Appendix No. 1

Stage II Risk Assessment Report

USAID
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USAID AFGHANISTAN OFFICE OF FINANCIAL MANAGEMENT

Public Financial Management Risk Assessment Framework

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN MINISTRY OF AGRICULTURE, IRRIGATION AND LIVE STOCK

Stage II RISK ASSESSMENT
October 10, 2012

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Background

Founded in 1947, Afghanistan has had a tumultuous existence. Rich with natural resources such as natural gas, petroleum, coal, copper, zinc, and iron, the country has all the necessary elements to jump start its economy. However, the Afghan's economy has been plagued with instability, but is now recovering from decades of conflict. According to Public Expenditure Financial Accountability (PEFA) reports, the economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. While the international community remains committed to Afghanistan's development and has pledged significant resources, the Government of the Islamic Republic of Afghanistan (GIRoA) will need to overcome a number of challenges, including low revenue collection, anemic job creation, and high levels of corruption, weak government capacity, and poor public infrastructure. According to a 2008 PEFA report, Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. However, capacity development in the line ministries needs strengthening. Compared with the progress in the Ministry of Finance (MoF), developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved. The internal audit function in line ministries does not meet recognized professional standards. While technical expertise in the line ministries has significantly improved in several areas, long-term fiscal planning remains uncertain.

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

The United States is committed to improving the quality of its aid in order to maximize development in Afghanistan. U.S. military action in Afghanistan including USAID's support of the U.S.G. Counterinsurgency strategy is expected to come to an end around December 2014. This counterinsurgency commitment remains in force for an approximate three year period until FY 2015. USAID anticipates that FY 2015 will be the beginning of a transformational decade to a normal USAID longer term development

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

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

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

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

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

risk in Afghanistan. Essentially, the foreign policy decision to engage in G2G assistance in Afghanistan has replaced the first two steps under the Agency ADS 220 policy–the enhanced DRG review and the PFMRAF Stage I assessment.

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

Objectives

The overall objective of this Stage II risk assessment is to determine whether the U.S. government can rely on the Ministry Agriculture, Irrigation and Live Stock s' (MAIL) systems, operation and internal controls to manage donors' funds. Specifically the assessment will:

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

Executive Summary

The United States Government committed to channeling at least 50 percent of its development assistance through the national budget of the Afghan Government[3]. This commitment comes with the responsibility to ensure effective use of funds provided by U. S. taxpayers and appropriated by Congress, and address fiduciary *risk in the Partner* Country Public Financial Management (PFM) system being considered for direct implementation of USAID-funded assistance. For that reason USAID developed the Public Financial Management Risk Assessment tool stage I rapid appraisal and the stage II risk assessment to enable it to meet that objective. The Public Financial Management Risk Assessment Framework (PFMRAF) is a multi-stage risk-based methodology whereby USAID seeks to understand the fiduciary risk environment in targeted countries to inform decisions whether to use or increase the use of partner country public financial management systems in delivering aid assistance. If the assessment reveals clear evidence of vulnerabilities to corruption, and the partner country government fails to respond, the use of partner country systems must not be authorized.

This Stage II assessment was performed to determine whether USAID can rely on the Ministry of Agriculture, Irrigation and Live Stock (MAIL) systems operation and internal controls to manage donors' funds. The assessment found that USAID cannot fully rely on the Ministry of Agriculture, Irrigation and Live Stock current systems operation and internal controls to manage donors' funds without substantive mitigation measures being incorporated into G2G agreements negotiated with MAIL.

The current governing body at the Ministry does not have the required management awareness and competence to lay the foundation for a strong control environment and to motivate staff to pursue the organization's goals. Senior management is still trying to figure out their roles and responsibilities, and has not been able to respond to *identified and* eminent control risks. In general senior management's attitude toward good governance has been very casual.

In some respect senior management has been cooperating with the donor community to assume greater responsibility to manage aid projects. By the same token senior management has not focused seriously on strengthening the Ministry's financial systems and management controls that would give donors reasonable assurance that funds transferred into the GIRoA's core budget will be safeguarded against waste fraud and abuse. During the assessment auditors noted that, budget formulation and execution are not tracked in the Ministry's Financial Management Information System (FMIS), financial transactions are not always recorded and recognized , and physical assets are not inventoried and documented in the FMIS. The auditors also noted that, employees' time and attendance is not consistently documented, and that several employees were on

[3] London conference of Afghanistan, January 2010 and the Kabul International Conference on Afghanistan, July 2010

leave without written authorizations and the unauthorized leaves were not deducted from the employees' wage statements.

Furthermore, MAIL's existing procurement processes are not transparent and need strengthen. The assessment found evidence of conflict of interest, as staff responsible for obtaining quotations is also responsible for evaluating them. In fact, vendor selection without formal bid evaluation is a common management practice.

Lastly, the assessment identified significant deficiencies in the Ministry's information and commutations systems. Monitoring and Evaluation (M&E) staffs at the provinces are reporting their observations to project implementers, however, these observations are not shared with mid and senior level management at the central M&E Directorate.

Under normal circumstances, the results of this assessment would lead USAID not to engage in Government to Government (G2G) assistance with the Ministry. However, since the determination to engage in direct G2G assistance with the Government of the Islamic Republic of Afghanistan (GIRoA) has been made already at the highest levels of the U.S. Government, USAID needs to take reasonable precautions *to mitigate* all identified risks. Appendix 1 details the identified risks and proposes possible mitigating measures to manage those risks.

Assessment Conclusion & Results

USAID cannot rely on the Ministry of Agriculture, Irrigation and Live Stocks' *(MAIL)* systems operation and internal controls to manage donors' funds.

- MAIL's financial management/accounting system is not adequate to properly manage and account for donors' funds.
- MAIL does not have the financial management capacity to manage proposed activities.
- MAIL's internal controls are not adequate to manage donors' funds.
- MAIL's procurement management unit does not have sufficient systems and management capacity to implement activities and manage donors' funds.
- Except for not complying with GIRoA's procurement laws regarding the composition of procurement committee, for the most part MAIL complied with applicable *laws and* regulations.

In addition, the internal controls environment is not adequate to mitigate risk of corruption, and it is unclear if there is the will to combat corruption. Nonetheless, we believe the identified risks can be reasonably mitigated. See appendix 1.

Management and governance structure

One of management's responsibilities is to implement structure that will enable it to execute its responsibilities in an accountable manner. The governance structure and management accountability needed to insure appropriate policies are developed and applied, procurement integrity observed, and robust financial controls put in place is missing. . MAIL's leadership committee and evaluation committee for land leases meet weekly to discuss strategic and policy issues; however, members from both committees do not understand their roles and responsibilities. Legal matters with the potential to detrimentally impact the Ministry's operations, including the use of unlicensed software are not prioritized. Management recognized the volatility of the operating environment, but has not discussed or considered business continuity and disaster recovery plans. Although management is aware of the threat of unauthorized use and access to its information systems, it has not taken action to mitigate or prevent the occurrence of that threat. Management's casual attitude toward good governance and the lack of general controls put donors' funds at risk.

Financial Management and Accounting Systems

To achieve success in program implementation a reliable public financial management system is vital. MAIL does not have sufficient financial management capacity to manage proposed activities, and its management and accounting systems are not adequate to properly manage and account for donors' funds. Accounting staffs do not record cash receipt in the MAIL's financial Management Information System (FMIS), and they do not prepare revenue analysis. Fixed assets are not registered, tagged and tracked, and periodic physical verification of fixed assets is not conducted. In addition, auditors noted several transactions that were not recorded and recognized in the MAIL's FMIS. Lastly, budget formulation and execution are not tracked in the FMIS. These conditions create a weak and inadequate internal controls environment, and indicate MAIL's inability to mange donors' fund without substantial involvement from donors.

Personnel Policies and Procedures

Recruiting, training and retaining qualified staff is vital for any organization's going concern. In addition, management attitude toward recruitment, human resources policy development, and investment in staff affects all levels of the organization. The assessment found that the MAIL does not properly review the history and background of employees, including employees in critical positions before they are hired. The assessment also found employee job descriptions are not signed, and annual employee code of conduct and conflict of interest forms are not documented. Further evidence of management's casual attitude, auditors noted during the assessment that staffs were taking leave; however, there were no records of leave of absence on file, thereby making it very difficult to track accurately employees' pay benefits. Similarly, provincial offices have difficulty tracking staff's time and attendance, because there are no basic automated attendance systems in these offices. MAIL's control environment weaknesses are systemic, as staff performance appraisals are not conducted timely, and, there is a lack of adequate training for newly hired staff. In addition to the human resources challenges, noted above, the Ministry does not have a documented succession plan. We understand MAIL is operating in a challenging environment, but the lack of attention to basic employment procedures, and the unwillingness or inability to enforce the most ordinary ethical conducts in the organization expose donors' fund to cronyism and nepotism.

Procurement and Purchasing system

Procurement is a critical organizational function, as huge amount of money are spent every year procuring goods and services. MAIL's inability to effectively management its procurement processes could have a significant negative impact on donors' funds. Contrary to GIRoA's procurement law, MAIL has no documented and defined procurement policy for advertisement below AFS 500,000 ($10,000). Furthermore, the MAIL's procurement processes are not transparent, as request for quotations are sometimes issued to vendors at the discretion of management – No documented vendor evaluation processes are applied. These inadequacies in the procurement processes are systemic and prevalent, the assessment revealed evidence of conflict of interest, as personnel responsible for obtaining quotations are also responsible for evaluating the quotations. There is also no segregation of duties at the provincial levels for purchases below AFS 500,000 ($10,000). This lack of accountability by public officials in the procurement process gives rise to potential fraud and puts donors' funds at risk.

Program Management and Monitoring

Monitoring is a key component of internal controls. It assesses the adequacy and quality of the internal control activities and systems performance over time. Opportunity for improvement identified and observations should be communicated to the appropriate level, in most cases to the senior management. The assessment found a significant weakness in the Ministry's communication and information sharing system. Staffs were preparing Monitoring and Evaluation (M&E) reports, these reports were shared with low level management, but not with senior level management. As a result, senior management (Minister and/or the Leadership Committee) did not have access to critical information on program management. The practice of provincial M&E staff reporting directly to the Provincial Directorate (project implementers) instead of the central M&E Directorate raises concern of conflict of interest which poses a risk that could lead to funds being used for unintended purposes and/or being utilized for inefficient programs.

Risk Assessment Measurement

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

USAID's PFM Risk Matrix

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

Scope and Methodology

The independently contracted auditors conducted the assessment under a scope which focused on five main areas. 1) Procurement, 2) Accounting and Internal Controls, 3) Monitoring and Evaluation, 4) Audit and 5) Human Resources. While the auditors conducted an in-depth assessment on the five areas mentioned above, they did not use the Agency's approved Public Financial Management Risk Assessment Framework (PFMRAF) checklist, and did not conform in many ways to the Agency's PFMRAF guidance on risk treatment and risk assessment measurements. However to ensure the Mission comply with the Agency's guidance and performs required due diligence, we reviewed the auditors' report and we met with the auditors who conducted the assessment to gain a general understanding of the nature of their work. We met and discussed with our internal financial analysts who had an understanding of the ministry's systems. We conducted limited research on other work performed by DFID on the MAIL. Based on auditors' work, our reviews, meetings and research, we completed the PFMRAF checklist and risk mitigation plan and we summarized our findings and understanding in this report.

At the time of the assessment it was not clear if the auditors understood that they had to define their findings in terms of risks so appropriate risk mitigation measures could be developed to address the identified risks. Because our review was conducted after the auditors had completed the assessment, and could not go back to determine the impact and probability, we relied on the understanding we've gained over the years of collaboration with the government. Based on that understanding we defined the potential risks and we took a conservative approach and considered most risks to be serious and probable unless the contrary was clearly evident.

Appendix 1

Risk Schedule:

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
			Management and governance structure		
1.	Senior officials: Losing focus on organizational goals and objectives Not being competent to manage USAID's funds Not being accountable	Serious	Probable	Critical	1. Develop clear terms of reference for the Leadership and Evaluation committee for the land leases. 2. Distribute copies of the terms of reference to each member of the Leadership and Evaluation committee 3. Transfer all assistance funding into an escrow bank accounts.
2.	Internal controls weaknesses and gaps may go undetected Inconsistencies in audit practices and approach Waste, fraud and abuse may go undetected	Serious	Probable	Critical	1. De-emphasize Internal Audit on the payment process. 2. Develop risk base audit approach in the annual audit program. 3. Develop a standard audit program and a checklist to serve as a guide for all audit engagements. 4. Audit all USAID projects annually. 5. Submit interim risk based audit reports to USAID.
3.	Unauthorized access to the computer systems Abuse of system access rights where system's users also have administrative rights Loss of vital data and	Serious	Probable	Critical	1. Develop a ministry wide Information Communication Technology system policy to include disaster recovery plan. 2. Develop unique user ID and password for all users of the information systems. 3. Define and restrict systems access to staff according to their roles and functions. 4. Back-up information technology systems regularly on and off site. 5. Audit all USAID projects annually.

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
	information in the event of system failure or disaster Financial data being manipulated				
4.	Penalties and legal proceedings issued against the Ministry for the use of unlicensed software Violating laws and regulations	Serious	Probable	Critical	Purchase licensed software for the Ministry's IT systems.
			Financial management and accounting systems		
5.	Public officials not being accountable for revenues that flow to the Ministry Engaging in off balance sheet financing for resources diversion	Serious	Probable	Critical	1. Develop a policy for accounting for revenue. 2. Prepare monthly reconciliations on revenue accounts. 3. Prepare monthly receivable aging analysis report. 4. Review and approve monthly receivable aging report. 5. Conduct periodic audits on revenue accounts. 6. Audit all USAID projects annually.
6.	Lack of physical control over fixed assets Diverting government property for personal use	Serious	Probable	Critical	1. Tag all fixed assets with an identification number. 2. Update fixed assets register on regular basis to reflect: date of purchase, asset type, location, serial number, tagged number. 3. Conduct periodic inventory of fixed assets, possibly every six months.

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
			Personnel policies and procedures		
7.	Project not being sustainable	Marginal	Probable	High	1. Develop and document a formal succession plan for staff and projects. 2. Establish a training committee to review and plan staff training needs. 3. Develop training plan for each member of staff. 4. Submit regular project reports to USAID.
8.	Employing unqualified personnel Nepotism and cronyism may lead to collusion between related parties	Serious	Probable	Critical	1. Develop a policy for recruitment. 2. Verify that adequate reference checks have been made on every prospective employee and properly documented. 3. Update if applicable, employee security checks periodically. 4. Update employees' code of conduct regularly. 5. Conduct annual ethics training for all employees. 7. Develop annual work objectives for all employees. 8. Document recruitment disclosure forms for senior management and HR staffs.
9.	Payments to employees for not working Funds being used for unintended purposes Improper payments to employees.	Marginal	Probable	High	1. Document time and attendance for all employees. 2. Link employees pay benefits to the time and attendance register and reconcile regularly. 3. Conduct compliance audit.
			Procurement and purchasing systems		
10.	Procurement system not being transparent Conflict of interest Not implementing	Serious	Probable	Critical	1. Develop written policies and procedures for the procurement processes. 2. Request OAA's involvement in all critical procurements. 3. Obtain signed conflict of interest from personnel who are involved in the procurement processes. 4. Develop a plan to introduce procurement reforms.

	Risks Of	Impact	Probability	Score	Suggested Mitigating Measures & Benchmarks
	standards so to facilitate illegal acts Vendor selecting scheme to defraud the government Acquiring sub-standard goods, to finance kickbacks and bribes				
	Program management and monitoring				
11.	Senior management not having access to critical programmatic information Funds being used for unintended purposes Covering-up mismanagement misconduct and abuse may go undetected	Marginal	Probable	High	1. Develop written policies and procedures for monitoring and evaluation and disseminate notices to all staff. 2. Send monitoring and evaluation reports to the M&E Directorate at the head office and copies to the provincial offices. 3. Submit copies of M&E reports to USAID.