

Fraud and Development Assistance Programs

Lessons from USAID in safeguarding foreign aid from
corruption and abuse

Background

This paper reviews the lessons learned from the accountability techniques and methods used by USAID to safeguard foreign assistance funds from corruption and abuse in USAID Missions abroad.

Measuring the occurrence of waste, fraud and abuse of government funds is a notoriously difficult task due to the secretive nature of malfeasance and the fact that some (how much?) of the loss goes undetected. This paper does not attempt to measure levels of loss in USAID Missions, nor does it discuss Agency-wide financial accountability issues, which are well-documented by the OIG and the GAO elsewhere. Instead, it documents types of anti-fraud mechanisms used by various USAID programs around the world, deemed “successful” based on the experiences and judgment of USAID staff who witnessed the mechanisms in effect and on OIG and GAO audit information where available.

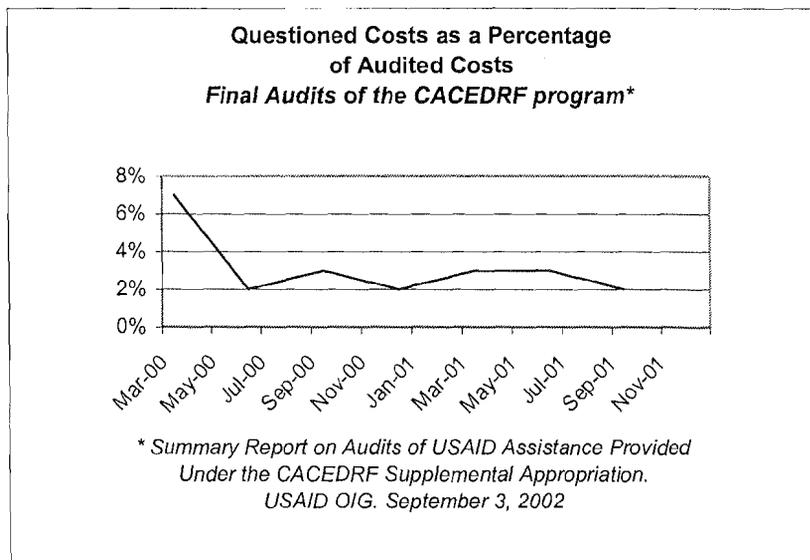
USAID has developed an expertise – a set of tools and experiences – for protecting development assistance program funds. In particular, the \$621 million Hurricane Mitch disaster recovery program (Central American and the Caribbean Emergency Disaster Relief Fund or CACEDRF) is considered an example of a successful financial accountability effort. USAID management,

USAID Office of the Inspector General (OIG) representatives, and the GAO all point to this program as a major success in the development and implementation of an accountability strategy that maintained the integrity of USG funds, to the satisfaction of the Inspector General. After more than two years of close monitoring the USAID OIG found that although several activities had not been implemented

on schedule, in terms of waste, there were only low-level problems and those were mostly associated with mismanagement not malfeasance.¹ Over the duration of the concurrent auditing, *questioned costs as a percentage of total audited costs* fell from 7% to 2%.

This paper presents other examples of accountability strategies used by USAID programs, although none carried out on the same scale as the Hurricane Mitch case.

The results in Central America and other cases discussed here suggest that USAID accountability mechanisms can provide effective deterrence and recovery measures for safeguarding USG funds. To be sure, the Hurricane Mitch experience was not without criticism. Some staff and



Of the 292.4 million
allocated by Congress for

ITRM
Committee
in (hand)

8.3
million
(30%)

was

allocated
to

transparency

and

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external evaluators called those efforts duplicative and unnecessarily expensive. Finding the right balance of financial oversight is a longstanding challenge for USAID.

The Agency can learn from and build upon the experiences document in this paper by working to institutionalize accountability measures for a more consistent application across programs. The techniques and methods discussed below may also be useful to foreign assistance programs administered by other USG Departments who want to reduce fraud, waste and abuse and meet Federal financial accountability standards.

The [Hurricane Mitch] strategy is innovative in the sense that it is not strictly an audit or investigations strategy, but includes many innovative types of activities, aimed at prevention and deterrence, that we brought into our strategy from outside the audit and investigations traditions.”

Everett L. Mosley, Inspector General and Timothy E. Cox, Regional Inspector General, San Salvador “Statement Before the House Committee on Foreign Operations,” March 21, 2001

The information in this paper is derived, in part, from interviews with USAID program personnel and review of available literature. Much of the research focused on USAID programs in countries where there had been a rapid “scale up” of foreign assistance over previously established levels. In addition, USAID Office of the Inspector General (OIG) senior audit personnel were interviewed, and a wide range of OIG audit reports, GAO reports and other materials relating to accountability issues were consulted.

Techniques and Methods used to safeguard USAID program funds

1. Assess the risk for corruption or mismanagement;
2. Make accountability a management priority;
3. Integrate accountability mechanisms into program design;
4. Dedicate resources to accountability;
5. Use intensive audit and monitoring oversight;
6. Train USAID personnel and partners in accountability; and
7. Communicate and coordinate with other donors.

1. Assess the risk for corruption or mismanagement

Risk assessments are becoming more frequently used at USAID. An early risk assessment is a useful tool for identifying low-, medium- and high-risk situations, which can then guide the types of controls program managers should put in place.

The guidance for conducting risk assessments is a relatively new, but welcome, addition to USAID's operating procedures. The Automated Directives Series (ADS) states that USAID's management controls must “provide for an assessment of the risks that Agency faces from both external and internal sources.” The OIG only began systematically highlighting Mission-level

risk assessments in its Semiannual Reports to Congress in late 2001, although it is by no means new to preventive studies such as “pre-award accounting system surveys” and “capacity audits”.

The USAID OIG has a well-developed understanding of what circumstances lead to higher or lower vulnerability. OIG risk assessments consider a number of relevant risk factors including: the record of the implementing partners, the type of activity being financed, the controls and implementation arrangements for each activity, the amount of funds devoted to each activity, level of experience among staff, degree of management support for financial controls, etc., depending on the particular circumstances of the country.

“Because these programs [Central American and Caribbean Disaster Recovery] were considered high risk, the OIG developed and implemented a comprehensive audit and investigative strategy, including the use of concurrent audits.”

*USAID OIG Semiannual Report to the Congress.
October 1, 2001- march 31, 2002.*

USAID staff emphasize the importance of evaluating potential partners. If a particular government Ministry is found to be weak and notably corrupt, direct cash transfers to that entity should be avoided or closely monitored. NGOs or consulting firms with poor accountability records can be avoided or strengthened. As an example, USAID/South Africa conducted pre-award assessments of grantee’s financial management systems to make sure they were capable of managing USAID funds. In post-grant audits of 20 grantees, only one was found to have insufficient financial controls.

Certain types of programs or certain assistance mechanisms are more vulnerable to financial loss than others, i.e., “rapid scale up” situations in which large quantities of funds are hurriedly programmed and spent due to a natural disaster or a political crisis in a country may have insufficient time and personnel to adequately maintain controls on funds. High-risk situations will require more aggressive auditing and monitoring. On the other hand, in low risk situations, techniques like gradual disbursement of funds and constant monitoring may retard project progress without providing any greater level of accountability. Under the Hurricane Mitch program for instance there was some criticism that audits were duplicative.

The overwhelming majority of the USAID personnel interviewed for this paper believe that direct transfer of funds to cooperating country governments (block grants, balance of payments, budget support) as opposed to channeling funding through projects implemented by USAID contracts, grants, cooperative agreements or credits to recipient government agencies, NGOs, consulting companies or other private sector institutions, is more vulnerable to fraud. It is difficult to detect or control fraud when funds are in the hands of a cooperating country government of questionable integrity. While project assistance may on the surface appear to be much safer, it is vulnerable to fraud in ways that do not affect direct transfers. The acquisitions/procurement process introduces opportunities for loss and the fact that funds pass through the hands of many intermediaries suggest that USAID staff should not assume funds are secure when they are channeled through *projects* as opposed to *direct transfers*. Vulnerability to

corruption has more to do with procedures and controls put in place by USAID than with the type of funding mechanism utilized in a particular program or project. Without sufficient controls, project funds are just as vulnerable as non-project funds.

One unusual use of risk assessment was made by the USAID program in Bosnia-Herzegovina. USAID funding in Bosnia-Herzegovina increased rapidly after the end of the four-year Bosnian war and the 1995 Dayton Peace Accords. Corruption in the Bosnia-Herzegovina government was determined to be high. The Mission identified, the Bosnian Payments Bureau, an official arm of government, as one of the greatest sources of graft in the government. It was, in effect, a financial clearinghouse for the Nationalist Party whose operation was the source of many illicit transactions and its dominance was damping the emergence of a banking sector. USAID succeeded in having that Bureau eliminated.

2. Make accountability a management priority

Top management support for accountability stated early and clearly during the process of developing program and project objectives can go a long way toward avoiding accountability and monitoring problems. Without such an explicit directive, accountability concerns can be subordinated to other imperatives, such as rapidity of assistance delivery.

According to OIG staff, until relatively recently, accountability was not a clearly articulated upper management priority in USAID programs. Accountability concerns were left to financial management personnel and auditors to resolve, often after problems were exposed. Recent years however, have seen an increased willingness, on the part of Mission management, to prioritize accountability and involve the IG in program management. HRM

The importance management places on accountability can be demonstrated by bringing stakeholders together and agreeing on some accountability principles and actions, as was done under the Stockholm Agreement used in the Hurricane Mitch recovery program. The Donors Cooperative Group for the Reconstruction and Transformation of Central America (which included representatives of affected Central American countries) adopted a series of goals and principles known as the Stockholm Declaration. The government of Honduras committed to these principles, which included the pledge to carry out reconstruction and transformation of affected Central American countries “on the basis of an integrated approach of transparency and good governance.” Informants state that the Honduran government was seriously committed to this objective, that it was widely publicized throughout Honduras during the reconstruction period, and that the Stockholm Declaration still has significance in Honduran politics today.

USAID staff report that it is helpful if a Mission gives high visibility to accountability. In Bosnia, the Office of the High Representative (OHR) designated by the Dayton Peace Accord in 1995 to oversee the transition in Bosnia-Herzegovina declared anti-corruption among of its highest objectives, which included establishing an anti-fraud department, and the USAID program has been a cornerstone of this policy from the beginning.

Several informants representing different USAID country programs stated that there is a general perception among aid recipients that USAID and the USG in general have a higher intolerance for corruption than do other donors such as the EU or the World Bank. This reputation alone may help make USAID resources less vulnerable than other donor programs and the US should make an effort to reinforce this image.

3. Integrate accountability mechanisms into program design

What have USAID programs done in addition to declaring that accountability is a priority? Several USAID Missions, where the potential for accountability problems was high and management had a commitment to accountability, have been able to design and plan programs to mitigate corruption concerns. USAID Missions have been resourceful in building financial accountability into programs, even in these cases where staff are under pressure to produce results quickly, for instance, in the context of extreme political pressure or humanitarian emergency.

“The United States and other International donors have established procedures for safeguarding assistance to Bosnia, and we found no evidence that assistance was lost on a large scale because of fraud or corruption.”

GAO. “Bosnia: Crime and Corruption Threaten Successful Implementation of the Dayton Peace Agreement,” July 19, 2000

Using USAID personnel to directly manage projects eliminates some potential sources of corruption and demonstrates a willingness to commit management resources to ensure a higher level of accountability. Direct project management by USAID personnel with meaningful financial management experience, should be considered when a high priority project carries a high risk of corruption. This may seem financially unfeasible, but it was done in South Africa in the beginning of the post-apartheid era. Many projects were run directly by USAID staff rather than subcontractors and/or non-governmental organizations, and were thus subject to USAID internal control procedures. USAID/South Africa also gave high priority to its controller and audit functions and brought in a former Controller as Deputy Director to oversee operations. Still lacking adequate staff for the job at hand, the Controller's office contracted with a corps of ex-patriot spouses to do face-to-face follow-up on grant closeouts. In retrospect, a USAID staffer reported it might have been more efficient to contract out the task of small grants management because of the necessity to monitor so closely. Outsourced accountability is another technique that has been used. In Honduras, USAID hired US auditing firms to provide technical assistance in financial management.

Another method for retaining USAID control over funds was used in Bosnia-Herzegovina where the US assistance program came on the heels of a devastating war and entered into a chaotic and corrupt environment. Reconstruction, rehabilitation and reform were an urgent priority and at the Dayton Peace Accords and the US agreed to provide \$500 million in cash assistance to the government. Extraordinary measures were taken to protect these funds. An agreement was reached whereby the money was transferred to the government and then immediately transferred

to USAID's account for programming. Virtually the entire amount was implemented by USAID. Only \$20-25 million was directly transferred to the government for critically needed health workers, teachers and pensions. The transfers were done in tranches over three years and subject to concurrent audits.

Another management tool that can both demonstrate a clear commitment to accountability and provide added weight to an accountability strategy is having implementing partners separate accountability and monitoring functions from substantive program or project management functions, as was done by USAID/South Africa. The principal advantage of this approach is a monitoring function free of programmatic pressures and prejudices. For example, the commitment to preventing currency collapse in a country might lead to pressure for direct cash transfers that could conflict with sound accountability principles. By separating the accountability function from the program management function, legitimate accountability concerns can get a fair hearing, and some personnel will be dedicated specifically to meeting accountability objectives.

As described above, the information from a risk assessment helps Missions decide how to transfer funds. In Indonesia USAID does not provide non-project assistance to the government. Technical assistance in the financial sector, for instance, is provided through advisers working with appropriate GOI entities to promote the development of a modern and market oriented financial infrastructure. Democracy and governance programs make extensive use of US based implementers and Indonesian NGOs. USAID provides training and technical assistance to assist NGOs in establishing adequate financial capability and applies strict financial guidelines to all implementers. It also has an extensive audit program.

4. Dedicate resources to accountability

Accountability costs money and takes time. If accountability is to be a management priority in reality, appropriate resources must be dedicated to providing the auditing and monitoring services required for implementation of a meaningful accountability strategy. This includes appropriate numbers of audit and monitoring staff to meet the specific accountability challenges. In some instances, the Hurricane Mitch disaster recovery assistance program being one prominent example, there has been a separate appropriation of funds to cover auditing and monitoring activities. \$1.5 million was programmed specifically for additional OIG expenses to ensure appropriate oversight of program funds.

In Bosnia-Herzegovina, the Mission increased staffing significantly to implement programs and maintain adequate controls. At the height of activity, there were some 200 - 300 people, including contractors to implement the program. This included a local "gum shoe" corps hired to follow-up individually on every grant, loan and program to check on compliance.

There is a trade off between accountability and time. USG programs must be willing to make the sacrifice of some time and resources to put the appropriate accountability mechanisms in place. One USAID staff member stated that during intensive USAID activities in post-Apartheid South

Africa, accountability was assured but the administrative cost and burden was enormous. This is most likely a permanent tension that will always exist between time/money and accountability.

5. Use intensive audit and monitoring oversight

The OIG carries out audits of implementers but also assessments of USAID's own internal control mechanisms.

In programs and projects that must proceed despite high vulnerability to corruption, USAID has applied vigorous audit and monitoring oversight actions. These actions include continuous presence of oversight from both the IG and program officers; clear and continuous reporting; increased professional audit presence, and utilization of concurrent audits or a similar intense audit program.

'Increased oversight of the disaster recovery program helped ensure that funds were spent for intended purposes and not misused... However, USAID faced numerous obstacles and challenges. Primarily USAID did not have the flexibility to readily replace key staff—primarily contracts officers—or the ability to expeditiously hire personal services contractors to help plan for and initiate the disaster recovery programs.'

GAO Report to Congressional Committees. "Foreign Assistance: disaster recovery program addressed intended purposes but USAID needs greater flexibility to improve its response capability," July 2002.

Any aggressive monitoring program should include the explicit requirement that all required internal procedures be followed by those responsible for implementing programs and projects. As noted earlier, strict adherence to internal controls may not always seem compatible with meeting program or project objectives, but doing so is essential to meeting accountability standards.

Where there was a perception of high vulnerability to corruption, early OIG involvement in risk assessment and developing an accountability strategy was thought to have been important in the ultimate success of the accountability effort. Involving the OIG at the risk assessment phase has an important additional benefit. Once the level of risk is measured, OIG personnel can assist in developing an accountability strategy to address the specific risks and can provide both guidance and assistance in implementing the strategy.

One technique that has proven extremely valuable in high-risk situations, whether implemented by the OIG or contract auditors, is the concurrent audit. This is essentially a continuous audit process that produces reports on a quarterly basis, as opposed to the more common annual audit. Although concurrent auditing is a resource intensive technique, it has proven very effective in providing audit results in a timeframe in which needed corrections can be made before problems become too well entrenched. In addition, the routine presence of auditors serves as a meaningful

deterrent to many forms of corruption. USAID has used concurrent auditing in many countries including the Hurricane Mitch countries, Bosnia, and Mozambique.

As mentioned above, for the auditing and monitoring techniques to be effective, decisions about their application should be preceded by risk assessment and strong management prioritization of accountability. Failure to set this foundation may cause considerable waste of auditing and monitoring resources.

One informant familiar with the USAID program in Georgia said that anti-corruption measures are built into virtually all of USAID's programs. Audits activity, which continues to the present, was used aggressively as a deterrent during the primary "scale-up" period on Georgia.

6. Use training and public outreach

Well-trained program staff are the first line of defense against fraud and other types of corruption. Aggressive monitoring of program and project activities requires knowledgeable personnel with a clear management mandate to report concerns to appropriate authorities. Since late 1999, the USAID OIG has developed training programs in fraud awareness and monitoring techniques for USAID personnel and implementing partners including a Fraud Indicators Handbook and a training video.

In addition, the OIG, in conjunction with USAID Missions, trains and equips NGOs and governmental institutions in the fundamentals of financial management and monitoring. Building the capacity of the institutions, be they governmental or non-governmental, to which USAID disburses funds to effectively participate in the overall accountability strategy is an opportunity that many missions have taken advantage of.

Egypt is the largest USAID program, receiving funding of approximately \$659 million in FY 2002. Not surprisingly Egypt seems to suffer more than any other Mission from fraud and abuse schemes, many of which are uncovered by the OIG. USAID/Egypt instituted Pre-Project Implementation Conferences for all large new projects as a technique to minimize accountability problems. These conferences are organized by the Controller's office and include representatives from the Controller's Office, Procurement Office, Management Office, and sometimes a representative from the IG to explain their audit procedures and other concerns. These week-long off-site conferences involve all key project implementers and about a dozen trainers. Egyptian counterparts are given an important role in organizing and managing the conference. The idea is to minimize problems that would require an audit. Participants are instructed in and discuss: channels of communication; how USAID programs are implemented; areas of accountability; and areas of vulnerability and potential for corruption. Comprehensive manuals in English and Arabic are handed out and discussed. Counterparts are given an orientation on how to eliminate most of the potential for corruption.

Measuring the impact of the pre-award conferences on the occurrence of fraud and abuse in Egypt is beyond the scope of this paper, but presumably being better educated reduces the incidence of unwitting errors. On the other hand, intentional defrauding of USAID can only be

prevented by convincing the potential defrauders that control mechanisms will not permit them to get away with the malfeasance. The high incidence of fraud cases in Egypt suggests that control mechanisms there are not intimidating enough to dissuade wrong-doers, despite the presence of a USAID Regional Inspector General's office.

One other useful tool worth noting in promoting active accountability partnerships with host country institutions, particularly government institutions, is to identify and seek to reinforce host country commitments to international anti-corruption agreements. The Inter-American Convention Against Corruption is an example of an international obligation to which many aid recipient countries in Latin America have subscribed. The Inter-American Convention Against Corruption was adopted in 1996 and its provisions commit ratifying countries to develop mechanisms needed to prevent, detect, punish, and eradicate corruption, including the giving and receiving of bribes and transnational bribery.

Another anti-corruption technique involves outreach to host country institutions. In particular USAID solicits involvement of host country Supreme Audit Institutions (SAI), or their equivalent, in the auditing and monitoring process for USAID programs and projects. The USAID OIG has worked with SAIs for over a decade and developed a process for approval of these institutions, essentially certifying that they meet required standards to be a participant in the USAID auditing and monitoring program. As partners, these institutions can provide valuable insight into local conditions and labor needed to gather audit information. USAID has signed MOUs with 19 SAIs.

Outreach also includes providing information to the public - setting an example in transparency. This can mean informing stakeholders about ethics, basic fraud awareness, and the potential for misuse of resources and providing a reporting avenue can produce significant results. In Georgia, USAID has distributed public service announcements (PSAs) through the media as an important part of the anti-corruption strategy. In Colombia, a USAID National Anti-corruption Public Awareness Campaign (started in September 2001) has reached a cumulative television audience of at least 23 million people. The objective is to reach at least 50% of the adult population with basic knowledge about their rights and duties in exercising citizen oversight and control. In Honduras, public information campaigns supported by USAID have increased citizen awareness of the importance of vigilance over the government of Honduras' administration of public resources, knowledge about what kinds of problems to look for, and clear instructions regarding what to do if corruption is identified. During the "scale-up" in Bosnia all tenders as well as selection results were announced in the newspapers.

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Outreach techniques for achieving accountability and transparency begins to cross the line from financial management functions to programs aimed at reducing corruption and building better governance. Indeed, the two frequently overlap. In Central America, USAID programs helped create a new audit unit in the national Comptroller General's Office and then USAID used this unit to oversee about half of the USAID reconstruction funds. Starting in 2001, the OIG has demonstrated active support of USAID anti-corruption/good governance programs through international anti-corruption for a, consulting, and meetings as well as strengthening of SAIs. USAID anti-corruption programs should, if successful help improve accountable management of

USG funds but they are meant to be effective over the long-term and should not be thought of as a substitute for the more direct control mechanisms outlined in this paper.

7. Communicate and coordinate with other donors

Donor consultative groups have become an important element of some USAID accountability activities. The presence of multiple donors and/or multiple US Government agencies providing assistance to address similar problems can create additional vulnerabilities to corruption. Increasingly other agencies of the USG are involved in provision of assistance. This is especially true in the anti-corruption arena where State, Treasury and Justice are important players along with USAID. Department of Defense is also involved in some countries. The most obvious risk to having multiple donors is that poor planning or poor coordination can result in multiple payments for the same or similar services. Another problem is that different donors may have different program or project priorities or may operate with different accountability standards. While each situation is different and may involve a different mix of donors and US Government participatory agencies, coordination is critical to avoiding accountability problems.

Active USAID participation in donor consultative or coordinating groups in situations requiring large amounts of aid from a variety of donors has provide a useful forum for arriving at agreements in principle with respect to accountability issues and should provide a forum for avoiding duplication of effort and funding. When donors cooperate in planning and delivering assistance they are able to deliver a consistent and sustained message about anti-corruption. The Donors Cooperative Group after Hurricane Mitch allowed donors to coordinate efforts with each other and with the cooperating country governments, speak with one voice on policy matters and avoid duplication at the programmatic level. Policy coordination included a strong and explicit message (through the Stockholm Declaration) regarding anti-corruption and other components of good governance, including participation of civil society in decision-making and respect for human rights. An important lesson is that USAID with the IDB and the World Bank also tried to create an auditing group, “Inspectoria de Proyectos,” to monitor use of both donor funds and national funds and make this information public. It is a four-year initiative funded at \$10-11 million for Nicaragua and Honduras each. The project was not functional, however, in time to be of use to USAID reconstruction efforts.ⁱⁱⁱ

USAID took the lead in coordinating the efforts of US Government agencies responding to the Hurricane Mitch disaster. Other than USAID, thirteen additional US departments and agencies received disaster recovery funds, eight of which were linked directly to USAID and many of which had limited experience working overseas. From the outset, USAID sought to incorporate the other agencies into its operational framework and largely succeeded in doing so, despite some complaints about the time it took to do so. However, the GAO found that “coordinating with and helping the other US departments and agencies develop their programs was burdensome and time consuming for the missions.”^{iv}

CONCLUSION

The techniques and methods discussed in this report, while not intended to be exhaustive, are at the core of the financial accountability strategy USAID has been successfully utilizing in recent years to reduce corruption and mismanagement in its programs and projects.

Already, the USAID OIG has applied the Hurricane Mitch model to Southern Africa Flood Rehabilitation and Reconstruction activities in Mozambique and Madagascar; to Central Asia especially Pakistan and Afghanistan; and is planning to do similarly in Iraq.

GAO's main criticism of the Hurricane Mitch experience was that USAID was slow in implementing. Although GAO attributes this to inflexible procedures rather than the special effort that went into assuring accountability, it should be recognized that there is a natural tension between saving time and money and assuring accountability.

The implementation of effective accountability strategies helps to ensure that USAID programs and projects maximize their substantive potential. It also give USAID an expertise and experience that can be better institutionalized internally and shared with other USG agencies, more widely.

ⁱ USAID/OIG. 2002. "Summary Report on Audits of USAID Assistance Provided Under the Central America and the Caribbean Emergency Disaster Recovery Fund (CACEDRF) Supplemental Appropriation." Report No. 1-598-02-003-S

ⁱⁱ Automated Directives Series, chapter 596.3.1

ⁱⁱⁱ Horn, Abigail. 2001. Lessons Learned: Accountability, Transparency, and Hurricane Mitch.

^{iv} GAO Report to Congressional Committees. "Foreign Assistance: disaster recovery program addressed intended purposes but USAID needs greater flexibility to improve its response capability." July 2002.