore, the funds are held within the Afghan financial sector prior to disbursement from DAB to MOI or MOD.

- *Visibility over disbursement bank account:* CSTC-A officials do not have visibility into the MOF bank account into which it disbursed funds. According to CSTC-A officials, their only way of ensuring that their direct assistance funds were disbursed as intended is by reviewing the expenditure codes in AFMIS, which are entered by MOI or MOD personnel.
- *Monitor direct assistance funds implementation:* CSTC-A officials reported issues with the monitoring of direct assistance funds implementation due to the continued widespread use of paper documentation for MOI and MOD procurements and salaries. CSTC-A's monitoring efforts relied on sporadic, unverifiable information entered into AFMIS by the MOF.
- *Internal audit of funds:* CSTC-A lacked capacity to conduct internal audits of funds because the CSTC-A directorate's audit team consisted of only four auditors who received on-the-job training but are not professional auditors. The team also experienced difficulty in obtaining requested documents. We released a report in December 2013 that highlighted internal audit issues, including the following: (1) CSTC-A was understaffed relative to its oversight responsibilities, (2) the majority of CSTC-A personnel who conducted oversight are not trained financial auditors, and (3) CSTC-A orders that increased security measures for all CSTC-A visits reduced interaction between advisors and their Afghan mentees.<sup>18</sup> CSTC-A officials agreed there is a need for more auditors to oversee its direct assistance funds programs, and, in its response to our December 2013 Report, CSTC-A stated it was formally pursuing additional manpower through two requests for assistance, a request for forces, and a request to realign 18 vacant billets from elsewhere in CSTC-A. CSTC-A's disbursements were made quarterly, or upon requests from MOI or MOD.
- *Third-party audit of funds:* CSTC-A officials stated they were unaware of any CSTC-A-contracted third-party audits that examined direct assistance. CSTC-A officials also stated they were unaware of any ministry-contracted third-party audits that examined direct funding.

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<sup>18</sup> SIGAR-14-12-SP, *Comprehensive Risk Assessments of MOD and MOI Financial Management Capacity Could Improve Oversight of Over \$4 Billion in Direct assistance*, December 03, 2013.

## APPENDIX III: DEPARTMENT OF STATE PROCESS AND ASSOCIATED CONTROLS FOR THE PROVISION OF DIRECT ASSISTANCE

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The Department of State (State), through its Bureau of International Narcotics and Law Enforcement Affairs (INL) has provided direct assistance to the Ministry of Counter Narcotics (MCN) for the Good Performers Initiative (GPI) and Governor-Led Eradication program (GLE).<sup>19</sup> Table 2 shows the amount of direct assistance funds INL has obligated and disbursed to the Afghan government for these two programs.

**Table 2 - State INL Direct assistance funds for Two Ongoing Programs**

Program	Ministry	Total Obligations (\$)	Total Disbursements (\$)
Good Performers Initiative	Ministry of Counter Narcotics	132,855,856	71,619,715
Governor Led Eradication	Ministry of Counter Narcotics	7,041,151	4,928,152
Total		139,897,008	76,547,868

Source: State INL data.  
Note: Data as of March 4, 2014

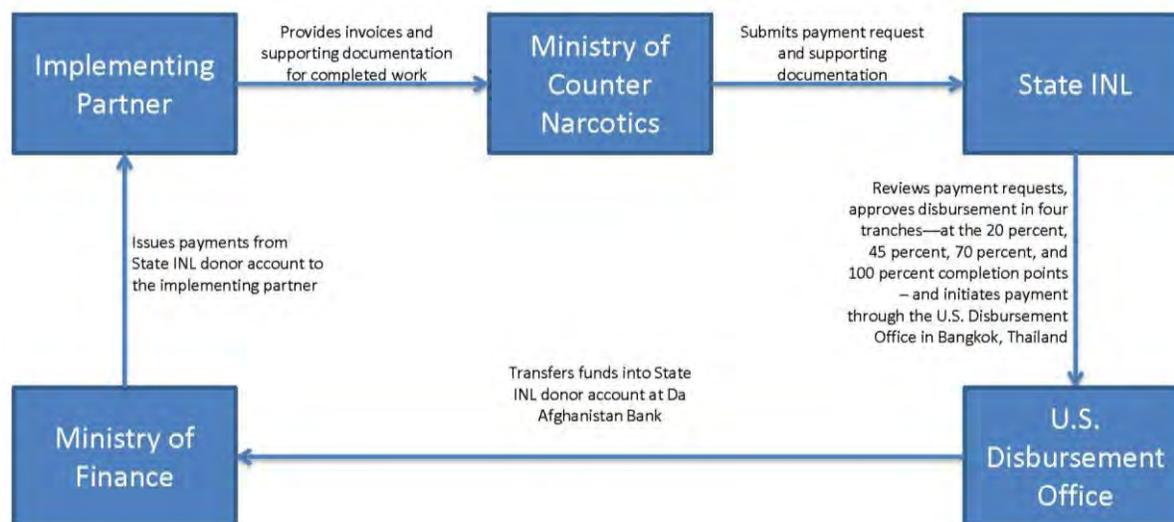
To provide these direct assistance funds to the Afghan government, State INL uses a reimbursement process that provides funds for completed work. The U.S. government has established a number of bilateral Letters of Agreement with the Afghan government that provide State INL the framework under which it operates in Afghanistan. State INL also has memoranda of understanding and “implementation instructions” with the MCN and the Ministry of Finance (MOF) for the provision of its direct assistance programs. In those agreements, State INL and MCN establish the policies and procedures for the implementation of the GPI and GLE programs, and the conditions that must be met prior to the disbursement of program funds. State INL and the MCN first determine if a province is eligible for Good Performers Initiative (GPI) funding. Following that determination, the MOF opens a non-interest-bearing bank account that is separate from other funding streams. MCN and State INL then select the projects that will be implemented with GPI funding. The implementing partner performs the work and provides invoices and supporting documentation to MCN, which then submits a payment request and supporting documentation to State INL. State INL reviews the supporting documentation and payment request, verifies their accuracy and, with concurrence from MCN, approves disbursements in four installments—at 20 percent, 45 percent, 70 percent, and 100 percent of project completion. The MOF disburses funds to the implementing partner based on invoice submission, monitoring reports, and MCN/State INL approval. Figure 3 shows the basic process State INL uses to provide GPI funds to the Afghan government.<sup>20</sup>

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<sup>19</sup> The Good Performers Initiative provides development assistance to provincial governors to reduce or eliminate poppy cultivation, or to maintain a poppy-free status. The Governor-Led Eradication program promotes the involvement of provincial governments in eradicating poppy crops by reimbursing expenses incurred as a result of poppy elimination efforts, including equipment and personnel costs.

<sup>20</sup> The GLE program has a different disbursement method than GPI; it receives a report from the United Nations Office on Drugs and Crime that details the amount of poppy eradicated. State INL then uses this report to pay a pre-determined dollar amount per hectare of poppy eliminated.

Figure 2 – State INL Good Performer’s Initiative Direct Assistance Process



Source: SIGAR analysis of State INL interviews and documentation.

To help protect these funds from waste, fraud, and abuse, State INL has instituted multiple controls, including the requirement for formal agreement with the Afghan government, establishment of funds disbursement conditions and reporting requirements, and the review of conditions satisfaction prior to disbursement. In addition, State INL’s reimbursement method for providing direct assistance to MCN has several controls built into it to help protect those funds from waste, fraud, and abuse. For example, State INL’s process allows it to review payment requests, invoices, and other documentation that support program expenses claimed by MCN.<sup>21</sup> Once it verifies that MCN met disbursement conditions and approves the disbursement, State INL transfers funds into the program-specific bank account at Da Afghanistan Bank. State INL monitors the account and may withhold fund transfers for account misuse.

While State INL has instituted other controls, they have not always been effectively implemented. For example, State INL uses some measures to mitigate risks associated with providing direct assistance to the ministry, including requirements for reviews by State INL of expenditure documentation and financial and project reports, joint State INL and MCN approval of payments, verification of eligible expenditures, and internal and external audits of program funds. These measures essentially constitute a risk mitigation strategy. However, State INL did not conduct a comprehensive ministerial capacity assessment prior to providing direct assistance funding to MCN.<sup>22</sup> In the absence of a

<sup>21</sup> For State INL’s GPI program, supporting documentation includes information regarding the relevant bank accounts, descriptions of the work completed for the project, the percentage of the project completed, project components and tasks, and photos of the project status. For the GLE program, payments are made based on documentation that includes the results of poppy eradication efforts compiled from United Nations Office on Drugs and Crime data.

<sup>22</sup> Section 7031 of the Consolidated Appropriations Act, 2012, Pub. L. No. 112-74, 125 Stat. 786, 1209-10 (2011), placed a limitation on the provision of direct government-to-government assistance. This section required, among other things, that each Afghan agency or ministry scheduled to receive assistance be assessed to determine that it has “the systems required to manage such assistance and any identified vulnerabilities or weaknesses of such agency or ministry have been addressed.” However, State INL’s direct assistance

comprehensive ministerial assessment, State INL cannot identify any inherent risks within MCN, the severity of a possible adverse event associated with those risks, or the likelihood that one would occur.<sup>23</sup> As a result, State INL's risk mitigation strategy cannot fully address underlying problems within the ministry.

The following list describes the controls State INL has implemented:

- *Formal agreement with the Afghan government:* State INL has entered into formal agreements with the MCN through memoranda of understanding and implementing instructions. These documents detail the procedures that both State INL and MCN will follow in executing the GPI and GLE programs and disbursing program funds. The implementing instructions for both programs provide guidelines for managing and implementing the programs, including procedures for project selection, commitments made by both State INL and MCN, and oversight procedures. The implementing instructions were signed by the director of the U.S. Embassy's International Narcotics and Law Enforcement Section, as well as by the Afghan MCN.
- *Fund disbursement conditions:* State INL included disbursement conditions in the agreements for its two direct assistance programs. These conditions include requirements that MCN provide bank statements to State INL, allow State INL to inspect MCN's accounting and document records, produce monthly reports regarding the use of program funds, and provide quarterly photo reports documenting the status of projects. Under the implementing instructions, MCN also committed to ensuring that completed projects are used in the manner in which they were intended.
- *Reporting/documentation requirements:* The agreements between State INL and the Afghan government require MCN to produce monthly technical and financial reports that contain the status of specific projects and a description of relevant activities. For State INL's GPI program, these reports are required to include information such as project descriptions, amount of funds allocated, amount of funds disbursed, contractor information, security concerns, and reasons for any unexpended funds. Reporting requirements for the GLE program include the number of poppy hectares expected to be eradicated, the number of hectares verified as eradicated, and copies of bank statements that demonstrate the transfer of funds from MCN to provincial accounts.
- *Monitoring and evaluation plan:* Under its memoranda of understanding with State INL, MCN must monitor and oversee all GPI projects. As part of this requirement, it must ensure that project work is completed correctly and in accordance with building standards. In addition, MCN monitored GPI projects to ensure they are being used in the manner for which they were intended and to assess project effectiveness. The monthly monitoring reports MCN provides to State INL include project activity descriptions, recommendations issued by the MCN monitoring team to the project implementation contractors, and general observations made by the monitoring team during their visit to the project site. For the GLE program, State

programs in Afghanistan started prior to the passage of this law and it did not do an assessment of MCN's ability to manage direct assistance funds prior to disbursements.

<sup>23</sup> USAID previously attempted to contract for an assessment of MCN, which was terminated because MCN refused to cooperate with the contractor.

INL's implementation letters require MCN to work with the United Nations Office on Drugs and Crime to ensure that all program payments are based on the office's poppy eradication verification reports.

- *Risk mitigation strategy:* State INL agreements with MCN include requirements for reviews by State INL of expenditure documentation and financial and project reports, joint State INL and MCN approval of payments, verification of eligible expenditures, and internal and external audits of program funds. While State INL used these external measures to mitigate risks associated with providing direct assistance to the ministries, these measures do not address the underlying problems within the ministries and, as such do little to build ministries' organic capabilities to manage donor funds. Moreover, the effectiveness of State INL's external risk mitigation measures may be limited by ongoing problems within the ministries.
- *Ministerial capacity building:* State INL hired a finance advisor whose responsibilities included planning and designing training programs relating to Afghan finance and administrative personnel in order to build their capacity, preparing and providing training materials for designed training programs, and overseeing budget expenses. According to State INL, this helped improve MCN's ability to manage direct assistance by assisting the finance and procurement units with the development of procedures and the creation of an updated procurement process to contract goods and services for projects.
- *Special joint bank account for disbursement:* MCN, as required by State INL's implementing instructions, maintained separate bank accounts for each State INL program, into which State INL deposits funds. State INL monitored these accounts, and they may not be used for any other program or purpose.
- *Ministerial submission and State review of invoices and supporting documentation prior to disbursement:* MCN provided State INL with documents detailing GPI project activities and payments when requesting the disbursement of program funds. These documents included information regarding the relevant bank accounts, descriptions of the work completed for the project, the percentage of the project completed, and the names of the individuals providing monitoring and supervision at the project site. In addition, MCN provided documentation of individual project components and tasks, including the quantities of materials used for the project and associated costs, as well as photos of the project status. Documents provided by MCN supporting the use of State INL's GLE program funds included results of poppy eradication efforts compiled from United Nations Office on Drugs and Crime data. State INL officials reviewed and approved invoices and documentation provided to them by MCN prior to the disbursement of funds. GPI program documentation reviewed by State INL included project activities and the status of individual project components, results of project monitoring and supervision conducted by MCN, and project payment requests. Prior to disbursing funds for its GLE program, State INL reviewed documentation that verified claims of poppy eradication efforts.
- *Review of condition satisfaction prior to disbursement:* State INL reviewed invoices and supporting documentation prior to disbursing funds. Documents reviewed to ensure MCN has satisfied GPI program conditions included MCN's project monitoring reports and project photo reports. To ensure GLE program condition satisfaction, State INL reviewed documentation supporting claims of poppy eradication efforts.
- *Reimbursement method of disbursement:* State INL's memoranda of understanding and implementing instructions set forth a process by which State INL approves the disbursement

of funds for eligible activities under the GPI and GLE programs based on a review of supporting documentation, including invoices.

- *Funds held outside of the Afghan financial system until disbursement:* State INL only disbursed funds to the Afghan government once payments are approved. Prior to disbursement to the program's bank account, U.S. funds are held outside of the Afghan financial sector.
- *Visibility over disbursement bank account:* In accordance with the GPI memorandum of understanding, State INL had regular access to program bank accounts through which it monitored transactions. According to State INL officials, while State INL cannot directly withdraw its direct assistance once disbursed to the GPI program bank account, it does have continuous online access to the account that allow it to view the status of funds, as required by the program's memorandum of understanding between State INL and the Afghan government. In addition, State INL received monthly bank statements from MCN regarding its GLE program account.
- *Monitor direct assistance implementation:* State INL monitored the use of its assistance funds through its visibility over the MCN program bank accounts. With this visibility, it observed the program transactions conducted with U.S. funds. In addition, State INL required MCN to directly monitor GPI projects and provide monthly progress reports to State INL for review. These reports are intended to ensure that projects implemented with State INL funds are completed correctly and in accordance with applicable standards.
- *Internal audit of funds:* State INL's internal financial team conducted quarterly audits of MCN's use of GPI program funds. These audits examined program expenditures, financial records, and other relevant documentation. INL officials also provided the results of the first GLE audit which cover the third quarter of 2013. These audits have found bookkeeping issues, missing supporting documentation, and procurements exceeding projected amounts. The reports made recommendations for corrective action.
- *Third-party audit of funds:* State INL contracted with KPMG Afghanistan Limited to perform an audit of the financial records related to the GPI program and the program's compliance with applicable agreements and regulations. KPMG completed the audit in May 2012 and the scope of the audit covered the period from March 2009 through September 2011. The audit's objectives were to (1) indicate whether program records conform to applicable bilateral agreements and generally accepted accounting principles, (2) evaluate MCN's internal controls related to the GPI program, and (3) assess whether MCN complied with agreement terms and applicable laws and regulations. The audit's findings included \$165,369 in questioned costs, some internal control deficiencies, and some instances of non-compliance with the program's implementing instructions. State INL contracts for audits of GPI that provide it with third-party findings. However, the recipient-contracted fiscal year audits required by the World Bank and Asian Development Bank—large multilateral donors—for their direct assistance programs have two benefits: they build the capacity of ministries to contract for audits and provide findings within 6 months of the end of each fiscal year. The failure to have audits completed within 6 months of the end of each fiscal year delays the possibility of identifying and addressing issues in a timely manner.
- *Reconciliation and reduction of ineligible expenditures:* According to State INL, the reimbursement process for GLE is preceded by the verification process, in which, depending on the province, some claimed eradication may be disallowed because only verified eradication is reimbursed, as agreed to in the memorandum of understanding. Provinces

may receive an advance payment based on a small percentage of the province's agreed-upon eradication target. Because advance funds may have been expended on GLE preparations and in any case have been transferred to governors at the beginning of the eradication season, MCN has generally been unsuccessful in recovering these amounts. In an effort to internal control GLE funds, State INL has limited the amount of advance payments, from 35 percent of the agreed-upon target in 2011, to 10 percent beginning in 2012. The memorandum of understanding for the 2013 cycle provided that prior-year debts would be withheld from the final payment. According to State INL officials, the memorandum of understanding for the 2014 cycle, in draft form at the end of our fieldwork, will require that prior year debts to the GLE program that are owed by the provinces will be withheld from the current year's advance GLE payment and, if necessary, from the final payment as well. For the GPI program, the State INL finance team conducted a reconciliation of GPI invoices prior to initial disbursement and did not reimburse ineligible expenditures. An external GPI audit found \$165,369 in questioned costs for expenditures that were either not approved by INL or were not included in the approved budget.

Although State INL instituted the above controls, it has not instituted others. Adoption of the following controls may help State INL further protect its direct assistance funds from waste, fraud, and abuse:

- *Ministerial capacity assessment:* State INL did not conduct a ministerial capacity assessment prior to providing direct assistance to MCN. The Consolidated Appropriations Act, 2012 which includes the Department of State, Foreign Operations, and Related Programs Appropriations Act, now requires the assessment of the ministry to ensure that the ministry has the capacity to manage such assistance and any identified vulnerabilities or weaknesses of such ministry have been addressed. Since State INL direct assistance programs started prior to the passage of this law, State INL did not do an assessment of MCN's ability to manage direct assistance prior to disbursements; however, the agency officials stated that they are currently developing a plan to complete such an assessment. USAID previously attempted to contract for an assessment of the Ministry of Counter Narcotics but terminated the contract because MCN refused to cooperate with the contractor.
- *Audit/financial reporting standards:* State INL did not require the Afghan ministries to maintain accounting records in accordance with generally accepted accounting principles. Without these standards, MCN practices were not aligned with accepted standards and thereby do not encourage the ministries to develop key financial management capacity.

## APPENDIX IV: U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT PROCESS AND ASSOCIATED CONTROLS FOR THE PROVISION OF DIRECT ASSISTANCE

The U.S. Agency for International Development's (USAID's) direct assistance commitments and obligations grew from \$1 million in fiscal year 2009 to nearly \$63 million in fiscal year 2011. In fiscal year 2013, direct assistance commitments grew to \$505 million.<sup>24</sup> Of the \$668 million in total commitments and obligations, USAID has disbursed nearly \$208 million for the five active direct assistance programs.<sup>25</sup> Table 3 shows the amount of direct assistance funds USAID has obligated and disbursed to the Afghan government.

**Table 3 – USAID Direct Assistance Funding for Five Active Programs with Disbursements**

Program	Ministry	Total Estimated Contribution (\$)	Total Obligations (\$)	Total Disbursements (\$)
Agriculture Development Fund	Ministry of Agriculture, Irrigation & Livestock	74,407,662	29,000,000	9,000,000
Basic Education and Literacy and Vocational Education Training	Ministry of Education	26,966,813	20,000,000	11,780,633
Civilian Technical Assistance Program	Ministry of Finance	36,256,560	36,256,560	28,810,610
Grant Agreement to Support Civil Service Reform	Ministry of Finance/Independent Administrative Reform and Civil Service Commission	15,000,000	15,000,000	10,750,000
Partnership Contracts for Health Services	Ministry of Public Health	236,455,840	190,286,911	147,172,081
Total		389,116,875	290,543,471	207,513,324

Source: USAID data.

Note: Data as of September 30, 2013

As called for by the Consolidated Appropriations Act, 2012, USAID uses a cost-reimbursement method of disbursement to fund its direct assistance programs.<sup>26</sup> USAID implements its direct assistance programs through "Implementation Letters" or "Grant Agreements" signed by the Afghan Minister of Finance, the USAID Mission Director, and, for three programs, the minister of the

<sup>24</sup> USAID has contributed \$1.25 billion to the World Bank-administered ARTF, which is the primary mechanism by which the international community provides non-security on-budget assistance to the Afghan government.

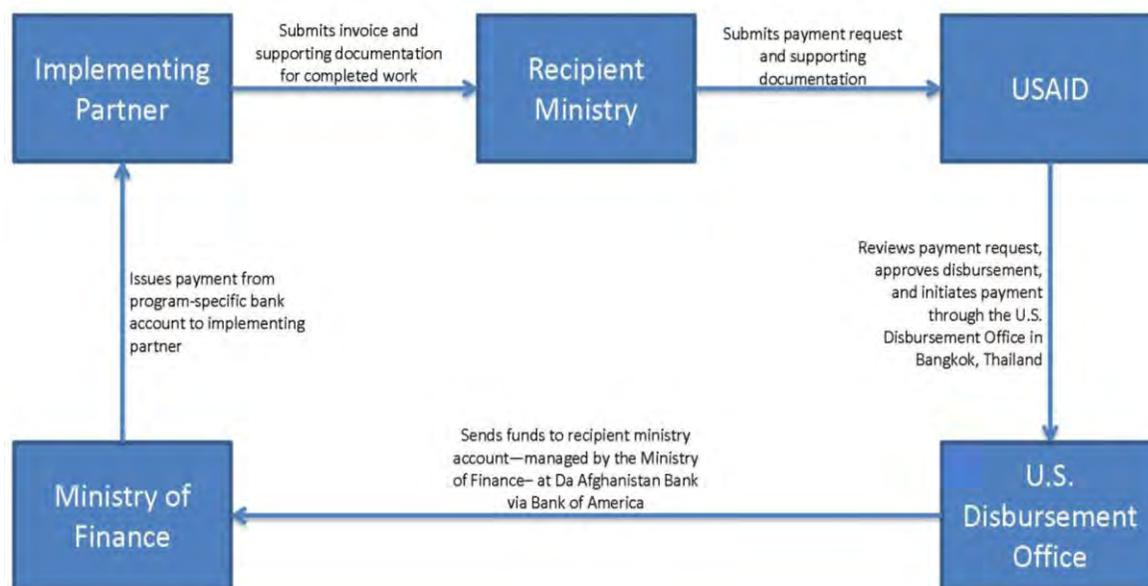
<sup>25</sup> An additional \$9 million was disbursed to programs that were no longer active, as of September 30, 2013, and, consequently, not included in our scope. USAID's direct assistance comes from its Economic Support Fund and is intended to finance numerous development and infrastructure projects and programs throughout the country. For example, USAID provided direct assistance to support improvements to the national electric transmission system, provide credit to small commercial farmers and agribusinesses, deliver and expand health services, and build civil service capacity and organizational governance, among many other projects.

<sup>26</sup> Pub. L. No. 112-74, § 7031(a), 125 Stat. 786, 1209-10 (2011).

recipient ministry. The relevant Afghan ministry then establishes a non-interest bearing, separate, special project bank account at Da Afghanistan Bank—Afghanistan’s central bank.

After performing the work mandated by its contract with the Afghan government, the ministry’s implementing partner provides invoices and supporting documentation to the responsible ministry.<sup>27</sup> The ministry then requests a payment from USAID, at which point USAID reviews the request and supporting documentation. If approved, USAID initiates a payment through the U.S. Disbursement Office in Bangkok, Thailand, which sends the funds via Bank of America to the special account at Da Afghanistan Bank. These funds are then transferred by the MOF to the implementing partner. Figure 3 shows the basic process USAID uses to provide direct assistance funds to the Afghan government.<sup>28</sup>

Figure 3 - USAID Direct Assistance Process



Source: SIGAR analysis of USAID interviews and documentation.

<sup>27</sup> The process differs for the Ministry of Public Health’s Partnerships Contracts for Health, which is a host-country contract program. According to USAID officials, host country contracting was used before the development of USAID’s Automated Directives System Chapter 220 (Use of Reliable Partner Country Systems for Direct Management and Implementation of Assistance), which provides USAID guidelines for direct government-to-government assistance. USAID officials also stated that USAID is moving away from host country contracting and toward cost-reimbursable direct assistance. The Ministry of Public Health is the only ministry with an active program funded as a host-country contract.

<sup>28</sup> This process, as well as the analysis presented in this section, is limited to USAID’s programs for the four of five ministries to which it provides direct assistance using “government-to-government” assistance. The safeguards differ for the Ministry of Public Health’s Partnership Contracts for Health, which is a host-country contract program. Host country contracting was used before the development of USAID’s Automated Directives System Chapter 220, which provides USAID guidelines for direct government-to-government assistance. The Partnership Contracts for Health does not use fund disbursement conditions or a reimbursement method of disbursement when delivering direct assistance. The failure to use these safeguards increases the vulnerability of USAID’s funds for this program to waste, fraud, and abuse. USAID officials stated that USAID is moving away from host country contracting and toward cost-reimbursable direct assistance. The Ministry of Public Health is the only ministry remaining with an active program funded as a host-country contract.

To help protect these funds from waste, fraud, and abuse, USAID has instituted multiple controls throughout the process, including determinations of ministerial capacity, the requirement for formal agreement with the Afghan government, establishment of funds disbursement conditions and reporting requirements, and the review of conditions satisfaction prior to disbursement. In addition, USAID's reimbursement method for providing direct assistance to Afghan ministries provides USAID with the opportunity to review the invoices, receipts, and supporting documents verifying the fulfillment of conditions. Based on this review, USAID then approves or rejects the disbursement.

While USAID has instituted other controls—such as establishing fund disbursement conditions, risk mitigation strategies, and conducting third party audits of funds—they have not always been effectively implemented. For example, in January 2014, we reported that “conditions precedent”—actions USAID requires ministries to take prior to the initial disbursement of funds—were USAID Mission in Afghanistan's (USAID/Afghanistan) primary method for addressing the risks it identified in its ministerial capacity assessments and internal risk reviews.<sup>29</sup> For the 104 risks identified in USAID's internal reviews, the mission identified 333 mitigating measures that would help reduce the risks associated with the provision of direct assistance for seven ministries.<sup>30</sup> However, we found that USAID/Afghanistan only included 24—less than 8 percent—of the identified mitigation measures as conditions precedent in its implementation letters with those ministries. USAID's low adoption rate of risk mitigation measures as conditions precedent is concerning because it allows direct assistance funds to flow to ministries that have not fixed their weaknesses—weaknesses that can expose U.S. government funds to waste, fraud, and abuse and undermine the effectiveness of other safeguards. For example, while USAID has a formal monitoring and evaluation plan in place for the Ministry of Public Health, USAID's risk review of that ministry found there was a serious risk of the ministry “concealing vital monitoring and evaluation information.”<sup>31</sup>

The following list describes the controls USAID has implemented:

- *Ministerial capacity assessment:* USAID contracted for assessments of all five receiving ministries' financial management capacity and internal control systems and conducted internal reviews for four of the five to determine if the ministries were able to properly manage and account for donor funds.
- *Formal agreement with the Afghan government:* USAID initiated its direct assistance programs through “Implementation Letters” or “Grant Agreements” signed by the Afghan Minister of Finance, the USAID Mission Director, and, for three programs, the minister of the recipient-ministry. One program, Partnership Contracts for Health, included the U.S. Ambassador as a signatory to the agreement.
- *Fund disbursement conditions:* Fund disbursement conditions varied by USAID program but generally included the establishment of a separate, non-commingled, non-interest-bearing, Afghani-denominated special account; the inclusion of the program in the ministry budget; the provision of a third-party authorization letter granting USAID information access rights to

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<sup>29</sup> SIGAR -14-32-AR. *Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries' Ability to Manage Donor Funds, but Concerns Remain*, January 30, 2014.

<sup>30</sup> The scope of this review differed from the scope of our January 2014 report on direct assistance. Specifically, SIGAR-14-32-AR included three additional ministries—Da Afghanistan Breshna Sherkat, Ministry of Mines, and Ministry of Communications and Information Technology—but did not include the Independent Administrative Reform and Civil Service Commission.

<sup>31</sup> SIGAR -14-32-AR. *Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries' Ability to Manage Donor Funds, but Concerns Remain*, January 30, 2014.

the special bank account; the provision of documentation that the ministry established appropriate processes and procedures for the disbursement of funds; the development of a monitoring and evaluation plan; the development of a financial reporting format; a letter from Da Afghanistan Bank stating that no funds will be released from the special account without a letter from USAID authorizing the release; and the provision of any other documentation requested by USAID to ensure funds will be used for appropriate program purposes. One program, the USAID Grant Agreement to Support Civil Service Reform, differed in that it established 23 performance benchmarks in its grant agreement, with disbursement amounts dependent on “satisfactory completion” of each benchmark.<sup>32</sup> While USAID developed risk-mitigation strategies for each ministry, these strategies are not reflected in the conditions precedent; in other words, funding is not predicated on the ministry addressing their weaknesses. Our January 2014 report found that conditions are USAID/Afghanistan’s primary method for addressing the risks it identified in its assessments and risk reviews. For the 104 risks identified in USAID’s risk reviews, the mission identified 333 possible mitigating measures that would manage the risks for seven ministries: Da Afghanistan Breshna Sherkat; Agriculture, Irrigation, and Livestock; Communication and Information Technology; Education; Finance; Mines and Petroleum; and Public Health. However, we found that USAID/Afghanistan has only included 70—or 21 percent—of the mitigation measures as conditions precedent and ongoing measures in its agreements with those ministries.

- *Reporting/documentation requirements:* All of USAID’s programs established reporting/documentation requirements. USAID included several of the documentation requirements in the conditions for disbursement, such as agency provision of documentation satisfactory to USAID that the ministry established appropriate processes and procedures for the disbursement of funds, a drafted monitoring and evaluation plan, and a precedent for the provision of any other documentation USAID may request.<sup>33</sup>
- *Audit/financial reporting standards:* The USAID programs established audit and financial reporting and review standards. For financial reporting, USAID required ministries to provide complete copies of executed contracts, invoices from the vendor, a full accounting of all activity in the separate bank account, quarterly reports, and financial reviews. For audit standards, USAID required the ministries to maintain books and records in accordance with generally accepted accounting principles prevailing in the United States or, at the government’s option, with approval by USAID, other accounting principles. USAID also required Afghan ministries to maintain program books and records for at least 3 years after the date of last disbursement or for as long as required to resolve any litigation, claims, or audit findings. The Partnership Contracts for Health implementation letter was different in that it established that the recipient ministry should request a USAID-performed or contracted audit of costs claimed under cost-reimbursable contracts in excess of \$500,000 awarded to U.S.-based firms; audits of smaller cost-reimbursable contracts should also be conducted.

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<sup>32</sup> The Partnership Contracts for Health program was performed under a “host country contract” mechanism and consequently did not establish disbursement conditions. According to USAID officials, host country contracting is not used frequently by USAID anymore, and the agency is moving to cost-reimbursable direct assistance funds instead of host country contracting.

<sup>33</sup> The Partnership Contracts for Health program did not have conditions but did establish the requirement that the Ministry of Public Health submit one semi-annual report and one annual report to USAID each year that details progress, results, challenges, and remedial actions.

- *Monitoring and evaluation plan:* USAID agreements with the Afghan government required the ministries to work with USAID and establish monitoring and evaluation plans with baselines, targets, and indicators prior to disbursements. We verified that this coordination resulted in formalized monitoring and evaluation plans for four of the five programs. The Grant Agreement to Support Civil Service Reform program did not have a formal monitoring and evaluation plan; however, the structure of the grant provided disbursements only after the “satisfactory completion of performance benchmark.”
- *Risk mitigation strategy:* USAID established risk mitigation strategies through internal risk assessments of four of the five ministries. The reports identified risks, the severity of an adverse event associated with the risk, the likelihood of the occurrence of the adverse event associated with the risk, and suggested mitigation measures. We verified that the strategies exist; however, our January 2014 report found that of the 333 total risk mitigation measures identified for seven ministries, USAID included only used 70 as conditions precedent and ongoing measures for their direct assistance programs. Our January 2014 report further showed that while USAID takes additional external measures intended to mitigate risks associated with providing direct assistance to the ministries—such as establishing separate bank accounts and providing funds on a reimbursement basis—these measures do not address the underlying problems within the ministries and, as such do little to build ministries’ organic capabilities to manage donor funds—one of the primary purposes of providing direct assistance to the Afghan government. Moreover, the effectiveness of USAID’s external risk mitigation measures may be limited by ongoing problems within the ministries. Additionally, our January 2014 report noted that USAID signed agreements with each of the reviewed ministries to approve direct assistance programs even though the risk reviews concluded that the ministries were unable to manage direct assistance without a risk mitigation strategy in place.<sup>34</sup>
- *Ministerial capacity building efforts:* USAID officials provided documentation to verify ministerial capacity building efforts for four of its five direct assistance programs.<sup>35</sup> Examples of capacity building included the drafting, publishing, and distribution of a financial policies and procedures manual to all ministry offices and a project designed to strengthen the capacity of the ministry to lead and manage financial governance of the program.
- *Special joint bank account for disbursement:* USAID established a separate, non-commingled, non-interest-bearing, Afghani-denominated special account at Da Afghanistan Bank for each program. This measure increased USAID’s ability to monitor the expenditures and the specific purpose for which the funds were disbursed.
- *Ministerial submission and USAID review of invoices and supporting documentation prior to disbursement:* USAID required the receiving Afghan government ministries to submit invoices and supporting documentation for review and approval prior to disbursements. USAID used the required supporting documentation to demonstrate that the ministry met conditions precedent.
- *Review of condition satisfaction prior to disbursement:* USAID has reviewed condition satisfaction for all four programs that established conditions precedent. In one case, we

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<sup>34</sup> SIGAR -14-32-AR. *Direct Assistance: USAID Has Taken Positive Action to Assess Afghan Ministries’ Ability to Manage Donor Funds, but Concerns Remain*, January 30, 2014.

<sup>35</sup> Capacity building for the Basic Education and Literacy and Vocational Education Training program is performed by USAID’s Office of Financial Management. According to USAID officials, the report on capacity building for this program was in progress.

found that when the ministry only complied with 5 of 13 conditions, USAID required that the ministry comply with all conditions precedent and supply USAID with adequate documentation to substantiate compliance prior to the release of funding. For the other three programs, USAID released funds after determining that the ministry met all conditions.

- *Reimbursement method of disbursement:* The reimbursement method of disbursement internal control was implemented through USAID's general disbursement process and is called for by law.<sup>36</sup> The program implementing partner provided invoices and supporting documentation to the ministry, the ministry requested payment from USAID, USAID reviewed the ministry payment request and supporting documentation, approved or disapproved the disbursement, and, if approved, initiated payment through the U.S. Disbursement Office in Bangkok, Thailand.
- *Hold funds outside of the Afghan banking sector until disbursement:* As a result of USAID's reimbursement-based disbursement process, the direct assistance funds do not enter the Afghan financial sector through the ministry account at Da Afghanistan Bank until USAID approved the invoices and supporting documentation.
- *Visibility over disbursement bank account:* USAID maintained visibility over the disbursement bank account through online viewing access provided by the Ministry of Finance.
- *USAID monitoring and evaluation of program implementation:* USAID implemented its monitoring and evaluation plans through periodic program reports. These reports included an assessment of progress toward the achievement of objectives, accomplishments, and challenges.
- *Third-party audit of funds:* USAID contracted with Ernst and Young to perform audits of all five programs. Examples of audit objectives included assessments of project internal controls, determination of validity and reliability of information, determination of whether the ministry complied with agreement terms and applicable laws and regulations related to the USAID-funded program. USAID's internal guidance, known as the Automated Directives System, requires that audits of foreign recipients must be completed within 9 months after the end of the fiscal year in which expenditures above \$300,000 were incurred. However, USAID did not complete any audits within the 9-month period. We are concerned that USAID's lack of regularly-received audit results makes it difficult for the agency to take action to identify and reconcile ineligible expenditures and address other issues with direct assistance implementation. The World Bank and Asian Development Bank work with the recipient-ministries to contract for third-party program audits within 4 months and 6 months, respectively. The failure to have audits completed within 6 months of the end of each fiscal year, as multilateral donors use, or 9 months, as required by USAID guidance, delays the possibility of identifying and addressing issues in a timely manner.
- *Reconciliation and reduction of ineligible expenditures:* USAID conducted monthly reconciliations of expenditures for all five programs. USAID has not identified ineligible expenditures for four of five programs and, therefore, has not initiated reductions. For the one program that did receive a reduction for ineligible expenditures, the Mission issued a bill of collection to the Ministry of Finance for \$77 in disallowed costs.

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<sup>36</sup> Pub. L. No. 112-74, § 7031(a), 125 Stat. 786, 1209-10 (2011).

Although USAID instituted the above controls, it has not elected to conduct internal audits of funds. Adoption of the following control may help USAID further protect its direct assistance funds from waste, fraud, and abuse:

- *Internal audit of funds:* USAID officials confirmed that the agency did not perform internal audits of funds. USAID's nonuse of internal audits means that it did not benefit from regular internal financial transaction audits that allow direct assistance providers to identify and address issues as they arise. According to USAID officials, USAID's Office of the Inspector General has the right to audit these programs but has not yet done so.

## APPENDIX V: DOD COMMENTS



HEADQUARTERS  
UNITED STATES FORCES-AFGHANISTAN  
BAGRAM, AFGHANISTAN  
APO AE 09354

USFOR-A-DCCR-S

17 October 2014

MEMORANDUM FOR United States Central Command Inspector General (CCIG), MacDill Air Force Base, FL 33621

SUBJECT: United States Forces-Afghanistan Response to SIGAR Draft Report (14-XX-SP), "Direct Assistance: Review of Processes and Controls Used by CSTC-A, State, and USAID".

1. Reference. SIGAR Draft Report dated September 12, 2014, requesting formal review and comment regarding "Processes and Controls Used by CSTC-A, State, and USAID" (the "SIGAR Draft Report").
2. I reviewed the enclosed CSTC-A comments to the SIGAR Draft Report dated 12 September 2014. I support MG Wendel's comments and the CSTC-A plans to improve ministerial financial management capacity and internal control systems.
3. The point of contact is Mr. Richard C. Flippo, DSN [REDACTED], [REDACTED].

Encl  
CSTC-A Response Memo, dtd 26 Sep 14

  
JEFFREY N. COLT  
Major General, U.S. Army  
Deputy Commander - Support  
United States Forces - Afghanistan



DEPUTY CHIEF OF STAFF SECURITY ASSISTANCE  
COMBINED SECURITY TRANSITION COMMAND – AFGHANISTAN  
KABUL, AFGHANISTAN  
APO AE 09356

REPLY TO  
ATTENTION OF

CSTC-A

26 SEP 2014

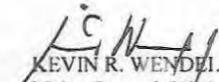
MEMORANDUM THRU

United States Forces - Afghanistan (CJIG), APO AE 09356  
United States Central Command (CCIG), MacDill AFB, FL 33621

FOR: Special Inspector General for Afghanistan Reconstruction, 2530 Crystal Drive, Arlington, VA  
22202-3940

SUBJECT: CSTC-A follow-up response to SIGAR Draft Report: "Direct Assistance: Review of  
Processes and Controls Used by CSTC-A, State, and USAID", dated September, 2014 (SIGAR 14-XX-  
SP Draft Report).

1. REFERENCE: Draft Report, dated September, 2014, Special Inspector General for Afghanistan Reconstruction (SIGAR 14-XX-SP Draft Report).
2. The purpose of this memorandum is to provide comments to the SIGAR Draft Report dated September, 2014. SIGAR makes no recommendations within the report, but CSTC-A provides comments to the draft content.
3. CSTC-A appreciates SIGAR's continued efforts of looking into the management of direct assistance within the Afghanistan Security Forces Funds (ASFF). Providing diligent oversight of direct assistance funding remains a top priority of CSTC-A. To ensure proper management of these funds, CSTC-A is implementing stronger controls within the FY1394 Commitment Letters to the Ministries of Interior, Defense, and Finance. In addition, CSTC-A will begin building increased ministerial financial management capacity and internal control systems through pursuit of a ministerial advisory contract. CSTC-A remains committed to being great stewards of U.S. and donor nation funding, while continuing to train, advise, and assist the Afghans into a more capable and independent country.
4. Point of contact for this action is CPT Todd R. Williams at DSN [REDACTED] or via e-mail at [REDACTED]

  
KEVIN R. WENDEL  
Major General, US Army  
Commanding General

Enclosure: CSTC-A Draft Report Comments

### **CSTC-A DRAFT REPORT RESPONSE**

#### **“Direct Assistance: Review of Processes and Controls Used by CSTC-A, State, and USAID” (SIGAR Draft Report 14-XX-SP)**

CSTC-A acknowledges the SIGAR report “Direct Assistance: Review of Processes and Controls used by CSTC-A, State, and USAID” and we appreciate the review of how CSTC-A manages direct assistance within the Afghanistan Security Forces Fund (ASFF). Although the review provides no recommendations, we appreciate the advice as well as the opportunity to provide a response.

CSTC-A conducted thorough reviews of previous Commitment Letters and past performance of the Ministry of Interior Affairs (MoI), the Ministry of Defense (MoD), and the Ministry of Finance (MoF). Based on these reviews, CSTC-A took steps to improve the GIRoA management of ASFF funds to include implementing controls and stronger language that close loopholes and ambiguity in the FY 1394 Commitment Letters. This language enforces requirements, and mandates withholding direct assistance if unauthorized spending is discovered. It also makes funding for fuel, facilities, Gender Integration, medical, supplies, and communications conditional on performance, documented consumption, and proven expenditures. Below is a summary of the CSTC-A tightened controls:

- CSTC-A eliminated the FY1394 developmental category of funding thereby eliminating automatic carry forward payments without a CSTC-A review.
- Starting in FY1394 CSTC-A will distribute funds to GIRoA in Afghanis rather than US dollars. This change eliminates the ability of GIRoA to profit from changes in currency exchange rates, reduces the ASFF U.S. Dollar amount and strengthens the Afghani, a long-term benefit for the people of Afghanistan.
- CSTC-A requires the creation of a separate treasury account for CSTC-A funds, requires monthly submission of account statements, and stipulates CSTC-A access (read only) to this account to ensure funds are expended properly. MoF acknowledges CSTC-A requires access to the treasury account in Da Afghanistan Bank before FY1394 funds are spent.
- CSTC-A insists GIRoA use the purchasing module in the Afghanistan Financial Management Information System (AFMIS). The proper recording of contract numbers in the purchasing module links payments to contracts thus significantly reducing the potential for duplicate payments, ensuring that payments are made against valid requirement, and enabling proper accountability of funds.
- CSTC-A must receive detailed monthly reports of expenditures from each Ministry, along with supporting documentation, and the ministries must promptly respond to CSTC-A auditors’ requests for information including all required documents. CSTC-A requires the Ministries to adhere to Generally Accepted Accounting Principles. CSTC-A, through its Essential Function 1 Advisory Group, performs train, advise and assist (TAA) functions to establish appropriate standard operating procedures and maintain required fiscal control and auditable records of ASFF funds.

**CSTC-A DRAFT REPORT RESPONSE**

**“Direct Assistance: Review of Processes and Controls Used by CSTC-A, State, and USAID”  
(SIGAR Draft Report 14-XX-SP)**

- CSTC-A mandates the use of an agreed-upon electronic pay system to ensure accurate and prompt payment to Soldiers and Policemen in both Ministries. An EPS provides much greater transparency in the pay process and is a key element for proper accountability of ASFF distributions.

In December 2013, CSTC-A stood up an internal Audit Division that to-date has completed three formal audits on MoI Payroll, Herat 207<sup>th</sup> Corps payroll, and Domestic Fuel within areas of concern. It also provided three reports on fiscal compliance and has seven more in progress ranging from MoI Electricity to the MoD Fuel Contract.

As the international Security Assistance Force (ISAF) executes change of mission to Resolute Support (RS), the coalition will shift emphasis from unit-based combat advising, to functionally-based advising. The coalition is more than doubling the amount of finance/budget advisors and procurement advisors to better assist the MoI and MoD in building both capability and capacity to properly manage their finances. The additional advisors will allow the coalition to expand its financial and procurement advisory role into many of the different functional areas within the two ministries, increasing the ability to identify systematic shortcomings.

In addition to the increased depth and breadth of financial and procurement advisor support to the ministries, CSTC-A is building increased ministerial financial management capacity and internal control systems through pursuit of a ministerial advisory contract. This contract provides western-educated Afghan nationals as subject matter experts and technical experts to train, advise, support, and enhance the operational and strategic capabilities of the Ministries of Defense and Interior with the intent of improving ministerial effectiveness. Specific areas of focus: improved program management, processes and systems development, best management practices, and acquisition/procurement competencies in accordance with established best practices. These contracted Afghan nationals will provide expertise in five functional areas to include: Human Resources Management, Logistics and Sustainment, Resource Management, Information Technology/Engineering/Communications and Procurement.

While there is room for improvement, CSTC-A continues to review GIRoA's past progress with management of direct assistance funding and continually seeks ways to correct deficiencies and build resource management capacity within the Afghanistan Security Institutions.

**APPROVED BY:**  
Charles B. Shea  
COL, CSTC-A CJ8  
Director

**PREPARED BY:**  
Clay D. Pettit  
LTC, CSTC-A CJ8  
Deputy Director  
DSN [REDACTED]

## APPENDIX VI: STATE INL COMMENTS

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United States Department of State

Washington, D.C. 20520

September 19, 2014

Mr. Jack Mitchell  
Director, Special Projects  
Office of Special Inspector General for Afghanistan Reconstruction  
1550 Crystal Drive, Suite 900  
Arlington, VA 22202

Dear Mr. Mitchell:

The Bureau of International Narcotics and Law Enforcement Affairs (INL) welcomes the opportunity to comment on the draft Special Inspector General for Afghanistan Reconstruction (SIGAR) report entitled, "Direct Assistance: Review of Processes and Controls Used by CSTC-A, State, and USAID" (September 2014). INL respects SIGAR's role in safeguarding U.S. taxpayer investment, and we share your goals of implementing programs free from waste, fraud, and abuse.

This letter responds to the SIGAR suggested improvements to controls related to the Good Performers Initiative (GPI) and Governor-Led Eradication (GLE) programs with the Ministry of Counter Narcotics (MCN). These INL programs are an important component of the U.S. government's efforts to build the Afghan government's capacity to combat the cultivation, production, trafficking, and use of illicit narcotics.

On September 17, 2014, INL awarded a contract to conduct a comprehensive public financial management risk assessment of MCN. Issues identified in previous assessment attempts were carefully considered in the design of this new capacity assessment. We also agree that the MCN should adhere to applicable international accounting standards and will investigate adding language to our Memoranda of Agreement with the Afghan government.

INL supports the work being done by the Asian Development Bank and other international organizations to train and provide direct assistance to the Government of the Islamic Republic of Afghanistan on proper international accounting standards. INL believes internal and external (third-party) audits are valuable tools for evaluating INL's work with the MCN. As recommended by SIGAR, INL will solicit third-party audits under International Public Sector Accounting Standards in order to identify and address any issues. These external

- 2 -

audits will build capacity of MCN as well as validate the on-going quarterly audits conducted by INL.

We appreciate SIGAR's thorough examination of INL programs in Afghanistan. INL looks forward to continuing to work with SIGAR on these issues.

Sincerely,



James A. Walsh  
Executive Director

cc: The Honorable James B. Cunningham  
U.S. Ambassador to Afghanistan  
General Lloyd J. Austin III  
Commander, U.S. Central Command  
General John F. Campbell  
Commander, U.S. Forces-Afghanistan and  
Commander, International Security Assistance Force  
Major General Kevin R. Wendel  
Commanding General, Combined Security Transition Command-  
Afghanistan  
Mr. William Hammink  
USAID Mission Director Afghanistan



**USAID | AFGHANISTAN**  
FROM THE AMERICAN PEOPLE

**MEMORANDUM**

**DATE:** October 3, 2014

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

**FROM:** Larry Sampler, AA/OAPA

**SUBJECT:** Response to SIGAR Special Project SP-88

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

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

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

**USAID's Risk Mitigation System**

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

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<http://afghanistan.usaid.gov>

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

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

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

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

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

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

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

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

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

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

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

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

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

### **Other Comments**

#### Third-Party Audits

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

### Internal Audits of Funds

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

**This report was conducted under  
project code SIGAR-082A.**

## SIGAR's Mission

The mission of the Special Inspector General for Afghanistan Reconstruction (SIGAR) is to enhance oversight of programs for the reconstruction of Afghanistan by conducting independent and objective audits, inspections, and investigations on the use of taxpayer dollars and related funds. SIGAR works to provide accurate and balanced information, evaluations, analysis, and recommendations to help the U.S. Congress, U.S. agencies, and other decision-makers to make informed oversight, policy, and funding decisions to:

- improve effectiveness of the overall reconstruction strategy and its component programs;
- improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors;
- improve contracting and contract management processes;
- prevent fraud, waste, and abuse; and
- advance U.S. interests in reconstructing Afghanistan.

## Obtaining Copies of SIGAR Reports and Testimonies

To obtain copies of SIGAR documents at no cost, go to SIGAR's Web site ([www.sigar.mil](http://www.sigar.mil)). SIGAR posts all publically released reports, testimonies, and correspondence on its Web site.

## To Report Fraud, Waste, and Abuse in Afghanistan Reconstruction Programs

To help prevent fraud, waste, and abuse by reporting allegations of fraud, waste, abuse, mismanagement, and reprisal, contact SIGAR's hotline:

- Web: [www.sigar.mil/fraud](http://www.sigar.mil/fraud)
- Email: [sigar.pentagon.inv.mbx.hotline@mail.mil](mailto:sigar.pentagon.inv.mbx.hotline@mail.mil)
- Phone Afghanistan: +93 (0) 700-10-7300
- Phone DSN Afghanistan: 318-237-3912 ext. 7303
- Phone International: +1-866-329-8893
- Phone DSN International: 312-664-0378
- U.S. fax: +1-703-601-4065

## Public Affairs

Public Affairs Officer

- Phone: 703-545-5974
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2530 Crystal Drive  
Arlington, VA 22202