MEMORANDUM January 23, 2014

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

FROM: Donald L. "Larry" Sampler (s)
Assistant to the Administrator for
Afghanistan and Pakistan

SUBJECT: USAID Response to SIGAR Audit Report, "Afghan Ministry Assessments:" (SIGAR 14-X Audit Report)

Executive Summary

Direct assistance is an important part of USAID's bilateral assistance program in Afghanistan in support of U.S. national security objectives. Oversight of these programs is critical and we welcome SIGAR's continuing examination of these efforts. While there is no way to eliminate risk completely or guarantee a result in undertaking development programming in Afghanistan, USAID, in the field and in Washington, is acutely conscious of the trust that has been placed with us to safeguard taxpayer funds while implementing development programs in support of the national interest. We are always looking at ways to refine and adopt improvements to our systems and look forward to continuing to work with SIGAR In that regard.

This SIGAR audit report on direct assistance to Afghanistan looks closely at a series of risk assessments and internal risk reviews funded and conducted by USAID to examine the internal processes of specific Afghan Ministries in advance of any direct assistance. This was done to ensure appropriate risk mitigation measures are in place and that USG funds are safeguarded, consistent with USAID procedures and Congressional requirements.

SIGAR's audit did not identify waste, fraud or abuse in USAID's direct assistance program. While the audit report examines and calls attention to the risks USAID identified in the Ministries that could potentially impact direct assistance programming in Afghanistan, it fails to acknowledge the full range of risk mitigation measures USAID subsequently employed. On the first page of

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the draft report, SIGAR explicitly states, “We did not examine the implementation of USAID-funded direct assistance programs, assess the effectiveness of USAID’s methods for safeguarding U.S. direct assistance funds, or determine whether fraud and misuse of funds existed with these programs.”

We therefore do not believe the report has any basis to conclude that USAID has failed to fully implement measures designed to mitigate the risks that we ourselves identified. We look forward to working closely with SIGAR in the future, should they choose to examine the actual implementation of these programs.

The Department of State and USAID have complied fully with the spirit and the letter of the law in providing Congress extensive information on the risks and risk mitigation measures for direct assistance in Afghanistan. In addition to the formal certifications and notifications required by law, USAID and the State Department provide Congress information through a variety of means, including testimony, briefings, written responses to questions, and additional Congressional notifications of intent to obligate appropriated funding. We are prepared to appropriately respond to any further requests from Congress with information on these programs.

We appreciate SIGAR’s review of the Department of State’s Fiscal Year 2011 certification and USAID’s FY2012 Congressional Notification with respect to direct assistance and will use SIGAR’s analysis to improve future submissions. The FY 2011 government assistance certification was submitted to Congress by the Department of State in September 2012 with an accompanying Memorandum of Justification that stated USAID had completed Public Financial Management Risk Assessments (risk assessments) of the Ministry of Finance and Ministry of Higher Education. This information was repeated in USAID’s FY2012 country Congressional Notification, which was transmitted in November 2012. In response to concerns raised by SIGAR about when the two assessments were finalized, USAID is reviewing the circumstances surrounding the receipt and completion of the assessments. We have confirmed that the risk assessments for the Ministry of Finance and Ministry of Higher Education that USAID made available to congressional staff, upon request, were the final versions of the assessments. USAID had in place at the time an overall process, that was accurately described in submissions to Congress, to identify deficiencies at all potential ministry partners and put in place strong risk mitigation measures prior to the disbursement of any FY 2011 on-budget funding.

We note that the memorandum of justification that accompanied the Fiscal Year 2011 certification said explicitly that the certification was not the end of our oversight process: "For each activity implemented through a direct government-to-government mechanism, USAID will develop, through project implementation letters … specific terms and conditions applicable to each activity…" This clearly indicated that USAID was continuing to work with the ministries to develop further plans to implement the findings of the risk assessments.

We appreciate SIGAR's acknowledgement of the extensive effort made by USAID to ensure that our assistance to the Afghan government is implemented with rigorous oversight and accountability to mitigate the risks USAID identified in its assessments of Afghan ministries. In particular we note that SIGAR highlights "positive developments" in our work, including the risk mitigation plan developed for Da Afghanistan Breshna Sherkat (DABS) that identifies specific mitigation measures to be employed to confront each weakness. USAID has already completed similar risk mitigation plans for individual ministries with which we have direct assistance programs.

Protection of Sensitive Information

Continued U.S. development engagement is critical to Afghanistan's stability and to protecting the vital interests of our own country. Improving governance, building infrastructure, creating economic opportunity, and enhancing the health and education of the people of Afghanistan are essential to solidifying our military gains and advancing our political and diplomatic goals for the country and the region.

USAID has learned from its experience in Afghanistan and in similar countries around the world and has applied best practices to design and implement on-budget and off-budget programs to mitigate risk. A key first step is understanding the precise capacity of government partners in order to protect U.S. funding from waste and abuse.

In this context, the United States requires close cooperation from government partners in providing very sensitive information to us about the capacity and deficiencies at potential recipient ministries in order to protect USG funds and ultimately improve ministry capacity. This information is truly sensitive and could be exploited in Afghanistan's highly political environment. USAID and the State Department have previously notified SIGAR that certain information provided in connection with this audit, including the risk assessments and

internal risk reviews, is Sensitive But Unclassified (SBU[1]) and therefore not appropriate for public distribution. In addition, USAID notes that the audit report's appendices 1-15 and other portions of the report directly quote information taken from SBU documents that is not appropriate for public distribution.

These risk assessments and internal risk reviews were generated for the internal use of the US Government and the entities that are the subject of the assessments. Demonstrating their openness and willingness to strengthen ministrial management controls, parts of the Afghan government provided unprecedented access for the independent auditors to complete the risk assessments based on understandings that the results of the risk assessments would not be made public. Unfortunately, public release of these materials will likely result in reduced cooperation from the Afghan Government and could undermine our ability to conduct proper oversight of direct assistance programs in the future. USAID and State Department at various levels have requested on numerous occasions that SIGAR not make this sensitive material available to the public, and we again request that SIGAR not make public sensitive information that could damage our bilateral relationships with the Government of the Islamic Republic of Afghanistan.

The conclusions of the USAID internal risk review for each Ministry are not in dispute and their specific details are not relevant to the findings of this audit, which focuses on the process by which the assessments were conducted. The fact that this audit did not examine the effectiveness of the risk mitigation measures put in place by USAID argues further for removal of specific details quoted from internal risk reviews on Pages 8-9 of the draft report as well as in the appendices. We are ready to work with SIGAR to identify again the specific text which we consider most damaging if released.

Draft Audit Recommendations

The Department of State and USAID agree with the substance of the three recommendations and are already complying with them. Therefore we recommend that all three be closed.

Recommendation 1: The USAID Administrator require compliance with all parts of Automated Directive Systems (ADS) 220 -except for the Stage 1 macro-level review - for the use of all direct assistance funds for fiscal year 2014 and beyond.

[1] Sensitive But Unclassified (SBU) is a designation equivalent to For Official Use Only (FOUO), which is used by the military and other agencies for information that warrants a degree of protection and administrative control and meets legal or regulatory criteria for exemption from public disclosure.

USAID Comments: USAID agrees with this recommendation, and in fact, USAID already complies with ADS 220 stage 2 requirements. For future years funding, USAID intends to continue to comply with the requirements of ADS 220, with the exception of completion of the Stage 1 assessment, as recommended by SIGAR, and therefore requests closure of this recommendation.

Recommendation 2: USAID/Afghanistan fully inform Congress of the status of ministry assessments USAID or its contractors have completed, the mitigating measures Afghan ministries have implemented, and the level of risk to U.S. funds.

USAID Comments: USAID has provided extensive information to Congress about direct assistance and regularly responds to Congressional requests for information regarding USAID's direct assistance in Afghanistan, including risks and risk mitigation measures. In early 2014, through the regular notification procedures of the Appropriations Committees, USAID will be providing updated information on its direct assistance program, and is ready at any time to provide Congress with access to additional information. As USAID is regularly updating Congress and providing extensive information on direct assistance in Afghanistan, we request this recommendation be closed.

Recommendation 3: USAID/Afghanistan develop a plan, similar to the one created for Da Afghanistan Breshna Sherkat (DABS), for each Afghan ministry that has a completed USAID risk review that defines how each of the risks identified are being or will be mitigated, and suspend direct assistance disbursement to these ministries until these plans are completed.

USAID Comments: USAID agrees with this recommendation. USAID has identified the risk mitigation plan developed for DABS as a best practice and has already prepared similar plans for the six ministries receiving USAID direct assistance. While USAID prepared a narrative risk report as part of each internal risk review, the DABS risk mitigation plan highlighted by SIGAR presents this same information in a matrix format, which provides a useful and more visual way to detail the condition/weakness, potential risk and action to address the condition/weakness. To simplify this going forward, a matrix will be included in addition to the narrative. USAID, therefore, requests closure of this recommendation.

USAID's Direct Assistance in Afghanistan

A major component of the USG's approach to development assistance in Afghanistan involves supporting the Afghan government, as developmentally appropriate, so it can take increasing ownership for development and sustain the gains made over the past decade. Using local systems has been a goal of the current and previous administrations, as announced at the Paris Declaration and in Busan. It is Agency policy to build host country capacity through measured and responsible use of partner country systems that acknowledges existing vulnerabilities, employs appropriate risk mitigation approaches during implementation, and provides for capacity building measures that correct vulnerabilities both prior to and throughout implementation. USAID employs a cautious and methodical approach to the design, implementation and management of direct assistance provided to the Afghan government.

Before USAID contemplates direct assistance to any Afghan government ministry or entity, it undertakes an extensive risk assessment, known as a Public Financial Management Risk Assessment (PFMRA), to determine whether the ministry or entity has the systems and controls necessary to effectively manage US government funds. To date, 13 risk assessments have been performed by independent international public accounting firms that have been approved by USAID's Office of Inspector General. These assessments, which SIGAR summarized in its report, were performed in accordance with agency policy. After completion of the risk assessment for each ministry, USAID also performed its own internal risk review. While USAID has conducted 13 risk assessments, it is moving forward with providing direct assistance to only seven of the assessed ministries.

Once a risk assessment is complete, the Mission responds to the deficiencies identified by working with the ministry to develop a risk mitigation plan to address deficiencies, some immediately and others over time. USAID uses a multi-tier risk mitigation plan and employs various techniques to address vulnerabilities identified. Each risk mitigation plan contains five standard risk mitigation measures:

1. Separate project bank accounts with specific authorization of use with USAID monitoring and audit rights.
2. Robust concurrent audit requirements with quarterly and annual reporting to identify and address issues on an ongoing basis.
3. Substantial involvement for those projects with significant procurement actions: Review/approval of solicitations, contracts, invoices prior to disbursements.
4. Incorporation of condition precedents and/or ongoing covenants based on the results of the risk assessments and the nature of the activities included in the direct assistance programs. This is followed by a comprehensive review to determine if the identified condition precedents have been met

and ongoing covenants are being addressed. The use of the implementation letter and related annex to document and reinforce terms of agreements.

5. For reimbursement type mechanisms, monitoring, review of programmatic and financial reports along with supporting documentation prior to payment of vouchers.

The risk mitigation plan begins with the selection of a repayment mechanism suited to the capacity of a given ministry, such as using a cost reimbursement agreement. The process continues with identification of "conditions precedent" (CPs) (which are actions required to be completed prior to any disbursement of funds), includes ongoing controls and risk mitigation measures during implementation of a project, and is generally supported by concurrent technical assistance to address vulnerabilities over the long term. The line ministry never touches the money.

The Mission Director, as principal officer in country for USAID, has the authority to sign the Approval of Use of Partner Country Systems (AUPCS), as outlined in ADS 220.2a-b. No "Global team" or Washington approval, as mentioned in the SIGAR report, is required for the AUPCS. The ADS 220 waiver in no way affected the detailed financial review process, and so the insinuation in the audit report that funds are "at risk" due to lack of a Washington review is not supported by the facts.

USAID then enters into project level agreements with each ministry receiving direct assistance. Most of USAID's project level agreements with ministries contain conditions precedent. USAID staff verifies at the outset whether a CP has been accomplished and no disbursements through government systems can occur until after all CPs are satisfied. And, again, , no funds are disbursed to line ministry systems.

Depending upon the nature of the project, USAID then selects a "reimbursement mechanism" for determining when funds may be disbursed to a ministry: either (a) reimbursement of actual costs already incurred or (b) reimbursement after achievement of specific milestones. Under either method, no funding is disbursed until USAID formally verifies and documents that goods and services have been received, milestones have been achieved, and costs can be reimbursed. After verification, funds are disbursed into the project bank account at the Central Bank. As a result of these disbursement procedures, as of December 2013, while approximately $1.06 billion has been committed for direct assistance, $745 million has been obligated and approximately $270

million has actually been disbursed.[2] Some activities envisioned at the time of the SIGAR field work to be performed as direct assistance will now be implemented by other means, therefore while the audit notes a commitment amount of $1.6 billion, the current amount as noted above is $1.06 billion.

In addition to the safeguards put into place related to our disbursement procedures, USAID also exercises direct oversight when substantial procurements are involved by reviewing and approving solicitations and contracts between the Afghan government and its third party contractors, as well as observing the procurement technical review panels. USAID also provides extensive off-budget technical assistance to ministries receiving direct assistance:At the Ministry of Public Health and Ministry of Education has established a third party program management unit within these Ministries, which reviews and verifies all aspects of their programs as well as provides technical assistance to the Ministry. USAID tailors the work with each ministry to suit the specific development needs and to provide the appropriate risk mitigation measures for each project.

While USAID acknowledges that the majority of the weaknesses identified in the risk assessments were rated as high or critical, the risk assessments were conducted at the institutional level and thus did not take into account whether particular weaknesses applied at the project level. Risks identified as “High” or “Critical” at the macro level of the ministry may not be relevant at the project level, especially given our extensive project-level mitigation measures. For example, direct assistance to DABS relies heavily on third party technical assistance and substantial USAID ongoing monitoring oversight, which mitigates vulnerabilities. USAID is substantially involved in DABS’ procurement process through reviews and approvals of solicitations, validation of signed contracts, and third-party verification of contract progress as part of the invoice review and disbursement process.

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,

[2] (1) In the case of direct assistance, “Committed” means the total estimated amount which USAID expects to fund for the project. “Obligated” means the amount USAID has set aside for disbursements. “Disbursed” means the amount USAID has transferred into the project account at the Central Bank.

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.

So 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.

As highlighted in SIGAR's report, the risk mitigation plan for DABS, "is a positive development," acknowledging that USAID has identified the weaknesses related to the DABS activity and how each of the weaknesses will be mitigated. Further, as noted in the SIGAR alert letter issued on December 31, 2013, mitigation measures applied to the DABS project to install power lines, SIGAR noted "these additional oversight provisions are reasonable." While USAID prepared a narrative risk report as part of each of its internal risk reviews, the DABS risk mitigation plan highlighted by SIGAR presents this same information in a matrix format, which provides a useful and more visual way to articulate the condition/weakness, potential risk and relevant actions to address the condition/weakness. USAID has already developed similar risk mitigation plans for each of the six ministries to which it provides direct assistance.

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. In one activity, for example, with the Independent Directorate for Local Government (IDLG), a USAID Inspector General-approved firm audited the program at our request and the audit identified anomalies that led us to suspend the program. USAID is in the process of verifying questioned costs from the audit.

SIGAR's draft audit report, as noted above, presents an incomplete picture of the direct assistance program by calling-out the risks that USAID itself has identified through our ministry risk assessments, while neglecting to fully recognize USAID's risk mitigation measures. The audit also fails to

acknowledge how USAID controls the flow of funds from accounts we control through until disbursed directly to the implementing partners.

Communication with Congress

The Department of State and USAID have complied with statutory requirements prior to U.S. assistance funds being made available for direct government assistance in Afghanistan. In meeting those requirements, the Department of State and USAID have consulted closely with the committees of jurisdiction, providing extensive information on the risks and risk mitigation measures for direct assistance in Afghanistan. Furthermore, we appreciate the value of Congressional oversight of U.S. assistance programming in Afghanistan and support SIGAR's role in the oversight process.

State and USAID make every effort to be thorough in the Certification and Congressional Notification (CN) processes with the common understanding between the State Department and USAID and their committees of jurisdiction that the submission of these formal documents to Congress is the beginning of a consultative process with Congress. The Fiscal Year 11 and Fiscal Year 12 country CNs for Afghanistan provided a top-line summary of a variety of programs and much more detailed discussions take place once the CN is submitted. Even at a summary level, the Fiscal Year 11 country CN #7 ran to 37 pages of text and the Fiscal Year 12 country CN #10 was 42 pages.

In subsequent discussions with and briefings for congressional committees of jurisdiction on the country CNs, it is not unusual for different committees to have different areas of focus and therefore to request disparate additional information on programs during separate briefings that we offer to each committee. Staff on these Congressional committees were active participants in reviewing these formal documents and asking follow-up questions at these briefings. Questions that State and USAID briefers were unable to answer or answer fully at these briefings were taken back and addressed in follow up briefings or written responses to the respective committees or staff who posed the questions. In addition, on many occasions, congressional staff follow-up with written questions following briefings.

It is also common for committees to place holds on funding that has been notified for Afghanistan, pending the provision of additional information requested from the Administration. Accordingly, the submission of CNs for Afghanistan to Congress is the beginning of a lengthy process that can take weeks or months to reach a point where all information sought by the committees has been provided and all of the notified funding can be obligated by USAID. Directly related to the Fiscal Year 2011 Afghanistan country CN

(dated November 21, 2011) and the FY12 Afghanistan country CN (dated November 15, 2012) combined, we provided at least sixteen briefings for Congressional staff, and in addition to the numerous questions answered during the briefings, the Administration answered approximately 45 follow-up questions from Congressional staff, totaling 32 pages of questions and answers.

We note that the memorandum of justification that accompanied the Fiscal Year 2011 Certification said explicitly that the certification was not the end of our oversight process: "For each activity implemented through a direct government-to-government mechanism, USAID will develop, through project implementation letters … specific terms and conditions applicable to each activity…"

With regard to other specific findings in the draft audit report:

- "USAID has only provided redacted copies of the Ernst & Young and KPMG public financial management assessment reports to some congressional staff."
    - This is incorrect. When USAID provided copies of the assessments (with limited redactions) to Congressional staff, as requested, it also offered access to un-redacted copies of the assessments. USAID has briefed numerous committee staff on direct assistance, as to risks and risk mitigation measures, both in the course of CN briefings and in other settings. This procedure has been utilized in an effective manner to keep Congress informed on other programs as well.

- "Additionally, USAID officials told us they have not provided Congress with copies of their internal risk reviews of Afghan ministries' ability to manage donors' direct assistance funds."
    - Congress has been provided extensive information about direct assistance in Afghanistan and has not requested access to these internal risk reviews. USAID is prepared and ready to appropriately respond to any requests from Congress for additional information on our Afghanistan direct assistance program.

- "While USAID informed Congress that the Ministry of Finance was considered qualified 'with the necessary risk mitigation strategy in place,' USAID did not fully disclose in the 2012 notification that it had identified 46 risks within the ministry."
    - The CN also did not list all of the specific mitigation measures USAID took to mitigate identified risks for individual ministries, for the simple reason that State and USAID anticipated providing that

level of detail in briefings or written responses to questions posed by the committee staff once they had reviewed the CN.

- "USAID's notification also did not disclose that the majority of measures intended to mitigate these risks had not been implemented at the time of the notification, even though the 2012 limitation on direct assistance states that funds may be made available for direct assistance to an Afghan government ministry only if 'any identified vulnerabilities or weaknesses of such agency or ministry have been addressed.'"
    - The Fiscal Year 2012 appropriations law stipulates that funds may be made available for direct Government-to-Government assistance only if any identified vulnerabilities and weaknesses have been addressed. The notification by itself does not make available any funds to any program. Funds are only made available as part of the implementation of a program.
    - Also, as noted above, the memorandum of justification that accompanied the Fiscal year 2011 certification made clear that there were a number of additional measures USAID would develop to ensure effective oversight of any USG funds made available under these programs.

ADS 220 Waiver

USAID has complied with the financial requirements set out in Agency policies in ADS 220 for direct assistance. Per the extensive documentation provided to SIGAR, USAID demonstrated it substantially complied with Agency policies on partner country systems in ADS 220.

USAID has made very clear it is still adhering to the core elements of the policy, with the sole exception of elements of Stage I, which is a macro-level, preliminary assessment that was for all intents and purposes already accomplished in Afghanistan. Particularly, USAID substantially complies with ADS 220 in the areas related to financial oversight. That USAID did not perform the macro-level Stage I review, including the "enhanced democracy, human rights, and governance review" would not have changed the decision to move to the Stage II assessments since the decision was made and communicated to Congress, the Afghan Government and the International Community.

The ADS 220 waiver was granted not only on foreign policy grounds, but also because, to quote the 2012 waiver, "USAID/Afghanistan has been engaged in direct G2G assistance to GIRoA for several years" (p. 3) and, "[m]ore

importantly, the Mission has complied with the spirit and purpose of the guidance" (p. 4). The ADS 220 waiver in place for Afghanistan only applies to appropriated funds made available to the Mission through Fiscal Year 2013, not Fiscal Year 2015 as stated in the audit report. As is made clear in the waiver memo for ADS 220, USAID is committed to fulfilling Agency requirements to the fullest extent possible. The risk assessments performed for USAID and summarized in this report are but one illustration of USAID's efforts to comply with Agency regulations. The statement that funds are "at risk" because of the waiver ignores the extensive documentation that SIGAR used to make this report that was done in accordance with Agency guidance. Furthermore, the implication that USAID does not require ministries to implement mitigation measures is inconsistent with the extensive documentation provided to SIGAR demonstrating how USAID itself mitigates the risks we identified.

Finally, as this audit does not examine the implementation of USAID direct assistance programs, we do not believe this report has any basis on which to question whether the identified vulnerabilities have been addressed prior to funds being made available.