

USAID Has Disbursed \$9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, but Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources



This report was originally issued on April 30, 2012. It was reissued on May 2, 2012, to reflect the U.S. Agency for International Development's (USAID) written comments on a draft of this report. USAID provided its comments to SIGAR after the original report had been publically released, but SIGAR considered the comments substantive and necessary for a full understanding of the issues presented and USAID's efforts to address them. As a result, SIGAR made changes to the summary page, the transmittal letter (page i), and the Comments section (page 22) to reflect USAID's comments. USAID's comments are reproduced in appendix III.

April 30, 2012



SIGAR

Special Inspector General for Afghanistan Reconstruction

SIGAR Audit-12-9

April 2012

USAID Has Disbursed \$9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, but Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources

What SIGAR Reviewed

Since 2002, the U.S. Agency for International Development (USAID) has awarded \$15.2 billion in Afghan reconstruction funds to its implementing partners through 305 major (over \$100,000) contracts, grants, cooperative agreements, and other funding mechanisms. Financial audits of funds expended under such awards provide USAID with independent assessments of how those funds were used. Ensuring that financial audits are conducted in a timely manner is critical to provide accountability over reconstruction funds in Afghanistan where USAID has experienced challenges in monitoring program implementation.

This report (1) identifies the awards that USAID has funded for Afghanistan reconstruction since 2002 and (2) assesses the extent to which financial audit requirements had been met for the various types of awards and implementing partners. To address these objectives, SIGAR selected a random sample of 64 awards to determine if audits had been done, reviewed applicable requirements and award files, and met with USAID contracting officers and other officials. SIGAR conducted its work in Kabul, Afghanistan, and Washington, D.C., from March 2011 to March 2012 in accordance with generally accepted government auditing standards.

What SIGAR Found

Since 2002, USAID has made 305 major awards to 149 different implementing partners to fund reconstruction activities in Afghanistan. As of September 30, 2011, USAID had disbursed \$9.5 billion through these awards, which had a total estimated value of \$15.2 billion. The awards included 136 contracts and task orders, 93 cooperative agreements, 53 grants, and 23 interagency agreements. The majority of USAID funding went to U.S. contractors, U.S. nonprofit organizations, and multilateral organizations. Ten implementing partners accounted for about 70 percent of total USAID funding.

Based on SIGAR's sample of 64 awards, SIGAR found that incurred cost audits of U.S.-based contractors were delayed due to a backlog of such audits caused by understaffing at the Defense Contract Audit Agency (DCAA) and lack of funding by USAID. As a result, nearly \$1.1 billion disbursed by USAID since 2003 to the 13 U.S. contractors in our sample had not been audited by DCAA as of September 30, 2011. Annual audits of U.S.-based nonprofit organizations were conducted in accordance with Office of Management and Budget Circular A-133, but they often did not include specific USAID Afghanistan awards, thereby providing limited accountability over reconstruction funds. Annual financial audits of awards to multilateral organizations and other non-U.S. entities were often conducted. However, in some instances, these audits only partially met requirements or the results were not provided to USAID. Audit requirements for funds provided to other U.S. agencies were vague or, in many cases, audits were not required.

Although the majority of USAID's 305 major awards for Afghanistan reconstruction had been completed or had expired as of September 30, 2011, most had not been closed due, in part, to delays in conducting close-out audits, as required. Therefore, USAID lacked assurance over the use and disposition of its funds and property for completed or expired awards, and also delayed the potential recovery of \$103 million in unliquidated obligations and \$27.3 million in unpaid cost share, which are resources the implementing partner is responsible for providing. Finally, although as much as half of the funds that USAID provides for contracts, grants, and cooperative agreements may flow down to sub-recipients, USAID lacked transparency with regard to whether financial audits of sub-awards were being conducted, as required.

What SIGAR Recommends

To strengthen accountability over USAID funds provided to its implementing partners in Afghanistan, SIGAR recommends that the Administrator of USAID (1) provide the funding needed to increase the quantity and timeliness of incurred cost audits of U.S. contractors, (2) develop a system to identify and prioritize award-specific audits of U.S.-based nonprofit organizations, (3) expedite the use of close-out audits for expired awards with unexpended obligations and unpaid cost share, and (4) amend prime awards to include a requirement for a financial audit plan for sub-awards. When preparing the final report, SIGAR considered comments from USAID. Overall, USAID generally concurred with the recommendations and noted that it has taken some steps to address them.



OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR AFGHANISTAN RECONSTRUCTION

April 30, 2012

The Honorable Rajiv Shah
Administrator, U.S. Agency for International Development
Dr. S. Ken Yamashita
USAID Mission Director to Afghanistan

This report discusses the results of the Office of the Special Inspector General for Afghanistan Reconstruction's (SIGAR) audit of the U.S. Agency for International Development's (USAID) financial audit coverage of funds provided to contractors, grantees, and other recipients and implementing partners for reconstruction activities in Afghanistan. This report includes four recommendations to the Administrator of USAID to help strengthen the agency's accountability over such funds.

When preparing the final report, we considered comments from USAID. Overall, USAID concurred with our recommendations and noted that it has taken some steps to address them. These comments are reproduced in appendix III. We conducted this performance audit under the authority of Public Law No. 110-181, as amended, the Inspector General Act of 1978, and the Inspector General Reform Act of 2008.

A handwritten signature in black ink, appearing to read "Steven J. Trent".

Steven J Trent
Acting Special Inspector General for
Afghanistan Reconstruction

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ABBREVIATIONS AND ACRONYMS

ADS	Automated Directives System
ARTF	Afghanistan Reconstruction Trust Fund
CAO	Control and Audit Office
DCAA	Defense Contract Audit Agency
FAR	Federal Acquisition Regulation
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAPA	Participating Agency Program Agreement
PASA	Participating Agency Service Agreement
SIGAR	Special Inspector General for Afghanistan Reconstruction
UN	United Nations
UNDP	UN Development Program
USAID	U.S. Agency for International Development



USAID Has Disbursed \$9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, but Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources

Since 2002, the U.S. Agency for International Development (USAID) has provided about \$9.5 billion in Afghanistan reconstruction funds¹ to contractors, grantees, and other third-party entities (referred to collectively as implementing partners)² by means of 305 individual contracts, task orders, grants, cooperative agreements, and other funding mechanisms (referred to collectively as awards). USAID officials are responsible for providing reliable, useful, and timely information for transparency and accountability of the programs that are funded through these implementing partners. Financial audits provide independent, objective, nonpartisan assessments of the stewardship, performance, or cost of government policies, programs, or operations, depending on the type and scope of the audit.³ Conducting financial audits is critical to help ensure that implementing partners have properly accounted for those funds and used them as intended. Achieving a high level of accountability over USAID funds for reconstruction efforts in Afghanistan is particularly important given that (a) the United States has significant national security interests in Afghanistan, a country which ranks among the most corrupt in the world, and (b) USAID has experienced a longstanding inability to adequately monitor program implementation due to security concerns.⁴

We initiated this audit to determine the extent to which financial audits were being conducted of costs incurred under USAID-funded awards for Afghanistan reconstruction. Specifically, our objectives were to (1) identify the universe of awards that USAID has funded for Afghanistan reconstruction since 2002 and (2) assess the extent to which financial audit requirements had been met for various types of implementing partners and awards, including expired awards and sub-awards.

To identify the universe of awards, we obtained data from USAID regarding major awards issued between February 1, 2002 and September 30, 2011. We conducted data reliability tests to ensure the accuracy and completeness of that data. To determine the extent to which financial audits had been performed on those awards, we selected a random sample of 64 awards and reviewed applicable files to determine whether financial audits had been performed. As of September 30, 2011, USAID had disbursed almost \$2.5 billion under these 64 awards (26 percent of disbursements for all 305 major awards⁵). We also reviewed relevant laws, regulations, policies, standard operating procedures, and other guidance relating to financial audits of USAID implementing partners, and interviewed USAID officials in Washington, D.C., and Kabul, Afghanistan, including contracting and assistance officers responsible

¹For purposes of this report, Afghanistan reconstruction includes any major contract, grant, agreement, or other funding mechanism entered into by USAID that involves the use of amounts appropriated or otherwise made available for the reconstruction of Afghanistan. Since fiscal year 2002, Congress has made funds available for Afghan reconstruction purposes to USAID through eight separate appropriations accounts, including the Economic Support Fund, Development Assistance, Child Survival and Health, and P.L. 480, Title II (food aid).

²Implementing partners include recipients of contracts, cooperative agreements, grants, and interagency agreements.

³U.S. Government Accountability Office, *Government Auditing Standards*, Sections 1.01 and 1.02, GAO-07-731G, July 2007.

⁴Since 2004, USAID/Afghanistan's Federal Managers Financial Integrity Act self-assessment has identified the lack of project monitoring by designated USAID staff as a significant internal control deficiency.

⁵USAID's Mission for Afghanistan defines "major" awards as all contracts, grants, cooperative agreements, and interagency agreements over \$100,000, and excludes personal services contracts.

for contracts and grant agreements, as well as their technical representatives. In addition, we met with USAID financial management personnel and officials of USAID's Office of Inspector General (OIG) based in Washington, D.C., and Kabul, Afghanistan. We conducted our work in Kabul, Afghanistan, and Washington, D.C., from March 2011 to March 2012 in accordance with generally accepted government auditing standards. A more detailed discussion of our scope and methodology is included in appendix I.

BACKGROUND

USAID has disbursed billions of dollars as part of the larger U.S. government and international effort to help the Afghan government secure and rebuild its country following the removal of the Taliban regime by coalition troops after the September 11, 2001, terrorist attacks in the United States. USAID's assistance programs in Afghanistan have focused on areas such as health, education, economic growth, agriculture, infrastructure, and governance to help stabilize the country and build the Afghan government's capacity to provide services and security for its citizens. The majority of USAID assistance to Afghanistan has been provided through various implementing partners by means of contracts, task orders, grants, cooperative agreements, and other funding mechanisms. According to USAID records, between February 1, 2002, and September 30, 2011, the agency made 305 major awards with a total estimated value of \$15.2 billion, of which \$10.4 billion had been obligated and \$9.5 billion disbursed as of September 30, 2011. The majority of these awards were overseen by technical program offices at USAID's Mission in Kabul.

Financial audits of contracts and grants help USAID and other stakeholders assess whether implementing partners have accounted for and used USAID funds as intended. Specifically, in addition to rendering an opinion as to whether an implementing partner's financial information is fairly presented, financial audits also evaluate a recipient's internal controls to identify material weaknesses and perform tests to determine whether a recipient complied with applicable laws and regulations. Financial audits may also be used to help finalize indirect cost rates, close out awards, settle termination claims, and review compliance with cost-sharing agreements. In addition, financial audits of recipients often result in savings to the U.S. government by identifying costs that may be disallowed and recovered because they do not comply with the terms of an award, lack adequate supporting documentation, are not allocable to a specific program, or are deemed unreasonable. Less measureable are the potential savings that may accrue due to the deterrent effect that a financial audit program has on implementing partners who may otherwise be more inclined to misuse USAID funds.

Chapter 591 of USAID's Automated Directives System (ADS) describes the agency's policies and procedures pertaining to financial audits of implementing partners.⁶ ADS 591 lists the primary responsibilities of individuals and offices at USAID headquarters and field missions with regard to determining which awards should be audited and ensuring that required financial audits are conducted. According to ADS 591, awards issued by USAID may be subject to a variety of financial audit requirements depending on the type of implementing partner, type of award, whether the implementing partner is based in the U.S. or another country, the amount of Federal funding received, and the status of the award (see appendix II). Generally, for-profit companies are subject to annual incurred cost audits by the Defense Contract Audit Agency (DCAA), and non-profit organizations with funding levels above designated thresholds are required to contract with private audit firms to conduct annual financial audits. USAID may also opt to have additional audits performed by contracting directly with independent audit firms. Funds provided under USAID awards may also require other financial audits depending on the status and circumstances of the award. For example, awards that expire as planned, or are terminated early, normally require a "close-out" or termination audit to help determine final indirect cost rates and evaluate the provision of agreed-upon cost-sharing. In addition, most USAID awards require the primary

⁶ADS is USAID's directives management program. Agency policy directives, required procedures, and helpful, optional material are drafted, cleared, and issued through ADS. Agency employees must adhere to these policy directives and required procedures.

implementing partner to “pass down” financial audit requirements in awards to sub-partners and ensure that costs incurred under sub-awards are audited.

USAID generally funds annual financial audits of U.S. contractors from its separately appropriated operating expense account. For other recipients, USAID often allows the use of program funds to cover audit costs. The costs of such audits are often included as line items in the budgets of program-funded grants and cooperative agreements. Also, USAID policy specifically states that the agency may perform audits of host government recipients and sub-recipients using program funds.

Among other duties, USAID’s OIG is responsible for ensuring that financial audits of USAID implementing partners are conducted in accordance with appropriate standards. Generally, only audit organizations, which the OIG has determined to be eligible, may perform financial audits of USAID’s partners. These organizations may include independent audit firms contracted by grantees, public accounting firms under contract to USAID, Federal audit agencies such as DCAA, host country supreme audit institutions, or the OIG. As of March 2011, the OIG had approved 12 independent firms to conduct financial audits of USAID implementing partners in Afghanistan.

To fulfill its oversight responsibilities, the OIG is required to review all financial audit reports of USAID implementing partners. Additionally, the OIG is to conduct quality control reviews of selected financial audits to ensure that they were performed in accordance with applicable standards. The OIG transmits award-specific audit reports it reviews to USAID management, along with related audit recommendations which the OIG tracks and reports on semiannually to the U.S. Congress. As of September 30, 2011, the OIG reported transmitting a total of 39 such audit reports covering \$857 million in USAID funds expended under Afghanistan reconstruction awards through 12 different awards. According to OIG records, those audit reports included a total of \$114 million in costs that were questioned by the financial auditors. USAID contracting and assistance officers sustained, or agreed to recover, about \$99.7 million of those questioned costs. In addition, the OIG reviews organization-wide financial audits of U.S.-based contractors conducted by DCAA and U.S.-based nonprofit organizations conducted by private audit firms.

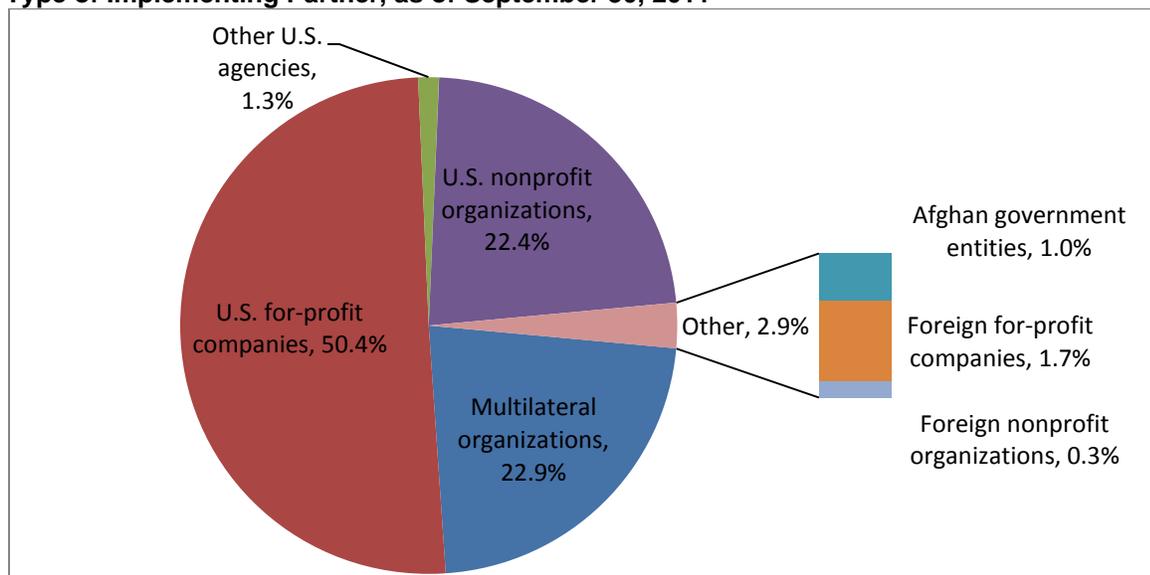
Last year, USAID took steps to increase the coverage of its financial audit program for implementing partners working on Afghanistan reconstruction activities. In April 2011, the Director of USAID’s Kabul Mission signed an action memorandum initiating a program to audit all locally incurred costs by program-funded implementing partners to improve USAID’s ability to ensure that its funds are properly accounted for and spent in accordance with applicable laws, regulations, and policies. The memorandum indicated that a more robust financial audit program would become a cornerstone of the USAID Administrator’s Accountable Assistance for Afghanistan (A3) initiative, designed to address the concern that Afghanistan is a difficult operating environment which poses significant challenges to executing proper financial controls. In particular, the memorandum stated that the goal of the new initiative was to limit the likelihood that USAID assistance would directly or inadvertently support terrorist groups or be diverted from its development purpose by extortion or corruption. However, the new audit program has not been fully implemented and will need time to recruit and train qualified staff, develop the capacity of local audit firms, and obtain necessary funding.

SINCE 2002, USAID HAS DISBURSED NEARLY \$9.5 BILLION UNDER 305 AWARDS FOR AFGHANISTAN RECONSTRUCTION

USAID records indicate that it issued a total of 305 major awards to 149 different implementing partners between February 2002 and September 2011 to fund reconstruction activities in Afghanistan and disbursed \$9.5 billion under these awards.⁷ The 305 awards included 136 contracts and task orders, 93 cooperative agreements, 53 grants, and 23 interagency agreements to fund other U.S. government agencies. As of September 2011, 100 of these awards were ongoing, while 205 had expired. Most awards were managed by technical program offices within USAID’s Kabul Mission.⁸

As of September 30, 2011, almost three fourths of these disbursements had gone to U.S. implementing partners and recipients, such as for-profit contractors, nonprofit organizations, and other government agencies. Nearly one-fourth of the funding went to multilateral organizations, such as the World Bank and United Nations (UN) agencies. Only about 3 percent went to foreign implementing partners and recipients, including the Afghanistan government. Figure 1 shows the percentage of USAID funds provided to each type of implementing partner.

Figure 1: USAID Disbursements under Major Awards for Afghanistan Reconstruction, by Type of Implementing Partner, as of September 30, 2011



Source: SIGAR analysis of USAID data.

Although USAID has issued major awards for Afghanistan reconstruction to 149 different implementing partners and recipients since 2002, as of September 30, 2011, 10 implementing partners accounted for about 70 percent of USAID funding for those awards (see table 1).

⁷The total award value as of September 30, 2011, was \$15.2 billion; of that amount, \$10.4 billion had been obligated.

⁸USAID’s technical program offices in Kabul include the Offices of Agriculture, Democracy and Governance, Economic Growth, Social Sector Development (Education and Health), Infrastructure Energy and Engineering, Program and Project Development, and the Stabilization Unit. In addition, five administrative awards, including a \$361 million contract for chartered air service, were managed by the Mission’s Executive Office.

Table 1: Implementing Partners Receiving Largest Amounts of USAID Afghanistan Reconstruction Funds, as of September 30, 2011 (dollars in millions)

Implementing partner	Type of implementing partner	Type of award(s)	Total estimated value	Total obligated	Total disbursed
Louis Berger Group, Inc./Black & Veatch	U.S. contractor	Contracts	\$2,076	\$1,814	\$1,664
World Bank	Multilateral organization	Grant	\$2,079	\$1,072	\$972
International Relief and Development, Inc.	U.S. nonprofit organization	Contracts and cooperative agreements	\$1,307	\$932	\$844
United Nations agencies	Multilateral organization	Grants and cooperative agreements	\$841	\$811	\$786
Development Alternatives, Inc.	U.S. contractor	Contracts and cooperative agreement	\$1,396	\$836	\$719
Chemonics International, Inc.	U.S. contractor	Contracts and cooperative agreement	\$972	\$692	\$599
Deloitte Consulting	U.S. contractor	Contracts	\$330	\$286	\$272
Creative Associates International, Inc.	U.S. contractor	Contracts and cooperative agreements	\$270	\$268	\$244
International Organization for Migration	Multilateral organization	Cooperative agreements	\$282	\$277	\$239
Tetra Tech/ Associates in Rural Development, Inc.	U.S. contractor	Contracts	\$516	\$293	\$232
Total			\$10,071	\$7,282	\$6,571

Source: SIGAR analysis of USAID data.

Note: Totals affected by rounding.

The U.S. contractors receiving the largest amount of USAID funding for Afghanistan have been Louis Berger Group, Inc., and Black & Veatch, which received about \$1,664 million since 2002. This amount includes \$701 million received between 2002 and 2007 under a contract to Louis Berger Group, Inc., to provide rehabilitation of economic facilities and services. In addition, Louis Berger Group, Inc., is a major participant in a joint venture with Black & Veatch. The joint venture received \$942.5 million between 2006 and 2011 under an indefinite quantity contract with 27 separate construction task orders. Black & Veatch also received \$20.6 million under another contract. The U.S. nonprofit organization receiving the largest amount of USAID funding for Afghanistan reconstruction has been International Relief and Development, Inc., which has received \$844 million since 2004 through five cooperative agreements and three contracts. The multilateral organization receiving the largest amount of funding has been the World Bank, through which USAID disbursed \$972 million to the Afghanistan Reconstruction Trust Fund (ARTF).⁹ USAID also provided a total of \$786 million to various UN entities (principally the

⁹ARTF was established in 2002 to provide a vehicle for international donors to pool resources and coordinate their support for the reconstruction of Afghanistan. Donor contributions enable the ARTF to finance both the operating costs of the Afghan government and key national development programs under the Afghan National Development Strategy.

UN Development Program and UN Office of Project Services) through 21 grants and 5 cooperative agreements.

FINANCIAL AUDITS OF MANY USAID IMPLEMENTING PARTNERS HAVE NOT BEEN DONE, BUT RESOURCES FOR AUDITS WERE LIMITED

Financial audits of costs incurred for Afghanistan reconstruction by some USAID-funded implementing partners were significantly delayed; not always conducted, as required; or provided limited assurance that funds disbursed under USAID awards to those implementing partners were properly used and accounted for. Specifically, annual incurred cost audits of U.S.-based contractors—the largest category of implementing partners of USAID funds for Afghanistan—were years behind schedule because DCAA lacked the staff to complete timely audits, and USAID budgeted only a small portion of the funds required for DCAA audits. In addition, annual audits of U.S.-based nonprofit organizations, although conducted as required, may not include specific USAID awards in Afghanistan, thereby providing limited accountability over USAID funds expended for reconstruction. Annual audits of USAID funds provided to most other entities were conducted, although a number of these audits only partially met requirements, audit requirements were sometimes vague or not applicable, or the results were not always provided to USAID as requested. Further, most expired awards were not closed out due, in part, to delays in conducting close-out audits. As a result, USAID lacked assurance as to the use and disposition of funds and property under expired awards and delayed potential recovery of \$103 million in unliquidated obligations and \$27.3 million in unpaid cost share—resources the implementing partner is responsible for providing. In addition, although as much as half of the funds that USAID provides for contracts, grants, and cooperative agreements may flow down to sub-recipients, USAID lacked transparency with regard to whether financial audits of sub-awards were being conducted, as required.

Incurred Cost Audits of U.S.-based Contractors Were Significantly Delayed due to Audit Backlog and Lack of Resources

The Federal Acquisition Regulation (FAR) designates DCAA as the U.S. government audit agency for contractors other than educational institutions and nonprofit organizations and requires DCAA to perform audits of costs incurred by contractors to determine the acceptability of these costs.¹⁰ Accordingly, USAID policy states that DCAA will normally audit U.S. for-profit firms for which USAID is the cognizant or principal funding agency.¹¹ Per USAID's policy, the Bureau for Management, Office of Acquisition and Assistance, Contract Audit and Support Division must assess risks associated with all USAID-funded U.S. contractors at least annually to determine if they should be audited. Per the FAR, U.S. contractors must provide annual incurred cost submissions within 6 months after the end of the company's fiscal year.¹² Incurred cost audits include an evaluation of both direct and indirect costs, with the objective of determining whether the costs are reasonable, allocable, and allowable. USAID policy indicates that if DCAA cannot be responsive to USAID's needs for an audit, a non-Federal public accountant may be used to perform the audit. DCAA's contract audit manual describes timeliness as a characteristic of quality audit reports.¹³ According to the manual, audit reports must be timely to be useful. DCAA has established a standard performance goal of completing corporate incurred cost audits within 12 months. Consequently, incurred cost audits would ideally be completed 18 months after the end of a contractor's fiscal year.

¹⁰See FAR 42.101. Also, DCAA guidance for contractors indicates that DCAA can audit both Department of Defense contractors and non-Defense contractors. Non-Defense contractors are audited on a reimbursable basis and only upon request by the cognizant agency.

¹¹ADS 591.3.1.2.

¹²FAR 52.216-7.

¹³DCAA Contract Audit Manual, section 10-103.1.

Our sample of 64 awards included 21 contracts, task orders, or cooperative agreements issued between fiscal years 2002 and 2011 that are subject to incurred cost audits. None had been done. Table 2 shows the amount of USAID funding provided to each of the U.S. contractors in our sample.

Table 2: Contracts, Grants, Task Orders, or Cooperative Agreements with U.S.-based Contractors, as of September 30, 2011 (dollars in millions)

U.S.-based contractor	Total estimated value	Total obligated	Total disbursed
Development Alternatives, Inc.	\$751.7	\$469.8	\$437.3
Louis Berger Group, Inc./Black & Veatch Joint Venture	\$218.2	\$211.8	\$201.5
Central Asia Development Group, Inc.	\$216.5	\$216.5	\$195.9
Emerging Markets Group	\$56.3	\$55.9	\$55.6
Chemonics International, Inc.	\$66.7	\$48.7	\$36.9
Checchi & Company	\$41.3	\$39.3	\$31.5
AECOM	\$34.5	\$31.0	\$27.0
Creative Associates International, Inc.	\$38.9	\$36.3	\$26.8
Associates in Rural Development	\$51.9	\$28.3	\$24.4
Advanced Engineering Associates, International	\$18.7	\$18.7	\$17.6
DPK Consulting	\$33.8	\$23.6	\$17.3
International Resources Group	\$33.0	\$23.5	\$16.2
Global Strategies Group	\$7.0	\$7.0	\$7.0
Total	\$1,568.5	\$1,210.3	\$1,094.9

Source: SIGAR analysis of USAID data.

Note: Totals affected by rounding.

None of the 21 awards in our sample had expenditures that were audited under USAID's memorandum of understanding with DCAA. According to USAID and DCAA records, the last incurred cost audit for each contractor in our sample was completed, on average, about 4 years after the period audited. For two contractors, the last incurred cost audit was completed 7 years after the period audited. Consequently, nearly \$1.1 billion disbursed by USAID to the 13 U.S. contractors in our sample had not been subjected to a DCAA incurred cost audit as of September 30, 2011. For example:

- Development Alternatives, Inc., had four contracts through which USAID had disbursed a total of \$437.3 million during the period 2005-2011. The most recent incurred cost audit for this contractor was issued by DCAA in October 2002 for costs incurred during 1998. In 2006, USAID requested that DCAA conduct incurred cost audits of Development Alternatives, Inc., for 1999, 2000, and 2001. The requested due date was July 31, 2010, but the audits had not been completed as of September 30, 2011.
- Since 2006, USAID has disbursed a total of \$942.5 million under a contract for a joint venture between Louis Berger Group, Inc., and Black & Veatch.¹⁴ The most recent incurred cost audit for Louis Berger Group, Inc., issued by DCAA in September 2005, was for 2000. The most

¹⁴The joint venture contract included 27 individual task orders as of September 30, 2011. USAID disbursed a total of \$942.5 million under all 27 task orders, of which \$201.5 million was for the 5 task orders included in our sample.

recent incurred cost audit for Black & Veatch, issued by DCAA in September 2011, was for 2004. No incurred cost audits have been conducted for the joint venture.¹⁵

- A March 2009 award to the Central Asia Development Group, Inc., through which USAID disbursed \$195.9 million, ended in November 2011 but had not been scheduled for an audit as of September 30, 2011. USAID did not schedule a DCAA audit for this contractor because it considered the company to be based outside the United States. Although the contractor's headquarters and administrative offices are located in Singapore, it was incorporated in Maryland and has an office in Baltimore. Adding to the confusion was that the cooperative agreement incorporated standard provisions that required the contractor to submit annual audits in accordance with Office of Management and Budget (OMB) Circular A-133—a requirement that did not apply because the contractor was not a nonprofit organization. The agreement did not require that the contractor provide USAID with an incurred cost submission which would have triggered a request for a DCAA audit. Consequently, USAID officials did not arrange for the contractor to be audited.
- The most recent DCAA incurred cost audit for Emerging Markets Group, which received \$55.6 million under a USAID contract during the period 2005-2011, was for 2001. That audit report was not issued until September 2008, more than 7 years after the period audited. Delays in performing financial audits may increase the difficulty of locating the documentation necessary to conduct those audits and postpone the identification and correction of internal control weaknesses and instances of noncompliance. Early communication of audit findings to those charged with governance or management may be important because of the relative significance and the urgency for corrective follow-up action. Delayed audits could also affect the potential recovery of unallowable costs identified through the audit process.
- The most recent incurred cost audit for Chemonics International, Inc., which had two awards in our sample through which USAID disbursed \$36.9 million between 2003 and 2011, was for 2002. That audit was not completed by DCAA until 2006, 4 years after the period audited.

Lack of Staff and Funding Contribute to DCAA Audit Backlog and Delays

One factor that limited the timeliness of incurred cost audits of USAID contractors was DCAA's backlog of requested audits caused, in part, by lack of staff and resources. Although DCAA has a standard performance goal of completing incurred cost audits within 12 months, the agency accomplished this goal for only 10 percent of its audits during fiscal year 2010. In September 2010 testimony before the Commission on Wartime Contracting in Iraq and Afghanistan, DCAA's director stated that the agency did not have the necessary staff to perform all the work it was asked to carry out.¹⁶ The Commission's final report to Congress in August 2011 stated that DCAA had accumulated a backlog of billions of dollars of unaudited contingency-contract costs. According to that report, the unaudited backlog totaled \$558 billion, having risen from \$406 billion in only 9 months. The Commission recommended, among other things, that Congress increase DCAA's staff and resources to improve that agency's ability to perform incurred cost audits.¹⁷

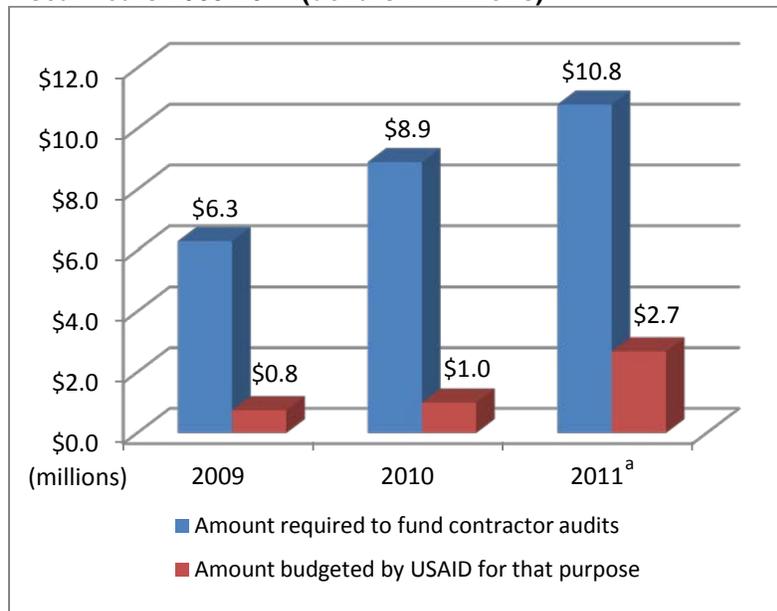
¹⁵Some USAID funds provided under the contract with the Louis Berger Group Inc./Black & Veatch Joint Venture were audited, but not through USAID's memorandum of understanding with DCAA. Instead, USAID's Kabul Mission contracted with KPMG Afghanistan, Ltd., to conduct financial audits of costs incurred in Afghanistan under the joint venture contract. As of September 30, 2011, KPMG had issued three reports for fiscal years 2007-2009 covering \$18.6 million in local costs, of which \$2.4 million was questioned.

¹⁶Testimony of Patrick J. Fitzgerald, Director, Defense Contract Audit Agency, before the Commission on Wartime Contracting in Iraq and Afghanistan, *The Contingency Acquisition Workforce: What Is Needed and How Do We Get There?*, September 16, 2010.

¹⁷Commission on Wartime Contracting in Iraq and Afghanistan's Final Report to Congress, *Transforming Wartime Contracting: Controlling Costs, Reducing Risks*, August 2011.

Incurring cost audits of USAID contractors have not been requested in a timely manner because of insufficient funding on the part of USAID. According to USAID’s Contract and Audit Support Division, its budget for financing incurred cost audits by DCAA met less than 20 percent of the agency’s needs to fund those audits during the last 3 fiscal years. Although USAID estimated that incurred cost audits would require a total of \$26 million during fiscal years 2009-2011, the agency budgeted only \$4.4 million (about 17 percent) for that purpose. Consequently, the Contract and Audit Support Division had to prioritize a few contractor audits to request from DCAA and postpone the remainder. Figure 2 shows the extent of USAID’s budget shortfall for funding DCAA incurred cost audits during fiscal years 2009-2011.

Figure 2: USAID Funding for DCAA Incurred Cost Audits, Fiscal Years 2009-2011 (dollars in millions)



Source: SIGAR analysis of USAID data.

^aThe amount received for 2011 through the agency’s normal budgeting process was \$1 million. A one-time re-allocation of \$1.7 million due to savings from another cost category brought the total received for 2011 to \$2.7 million.

According to USAID’s Contract and Audit Support Division, funds for DCAA audits were limited because they were allocated from USAID’s operating expense appropriation rather than its program appropriations.¹⁸ USAID’s operating expenses are typically about 10 percent of its program funds and provide funding primarily for salaries of USAID employees. Agency policy requires that operating expense funding be used to provide for the cost of doing business—defined as general activities required or expected to be performed by any Federal agency irrespective of its mandate/program.¹⁹ According to that policy, all costs not specifically and directly relating to identified projects are mandated to be funded from the operating expense account. USAID budget officials at USAID headquarters considered DCAA audits to be an operating expense.

¹⁸Since 1976, USAID has received an annual appropriation for operating expenses in addition to separate appropriations for its program funds. See GAO 03-1152R, *USAID’s Operating Expense Account Does Not Fully Reflect the Cost of Delivering Foreign Assistance*, September 30, 2003.

¹⁹ADS Chapter 601.

However, incurred cost audits performed by DCAA cover USAID funds that, for the most part, can be directly tied to specific programs. According to DCAA's guidance for contractors, both direct and indirect costs should be accumulated by contract to determine their allowability. Further, financial audits contracted by USAID missions are typically paid from program funds.

OMB Circular A-133 Audits Conducted as Required but Provided Limited Assurance That Funds to Some U.S. Nonprofit Organizations Were Used as Intended for Specific Awards

According to USAID policy, awards to U.S. nonprofit organizations must include provisions requiring them to contract with an independent, non-Federal auditor to perform an annual financial audit in accordance with OMB Circular A-133 if they expend \$500,000 or more in Federal funds within their fiscal year.²⁰ OMB Circular A-133 audits must be conducted in accordance with auditing standards approved by the Comptroller General of the United States and should include an examination of an implementing partner's financial records, financial statements, general management of its operations, internal control systems, and expenditures of Federal assistance received during the audit period. They are typically performed by an independent certified public accountant and encompass both financial and compliance components. Per USAID policy, U.S.-based nonprofit organizations required to have an OMB Circular A-133 audit performed must submit a copy of the audit report, along with a standard data collection form, to a Federal Audit Clearinghouse within 9 months of the end of the period audited. The audit must cover expenditures made by the entire organization unless the auditee expends Federal awards under only one Federal program. In that case, the auditee may elect to have a program-specific audit conducted in accordance with OMB Circular A-133.

Single audit reports done in accordance with OMB Circular A-133 are not intended to provide detailed audit coverage of all the Federal awards or provide detailed financial information for individual awards. While expenditures under a specific USAID award might be reviewed during an OMB Circular A-133 audit, the likelihood depends to a large extent on the amount of funding received under that award relative to total Federal funding received. According to OMB Circular A-133, audit firms conducting annual audits in compliance with that circular are required to identify each Federal award and determine whether that award constitutes a major program.²¹ Major programs are to receive more audit scrutiny than non-major programs.

Our sample of 64 awards included 21 grants and cooperative agreements issued between 2002 and 2011 through which USAID had disbursed more than \$168 million to 19 U.S.-based nonprofit organizations as of September 30, 2011 (see table 3). All 19 U.S. nonprofit organizations in our sample had completed and filed their annual OMB Circular A-133 audit reports, as required.

²⁰ADS 591.3.1.1.

²¹According to OMB Circular A-133, auditors should use a risk-based approach to determine which Federal programs are major programs. The risk-based approach should include consideration of current and prior audit experience, oversight by Federal agencies, and inherent risk.

Table 3: Grants and Cooperative Agreements to U.S. Nonprofit Organizations, as of September 30, 2011 (dollars in millions)

U.S. nonprofit organization	Total estimated value	Total obligated	Total disbursed
Consortium For Elections and Political Process Strengthening	\$35.1	\$35.1	\$34.9
International Fertilizer Development Center	\$32.5	\$32.5	\$32.5
The Asia Foundation	\$20.1	\$20.1	\$19.9
New Mexico State University	\$16.1	\$16.1	\$16.1
Volunteers for Economic Growth Alliance	\$15.0	\$9.2	\$9.0
Counterpart International, Inc.	\$45.0	\$12.3	\$8.0
Internews Network, Inc.	\$7.9	\$7.9	\$7.9
University of Nebraska	\$7.7	\$7.7	\$7.7
University of California-Davis	\$6.8	\$6.8	\$5.1
CARE International	\$4.8	\$4.8	\$4.8
Small Enterprise Assistance Funds	\$10.0	\$4.0	\$4.0
Wildlife Conservation Society	\$8.0	\$6.0	\$3.5
Voice For Humanity	\$3.0	\$3.0	\$3.0
Mercy Corps	\$2.9	\$2.7	\$2.7
Cornell International Institute for Food, Agriculture and Development	\$2.5	\$2.5	\$2.4
Arzu, Inc.	\$2.3	\$2.3	\$2.3
International Foundation of Hope	\$4.0	\$2.0	\$2.0
Management Sciences for Health	\$2.0	\$2.0	\$2.0
Catholic Relief Services	\$.5	\$.4	\$.4
Total	\$226.2	\$177.4	\$168.2

Source: SIGAR analysis of USAID data.

Note: Totals affected by rounding.

Accountability Limitations of OMB Circular A-133 Audits for U.S. Nonprofit Organizations

Disbursements by USAID under the 21 grants and cooperative agreements in our sample constituted a relatively small percentage of total Federal funding provided to the respective nonprofit organization. Consequently, the awards were seldom considered major programs by the auditors conducting the organizations' OMB Circular A-133 audits, and auditors would have applied few if any tests toward auditing expenditures under those USAID awards. A comparison of expenditures under the 21 USAID awards in our sample to expenditures of all Federal funding sources for the 19 organizations during the same period revealed that total expenditures under the 21 awards constituted less than one percent of total Federal funds expended by those same organizations. For example:

- The Consortium for Elections and Political Process Strengthening expended \$22 million during fiscal years 2003-2006 under a USAID cooperative agreement. During that same period, the organization expended a total of \$376 million in Federal funding. The amount expended for the USAID award made up less than six percent of the organization's total Federal funding for that year.
- The Asia Foundation expended about \$1.4 million during fiscal year 2009 under a USAID grant. During that same year, the organization expended a total of \$53 million in Federal funding. The amount expended under the USAID grant made up less than three percent of the organization's total Federal funding for that year.
- New Mexico State University expended \$16.1 million during fiscal years 2008-2011 under a USAID cooperative agreement.²² During those same years, the organization expended a total of \$1.1 billion in Federal funding. The amount expended under the USAID award made up about one and a half percent of the organization's total Federal funding for the same period.
- CARE International expended \$614,594 during fiscal years 2004-2005 under a USAID grant. During that same period, the organization expended a total of \$443 million in Federal funding. The amount expended under the USAID grant made up just over one-tenth of one percent of the organization's total Federal funding for those years.
- The Cornell International Institute for Food, Agriculture and Development expended \$2.4 million during fiscal years 2007-2010 under a USAID cooperative agreement. During those same years, the organization expended a total of \$2.4 billion in Federal funding. The amount expended under the USAID award made up one-tenth of one percent of the organization's total Federal funding for the same period.

USAID policy states that financial audits performed in accordance with OMB Circular A-133 do not limit the authority of USAID or the OIG to conduct or arrange for additional audits, reviews, and evaluations.²³ Similarly, OMB Circular A-133 states that its provisions neither limit the authority of Federal agencies to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any audited organization to constrain Federal agencies from carrying out additional audits.²⁴ However, the circular allows Federal agencies to request an auditee to have a particular Federal program audited as a major program in lieu of the agency conducting or arranging for an additional audit.²⁵

Although agreements for all 21 sampled awards included audit rights allowing USAID, or any duly authorized representative, to have timely and unrestricted access to the organization's financial records to conduct an audit, USAID did not exercise those rights to obtain award-specific financial audits. Nor did USAID request that any of the sampled awards be included in an OMB Circular A-133 audit as a major program in lieu of conducting or arranging for an award-specific audit. As a result, more than \$2 billion in total USAID disbursements to U.S. nonprofit organizations were not subjected to audits of awards made specifically for Afghanistan reconstruction.

²²An award-specific financial audit of USAID's cooperative agreement with New Mexico State University was conducted by a private audit firm. The audit covered \$10.5 million in total costs for the period March 3, 2008, through September 30, 2010. The auditors questioned costs totaling \$728,257. No costs under this award were questioned by the A-133 auditors who covered the same period of expenditures.

²³ADS 591.3.1.1.

²⁴OMB Circular A-133, Subpart A, Section 215(a).

²⁵OMB Circular A-133, Subpart A, Section 215(c).

USAID Relies on Multilateral Organizations to Audit Awards

USAID does not normally arrange for financial audits of funds provided multilateral organizations. Instead, USAID generally relies on the organizations' own audit policies and procedures. However, USAID policy requires that each organization receiving USAID funds (1) confirm that its program will be subject to an independent audit in accordance with its usual auditing procedures and (2) agree to make audit reports available to USAID, along with other related information as may be reasonably requested with respect to questions arising from the reports.²⁶

Our sample included two awards issued between 2002 and 2006 through which USAID had disbursed a total of \$977.6 million to two multilateral organizations as of September 30, 2011. Table 4 shows the amount of USAID funding provided under the two awards.

Table 4: Grants to Multilateral Organizations, as of September 30, 2011 (dollars in millions)

Multilateral organization	Total estimated value	Total obligated	Total disbursed
World Bank	\$2,079.5	\$1,072.0	\$972.0
UN Development Program	\$6.0	\$5.6	\$5.6
Total	\$2,085.5	\$1,077.6	\$977.6

Source: SIGAR analysis of USAID data.

One award is a grant agreement with the World Bank through which USAID makes contributions on behalf of the U.S. government to ARTF. With expected U.S. contributions of more than \$2 billion over the life of the fund, the ARTF grant constitutes one of USAID's largest awards for Afghanistan reconstruction. As of September 30, 2011, USAID had disbursed \$972.0 million to the fund.

USAID's grant agreement with the World Bank states that the World Bank would require the Afghan government to audit ARTF funds annually and submit related audit reports to the World Bank within 6 months of the end of the fiscal year audited. Although the agreement does not require the World Bank to provide USAID with copies of those audit reports upon request, as required by USAID policy, the Mission has obtained audit reports of ARTF funds conducted by the Afghan government's Control and Audit Office (CAO). As Afghanistan's supreme audit institution, CAO is responsible for auditing the records and accounts of all ARTF expenditures, with technical assistance from the international auditing firm PKF International. In conducting these audits, CAO examines whether Afghan government expenditures are eligible for ARTF funding. According to its agreement with the World Bank, the Afghan government must reimburse ineligible ARTF expenditures to the trust fund. As noted in our prior audit report on ARTF, although CAO audits have identified millions of dollars in ineligible expenditures, the findings resulted in a substitution of the ineligible expenditures for an equal amount of eligible expenditures, rather than the Afghan government reimbursing the funds to ARTF.²⁷ Further, although

²⁶See Sections 9 and 10 of USAID's *Standard Provisions for Cost-type Awards to Public International Organizations*, a mandatory reference for ADS Chapter 308.

²⁷SIGAR Audit-11-14, *The World Bank and the Afghan Government Have Established Mechanisms to Monitor and Account for Funds Contributed to the Afghanistan Reconstruction Trust Fund, but Some Limitations and Challenges Should Be Addressed* (July 22, 2011).

CAO is responsible for auditing one of USAID's largest awards, we have called CAO's lack of organizational, external, and personal independence into question.²⁸

The second award is a grant agreement valued at \$5.6 million with the UN Development Program (UNDP), valued at \$5.6 million. It was made in March 2006 and ended in December 2008. USAID did not have financial audits conducted of this award because the grant agreement did not require it. Instead, the grant agreement included a confirmation by UNDP that the award would be audited by applying established procedures under appropriate provisions of the financial regulations and rules of the United Nations. However, the USAID official responsible for monitoring the award did not know whether UNDP had audited the award. Although USAID is entitled to access audit reports issued by a UN internal oversight entity, the USAID official indicated that USAID had neither requested nor received an audit report for this award. The USAID official subsequently requested a copy of audits of the award from UNDP, but received no response.

Most Awards to Foreign Entities Were Conducted as Required

USAID also awarded funds to several Afghan government entities and other non-U.S.-based implementing partners to carry out reconstruction-related activities. Of the three grants to Afghan government entities, one audit was conducted as required but did not cover the last 6 months of the award, no funds were disbursed under the second—and largest—award, and the third award was not audited in accordance with USAID requirements because officials refused access to records. Awards to non-U.S. nonprofit organizations were conducted as required, and audits of non-U.S. for-profit companies were not required because these awards were fixed-price contracts, which do not require annual financial audits.

Funds Awarded to Afghan Government Entities Generally Met Audit Requirements, Although One Entity Refused Audit Firm's Access to Its Records

USAID typically awards funds to host government entities through bilateral grants documented by implementation letters pursuant to Strategic Objective Grant Agreements signed by USAID and host country officials.²⁹ Such agreements include standard provisions requiring the host government to maintain records pertaining to grant funds in accordance with established accounting principles.

According to USAID policy, financial audit requirements for awards to host government entities are similar to those for non-U.S.-based nonprofit organizations; the awards are subject to USAID's *Guidelines for Financial Audits Contracted by Foreign Recipients (Guidelines)*.³⁰ The principal difference is that host government entities may have audits performed by its supreme audit institution, instead of by private audit firms. These government audit institutions may audit USAID funds provided to host government entities only with OIG approval. As noted previously, the Afghan government's CAO serves as its supreme audit institution but had not been approved by USAID's OIG to conduct audits of USAID-provided funds at the time of our audit.

Our audit sample included three grants awarded to three Afghan government entities between 2007 and 2011. USAID had not disbursed funds for one grant as of September 30, 2011. For the remaining two grants, USAID had disbursed a total of \$2.9 million to two Afghan government entities as of September 30, 2011. Table 5 shows the amount of USAID funding provided under the three awards.

²⁸SIGAR Audit-10-8, *Afghanistan's Control and Audit Office Requires Operational and Budgetary Independence, Enhanced Authority, and Focused International Assistance to Effectively Prevent and Detect Corruption* (April 9, 2010).

²⁹ADS 350.3.1.

³⁰ADS 591.3.2.1.

**Table 5: Grants to Afghan Government Entities, as of September 30, 2011
(dollars in millions)**

Afghan government entity	Total estimated value	Total obligated	Total disbursed
Ministry of Finance	\$2.0	\$1.7	\$1.7
Program-e-Tahkem Solh (Commission for Peace and Reconciliation)	\$2.7	\$1.3	\$1.2
Ministry of Agriculture, Irrigation, and Livestock	\$85.0	\$0	\$0
Total	\$89.7	\$3.0	\$2.9

Source: SIGAR analysis of USAID data.

A review of USAID's award files found that all three grants included standard language requiring the Afghan government entities to maintain books and records relating to grant funds, as well as provide USAID, or its representatives, with rights to audit those records. As of September 30, 2011, \$1 million of the \$2.9 million disbursed had been audited, as required.

- USAID disbursed \$1.7 million through one grant to the Afghan Ministry of Finance. An implementation letter signed in June 2010 provided funding for the salaries of certain Afghan government officials from February 1, 2010 to March 20, 2011. Expenditures of \$1 million made under that grant during the period June 6, 2010 to September 30, 2010 were audited by a private Afghan audit firm, resulting in \$356,469 in questioned costs and the identification of one significant internal control deficiency and one material instance of noncompliance with local tax laws. However, the audit did not cover the entire period of the grant. Consequently, another audit will be necessary to cover expenditures that were made during the last 6 months of the award.
- The second grant, with disbursements of \$1.2 million, was approved by USAID in July 2007 to provide operating funds to the Afghan government's Program-e Tahkem-e-Solh Commission, an independent government body created by the Afghan President to facilitate peace and reconciliation between the government and ex-combatants. USAID arranged for a financial audit of the award by a private audit firm, but the audit was never conducted because commission officials were unwilling to provide access to their records. USAID files show that commission officials refused two separate attempts to audit their records by agency-contracted audit firms, but eventually consented to a financial review by a team that included only USAID Afghan employees and an auditor from the Afghan CAO. The financial review questioned costs of \$11,132, an amount later reduced to \$8,462 after Afghan officials provided supporting documentation. However, a full financial audit in accordance with the USAID *Guidelines* has not been conducted.
- The third grant consisted of an implementation letter signed in July 2010 to establish an agricultural development fund for loans and grants to small commercial farmers. According to the letter, grant proceeds would be used solely as capital for loans and grants. USAID planned to provide \$85 million directly to the Afghan Ministry of Agriculture, Irrigation, and Livestock, and \$15 million to a contractor to initiate and manage the new fund. The implementation letter required the Afghan government to have annual audits conducted by the CAO or an independent auditor in accordance with USAID's *Guidelines*. The audits, to be completed no later than 9 months after the end of the Afghan government's fiscal year, were to determine whether the receipt and expenditure of funds provided under the implementation letter were in accordance with generally accepted accounting principles and whether the Afghan government had complied with the terms of the implementation

letter. As of September 30, 2011, none of the \$85 million had been disbursed to the Ministry, so a financial audit of that portion of the grant was not yet required.³¹

Audits Were Conducted as Required for Non-U.S.-based Nonprofit Organizations

USAID policy states that agreements with foreign (non-U.S.-based) nonprofit organizations must include standard provisions requiring them to contract with independent auditors, acceptable to the OIG, to perform financial audits of the funds provided through USAID awards.³² The contracted audits must be performed annually in accordance with USAID’s *Guidelines* whenever a recipient expends \$300,000 or more in USAID funds during its fiscal year. According to the *Guidelines*, financial audits of the funds provided by USAID must be performed in accordance with *U.S. Government Auditing Standards*, or other approved standards where applicable. The specific objectives of a recipient-contracted audit are to express an opinion on the fund accountability statement, evaluate the recipient's internal controls and identify significant deficiencies, perform tests for compliance with agreement terms and applicable laws and regulations, review indirect cost rates, and determine if the recipient has taken adequate corrective action on prior audit report recommendations.³³

According to agency policy, USAID officials must ensure that the responsible OIG office receives recipient-contracted audit reports for desk review within 9 months after the end of the fiscal year in which the expenditures were incurred.³⁴ According to the *Guidelines*, even when a recipient-contracted audit is not required, if USAID determines that an audit must be performed, the audit report must be submitted to the OIG for review and issuance. Further, the OIG reserves the right to conduct audits using its own staff, notwithstanding acceptable audits performed by other auditors, in cases where special accountability needs are identified.

Our sample included two cooperative agreements issued in 2008 through which USAID had disbursed \$28.5 million to two different non-U.S.-based nonprofit organizations as of September 30, 2011 (see table 6).

Table 6: Cooperative Agreements to Non U.S.-based Nonprofit Organizations, as of September 30, 2011 (dollars in millions)

Non-U.S.-based nonprofit organization	Total estimated value	Total obligated	Total disbursed
American University of Afghanistan	\$42.1	\$24.8	\$22.7
Turquoise Mountain Trust	\$10.6	\$7.4	\$5.8
Total	\$52.7	\$32.2	\$28.5

Source: SIGAR analysis of USAID data..

³¹As of June 20, 2011, the contractor managing the fund, Development Alternatives International, Inc., had disbursed about \$4.5 million of the \$15 million. USAID officials did not include those disbursements in their fiscal year 2011 audit plan because the funds had been provided to a U.S. contractor which should eventually receive an incurred cost audit by DCAA.

³²ADS 591.3.2.1

³³The fund accountability statement is the basic financial statement to be audited that presents the recipient's revenues, costs incurred, cash balance of funds provided to the recipient by USAID, and commodities directly procured by USAID for the recipient's use.

³⁴ADS 591.3.2.1d.

Financial audits were conducted, as required, of expenditures under both USAID awards. An audit of \$9.5 million of USAID funds expended by the American University of Afghanistan during 2008-2009 resulted in questioned costs of \$685,643 of which USAID agreed to recover \$116,273. Two annual audits covering \$2.9 million of USAID funds expended by Turquoise Mountain Trust between 2008 and 2009 resulted in questioned costs of \$17,781, all of which USAID agreed to recover.

Fixed-price Awards to Non-U.S. Contractors Do Not Require Annual Financial Audits

Our audit sample also included three fixed-price awards issued between 2004 and 2007 through which USAID had disbursed \$65.7 million to three non-U.S.-based contractors as of September 30, 2011.³⁵ Missions must assess risk at least annually to determine when financial audits of foreign (non-U.S.-based) contractors are required.³⁶ However, USAID policy also states that fixed-price contracts are not subject to an annual audit requirement.³⁷

Financial Audits of Funds Provided to Other U.S. Agencies Not Conducted because Audits Were Not Required or Audit Requirements Were Vague

USAID normally implements programs through contracts and grants with private-sector entities and individuals. Under appropriate circumstances, however, USAID may engage other Federal agencies to help implement its programs. Section 632(b) of the Foreign Assistance Act of 1961 allows USAID to “buy” the services of other Federal agencies. According to ADS 306, USAID may use several interagency agreements for this purpose, including Participating Agency Service Agreements (PASA) and Participating Agency Program Agreements (PAPA). Under a PASA, the participating agency is expected to supply USAID with personnel that have the requisite expertise called for by the agreement. Participating agency personnel working under a PASA receive personnel support from their own agency, but work in USAID space or under USAID supervision. In contrast, under a PAPA, a participating agency normally performs work autonomously from USAID—similar to a contractor.

According to USAID policy, it is accountable for the funds it obligates under the Foreign Assistance Act and must provide the necessary oversight and coordination for the services or program it finances.³⁸ Although USAID does not typically audit another U.S. agency, USAID may require it to include audit clauses in agreements that it enters into with contractors, grantees, and cooperative agreement recipients. Normally, PASAs do not include such audit clauses because the participating agency is not likely to make awards of a size that would warrant audits. However, ADS 306 requires that PAPAs include standard provisions for audit requirements for funds transferred by the agreement, including funds to contractors or grantees.

Our sample included 12 PASAs, PAPAs, and other interagency agreements issued pursuant to section 632(b) between 2003 and 2010 through which USAID had disbursed \$88.2 million to seven U.S. government agencies as of September 30, 2011 (see table 7).

³⁵The three firms were Afghanistan Management Group (\$35 million), Descon Holdings, Ltd., (\$27 million), and Land Bridge International, LLC, (\$3.7 million).

³⁶ADS 591.3.2.1(f).

³⁷ADS 591.3.2.1(g).

³⁸ADS 306.3.2.21.

**Table 7: Awards to Other U.S. Government Agencies, as of September 30, 2011
(dollars in millions)**

U.S. government agency	Total estimated value	Total obligated	Total disbursed
U.S. Army Corps of Engineers	\$50.2	\$47.1	\$45.2
Department of State	\$29.5	\$29.5	\$29.5
Federal Aviation Authority	\$6.4	\$5.4	\$5.2
U.S. Geological Survey	\$5.0	\$5.0	\$5.0
U.S. Institute of Peace	\$2.1	\$2.1	\$2.1
Department of Agriculture	\$1.0	\$0.9	\$0.9
Defense Contract Audit Agency	\$0.5	\$0.5	\$0.3
Total	\$94.7	\$90.5	\$88.2

Source: SIGAR analysis of USAID data.

Six PASAs and another agreement for commercial services did not require a financial audit. Of the four PAPAs in the sample, three agreements were with the U.S. Army Corps of Engineers and one was with the Department of State. As of September 30, 2011, USAID had transferred a total of \$31.6 million under those agreements to fund activities that included the construction of roads, university classrooms, and refurbishment of schools and clinics. Each PAPA and another agreement with the U.S. Institute for Peace³⁹ contained vague language regarding financial audit requirements, including language from USAID's standard provisions for such agreements that provided audit rights to both participating agencies, but was unclear regarding if and by whom financial audits should be conducted. The Inspector General Act does not include specific audit requirements for interagency agreements or for contractors and grantees financed by funds provided through such agreements. As a result, neither USAID nor the participating agencies arranged for financial audits of funds provided under the agreements.

Delays in Close-out Audits Limit Assurance Regarding Proper Use and Disposition of Funds and Property

Over two-thirds of USAID's 305 major awards for Afghanistan reconstruction had expired as of September 30, 2011, but the majority of those expired awards were not closed out within suggested timeframes. Consequently, USAID lacked assurance as to the proper use and final disposition of funds and property provided under the expired awards, many of which carried large balances of unliquidated obligations and unpaid cost share.⁴⁰

USAID's close-out procedures for awards are designed to help ensure that the disposition of all funds, as well as non-expendable property, is properly authorized and documented. An important component of the close-out process is the use of close-out audits. According to USAID policy, field missions have the responsibility for ensuring administrative closeout of their own awards, as well as those transferred to the

³⁹The U.S. Institute for Peace is a Congressionally-funded independent Federal institution administered by a bipartisan board of directors appointed by the U.S. President and confirmed by the Senate and charged with preventing and resolving violent international conflict.

⁴⁰Cost share refers to the resources, including cash and in-kind, that a recipient contributes to the total cost of an agreement. Cost sharing becomes a condition of an award when it is part of the approved award budget. Cost sharing must be verifiable from the recipient's records, is subject to Federal post-award requirements, and can be audited.

field, and the deobligation of residual balances.⁴¹ The policy states that field mission contracting and assistance officers should take the lead role in ensuring that such closeouts are accomplished. Further, agency guidance indicates that contracting and assistance officers should initiate the administrative closeout of an award as soon as possible after completion of an award, but no later than 3 months after completion.

Per USAID policy, obligated funds must be deobligated when a determination is made that the funds are no longer needed for the purposes for which they were obligated.⁴² Obligation managers must continuously monitor unexpended obligated balances and request that excess or unneeded funds are deobligated. In field missions, obligation managers should provide confirmation to the mission controller that residual funds are available for deobligation.

According to USAID's audit policy, a "close-out" financial audit must be performed for all awards with cumulative expenditures in excess of \$500,000.⁴³ As a general rule, annual incurred cost audits fulfill the close-out audit requirement for U.S. and foreign for-profit organizations. Similarly, OMB Circular A-133 annual audits fulfill the close-out audit requirement for U.S. nonprofit organizations, and annual audits in accordance with USAID's *Guidelines* fulfill the close-out audit requirement for foreign nonprofit organizations. In any case, the contracting or grant officer may not proceed with the close-out process until USAID has taken final action on all audit recommendations. Thus, delays in conducting close-out audits contribute to delays in closing out expired awards and deobligating residual funds. Further, close-out audits help determine whether recipients provided cost sharing contributions in accordance with the terms of the agreement. If a recipient does not meet its cost sharing requirement, those costs may be questioned.⁴⁴

More than \$130 Million Remains in Unexpended Obligations and Unpaid Cost Share from Expired but Unclosed Awards

As of September 30, 2011, of the 64 sampled awards, 41 had expired but only 13 had been closed out. Of the 28 expired but unclosed awards, 16 included obligated but unexpended balances totaling \$16.8 million. The majority of those unexpended funds (\$15.7 million) were obligated under 8 expired awards to U.S. contractors. Two of the expired but unclosed awards had unpaid cost share totaling \$1.5 million.

Based on these findings, we expanded the scope of our testing to include the entire universe of USAID's 305 major awards for Afghanistan reconstruction. We found that, of the 205 awards that had expired as of September 30, 2011, 90 had unspent obligations totaling \$103 million. Although 72 awards, with a total of \$96 million in unspent obligations, expired less than 3 years prior to September 30, 2011, 18 awards, with a total of \$7 million in unspent obligations, had expired 3 or more years earlier. The oldest expired award with unspent obligations ended in 2004 and still carried a balance of \$335,626 as of September 30, 2011, nearly 7 years later. In addition to expired awards' unspent obligations, we identified 13 expired awards with unpaid cost share totaling \$27.3 million as of September 30, 2011.

⁴¹ADS 621.3.10 and Contract Information Bulletin 90-12, *Guidance for Missions – Closing out Contracts, Grants and Cooperative Agreements*.

⁴²ADS 621.3.9.

⁴³ADS 591.3.3.2.

⁴⁴Section 3.4 of USAID's *Guidelines for Financial Audits Contracted by Foreign Recipients*.

USAID officials in Afghanistan were aware of the large number of expired but unclosed awards in its portfolio and have taken steps to close out those awards and reprogram unused funds.⁴⁵ During a risk assessment conducted by USAID's Mission for Afghanistan in conjunction with the agency's annual Federal Managers Financial Integrity Act review for fiscal year 2011, contracting officials acknowledged that acquisition and assistance instruments were not being closed out in a timely manner due to understaffing. The same officials indicated that they were taking steps to address this weakness with the creation of a contract management team.

A reason that expired awards were not being closed out in a timely manner was because of the delays in conducting incurred cost audits of U.S. contractors. USAID officials did not arrange for close-out audits of the expired contracts in our sample because they assumed that the close-out requirement would be met through annual DCAA incurred cost audits. However, as previously discussed, none of the U.S. contractors in our sample had received an incurred cost audit from DCAA covering the period of expenditures under their respective awards.

Close-out audits can help USAID's contracting and grant officers expeditiously close out expired awards by providing assurance as to the proper use and disposition of funds, including required cost share. Unlike most Federal agencies, USAID has authority to re-obligate funds that it identifies as no longer needed under an original obligation, but the reobligation must take place within a specified period of time.⁴⁶ Further, most USAID contracts and grant agreements only require recipients to retain financial records for 3 years, unless any litigation, claim, or audit is started before the expiration of the 3-year period. Consequently, long delays in starting a close-out audit could result in the loss of accounting records and other supporting documentation, as well as delays in recovering unliquidated obligations and unpaid cost share. As of September 30, 2011, USAID had 90 expired awards with unexpended obligations totaling \$103 million and 13 expired awards with unpaid cost share totaling \$27.3 million.

USAID Lacked Transparency over Audits of Sub-recipients

In most circumstances, sub-recipients that receive USAID funds through an implementing partner are subject to the same financial audit requirements. Awards usually include "flow-down" clauses requiring sub-recipients to meet USAID audit requirements and to maintain their books and records for a specified period of time so that they may be audited. For example, ADS 591 states that implementing partners must ensure that their U.S. nonprofit sub-recipients expending \$500,000 or more in Federal funds during their fiscal year are audited in accordance with OMB Circular A-133. Similarly, they must also ensure that their foreign nonprofit sub-recipients adhere to USAID's standard provisions for non-U.S. nongovernmental grantees, which require annual audits in accordance with the USAID *Guidelines* for foreign nonprofit organizations receiving \$300,000 or more in USAID funds during their fiscal year. Further, the FAR requires contractors receiving Federal funds to insert a clause in sub-contracts containing all the audit terms to which the prime contractors are subject.

According to USAID audit policy, USAID's legal relationship is with the implementing partner or prime. Therefore, USAID is not responsible for directly monitoring sub-recipients unless otherwise required by

⁴⁵In April 2011, an internal memo from the mission's financial management office to the mission's contracting office listed the awards that had expired as of February 28, 2011. The list included 53 expired awards with unliquidated obligations totaling \$36.2 million. According to the memo, those amounts could be reprogrammed and put to better use for other activities. The memo requested that mission contracting officials "initiate close-out actions where appropriate and coordinate with [the mission financial management office] on the de-obligation of funds and resolution of audit or other financial issues, if any." A similar list, dated October 13, 2011, indicated that USAID officials had deobligated about \$6 million from expired awards, but 47 expired awards with a total of \$30.1 million in unexpended obligations had not been closed.

⁴⁶According to ADS 621.3.11, USAID appropriated funds that are obligated within their initial period of availability will be available for 4 additional years for deobligation and reobligation. At the end of the 4 years, the funds "expire" and are no longer available for new obligations.

law. Per the policy, an independent auditor performing a review of the prime must determine whether it has met the audit and monitoring requirements pertaining to sub-recipients. However, USAID retains the right to request an audit of a sub-recipient if the agency determines that the potential for waste or fraud exists.

USAID officials have no systematic way of determining whether appropriate flow-down clauses are included in sub-recipient contracts and agreements, or whether the sub-recipients are audited, as required. A primary reason is USAID's reliance on primes to ensure compliance relating to sub-recipients. Also, USAID's accounting system does not track the level of funds passed through primes to sub-recipients. For example, USAID program files in Kabul indicated that one of USAID's major contractors for Afghanistan reconstruction, Louis Berger Group, Inc., was not obtaining required annual incurred cost audits of its subcontractors. As a result, at least three of its subcontracts, valued at \$24 million, had not been audited, as required. This increased the risk that unallowable costs may be charged to USAID through the prime contractor.

Although an exact percentage was not available, USAID contracting and grant officials whom we interviewed suggested that up to 50 percent of USAID funding provided to implementing partners for Afghanistan reconstruction may be passed to sub-recipients. Consequently, as much as half of the \$9.5 billion in USAID disbursements under awards for Afghanistan reconstruction may have gone to sub-recipients for which USAID has little visibility or accountability in terms of financial audits.

CONCLUSIONS

Since 2002, USAID has provided nearly \$9.5 billion in Afghanistan reconstruction funds to its implementing partners in Afghanistan. Financial audits of funds expended under these awards provide USAID with assurance that the funds were properly accounted for and used as intended. This assurance is critical because the restrictive security environment in Afghanistan makes it difficult to monitor program activities. However, for a number of reasons many awards have not been audited.

Delays in annual incurred cost audits of U.S. contractors, through which USAID provides more than half its funding for Afghanistan reconstruction, are a primary concern. DCAA is experiencing a large backlog and USAID's funding for audits of contractors has been constrained, resulting in audits that are not performed until a number of years after the period being audited. In addition, Office of Management and Budget Circular A-133 audits of U.S. nonprofit organizations provided limited accountability over funds used specifically for activities in Afghanistan. Further, USAID has not used financial audits to close out expired awards, leaving more than \$130 million in unexpended obligations and unpaid cost sharing on its books. Finally, USAID lacks transparency with regard to financial audits of expenditures under sub-awards. As a result, USAID has limited assurance that billions of dollars expended for Afghanistan reconstruction since 2002 have been properly accounted for or used as intended.

RECOMMENDATIONS

To improve financial audit coverage of U.S.-based contractors, we recommend that the Administrator of USAID take the following action:

1. Increase the quantity and timeliness of incurred cost audits of U.S. contractors by (a) using appropriations for program funds to help finance those audits and (b) contracting with private audit firms for those instances in which DCAA cannot respond to audit requests.

To provide better accountability over funds provided to contractors and grantees for Afghanistan reconstruction, we recommend that the Administrator of USAID take the following actions:

2. Develop a system to identify and prioritize awards to U.S. nonprofit organizations to determine whether USAID should (a) request that the awards be audited as major programs by the organizations' OMB Circular A-133 auditors or (b) contract for award-specific financial audits of those awards.
3. Expedite close-out audits for expired awards, especially for (a) the 90 expired awards with \$103 million in unexpended obligations and (b) the 13 expired awards with \$27.3 million in unpaid cost share as of September 30, 2011.
4. Amend USAID's awards for Afghanistan reconstruction to include a requirement that prime recipients develop and submit to the respective contract or agreement officer a plan for ensuring that financial audits of expenditures under sub-awards are conducted, as required.

COMMENTS

In commenting on a draft of this report, USAID found the report informative and objective and noted that it fully recognizes the need to conduct more financial audits in a timely manner to ensure accountability for the funds channeled by USAID through its implementing partners. Overall, USAID generally concurred with the recommendations and noted that it has taken some steps to address them. USAID also provided some technical comments, which we incorporated into the final report, as appropriate. These comments are reproduced in appendix III.

In response to recommendation one, USAID acknowledged that it has experienced significant delays with DCAA audits and described steps it has taken to increase their timeliness. USAID stated that it will consider contracting with private audit firms to conduct the audits in a more timely manner, but noted that the lack of qualified audit firms in Afghanistan would require hiring U.S. and international audit firms that will likely increase audit costs. While USAID also stated that its Kabul Mission was already using program funds to finance audit costs, we encourage USAID headquarters to do the same when contracting for incurred cost audits of U.S. contractors doing work in Afghanistan.

In response to recommendation two, USAID said that it does not have authority to direct a U.S. nonprofit organization's auditor to reclassify a USAID project as a major program. However, as we note in the report, Section 215(c) of OMB Circular A-133 specifically allows Federal agencies the option of requesting that particular programs be audited as major programs in lieu of conducting or arranging for additional audits. We encourage USAID to take advantage of this provision. In regard to the second part of the recommendation, USAID noted that its Kabul Mission has already identified and prioritized numerous awards for award-specific audits in developing its fiscal year 2012 Audit Inventory and Audit Plan.

In response to recommendation three, USAID acknowledged the need to audit all awards in a more timely fashion and is already pursuing more aggressive means to audit and close out awards. USAID stated that it will take action on unexpended obligations, and will further review awards and take appropriate recovery action when cost share requirements were not met.

In response to recommendation four, USAID stated that it will request that its Office of Acquisition and Assistance in Washington, D.C., review the standard audit language required for all awards, and will notify SIGAR of the review results.

APPENDIX I: SCOPE AND METHODOLOGY

This report provides the results of our review of financial audits of major USAID contracts, grants, and other awards for Afghanistan reconstruction. This report identifies the universe of awards that USAID has funded for Afghanistan reconstruction since 2002 and assesses the extent to which financial audit requirements had been met for various types of recipients and awards, including expired awards and sub-awards. The period of our review was from February 1, 2002 to September 30, 2011.

To identify the universe of awards that USAID has funded for Afghanistan reconstruction since 2002, we obtained a listing of major grants and contracts from USAID. The listing was from a monthly report entitled *Status of Major Grants and Contracts* issued by USAID's Mission for Afghanistan's Office of Financial Management as of September 30, 2011. The report indicated that it included all awards over \$100,000 and excluded personal service contracts. The report included data fields for each award that identified the technical office responsible for the award, award number, program area, latest modification number, name of contractor/recipient, program name, close-out status, start and end dates, agreement type, and name of the contract/agreement officer's technical representative. In addition, the report displayed financial information for each award that included total estimated cost, required and actual cost share, obligated amount, mortgage balance (total estimated cost minus obligated amount), disbursement per Phoenix (USAID's accounting system), undisbursed balance, quarterly accruals, total accrued expenses, life of project in months, number of months elapsed, pipeline amount (obligated amount minus total accrued expenses), average expenditures per month, and remaining life of project in months. We analyzed the data by sorting it several different ways, grouping the awards by recipient to determine the top ten recipients in terms of disbursements received, and separating expired awards from active, ongoing awards.

We performed data reliability tests to determine the accuracy and completeness of the computer-processed data in the report by comparing dates and financial balances for the random sample of 64 awards to physical records kept in offices at USAID's Mission for Afghanistan in Kabul, Afghanistan. We found only a few minor discrepancies which we submitted to USAID for correction. We also compared disbursement balances for all awards listed in the report to accounting data downloaded from USAID's Phoenix system by our forensic audit team in Washington, D.C. We were able to reconcile the total disbursements in the report with data from USAID's accounting system to within 97.4 percent accuracy. We determined that the data were sufficiently reliable for purposes of the audit objectives.

We assessed the internal controls of USAID's Bureau for Management, Office of Acquisition and Assistance, Contract Audit and Support Division regarding the receipt of incurred-cost submissions from U.S.-based contractors, risk assessments to determine whether to request DCAA incurred-cost audits, and the request and tracking of scheduled audits. We assessed USAID/Afghanistan's Office of Financial Management's internal controls regarding the preparation of annual award inventories and the execution of annual audit plans for recipient-contracted and agency-contracted audits. We also assessed USAID/Afghanistan's Office of Acquisition and Assistance's internal controls regarding the completeness and accuracy of physical and electronic project files.

To determine the extent to which financial audits had been performed for USAID awards for Afghanistan reconstruction, we selected a statistically valid random sample of 64 awards issued between February 1, 2002 and September 30, 2011, stratified by type of award, to ensure that representative samples from each category of award—contracts, grants, cooperative agreements, and interagency agreements—were selected. As of September 30, 2011, the 64 sampled awards had received almost \$2.5 billion (26 percent of funding for all 305 major awards). The sampled awards included 24 contracts or task orders to U.S. and foreign contractors, 23 grants and cooperative agreements to U.S. and foreign nonprofit organizations, 12 interagency agreements with other U.S. government agencies, 3 awards to Afghan government entities, and 2 awards to multilateral organizations. Of the 64 sampled awards, 41 had expired as of September 30, 2011, and the other 23 were ongoing. Table 8 shows a summary of the 64 awards selected for the sample.

Table I: 64 Awards Selected for Audit Sample, as of September 30, 2011 (dollars in millions)

Type of recipient	Total awards	Total estimated value	Total obligated	Total disbursed
U.S.-based contractors	21	\$1,569	\$1,210	\$1,095
U.S.-based nonprofit organizations	21	\$226	\$177	\$168
Multilateral organizations	2	\$2,085	\$1,078	\$978
Afghan government entities	3	\$90	\$3	\$3
Non-U.S.-based nonprofit organizations	2	\$53	\$32	\$29
Non-U.S.-based contractors	3	\$66	\$66	\$66
Other U.S. government agencies	12	\$95	\$91	\$88
Total	64	\$8,183	\$2,657	\$2,426

Source: SIGAR analysis of USAID data.

Note: Totals affected by rounding.

To determine financial audit requirements, we reviewed laws, regulations, policies, standard operating procedures, and other guidance relating to financial audit requirements of recipients of USAID funds. We reviewed USAID policy regarding financial audits of recipients in Automated Directives System (ADS) Chapter 591, *Financial Audits of USAID Contractors, Recipients, and Host Government Entities*. For awards to U.S. contractors, we reviewed relevant sections of the Federal Acquisition Regulation, USAID Acquisition Regulation, and ADS 301-*Responsibility for Procurement*. For awards to U.S. nonprofit organizations, we reviewed Office of Management and Budget’s Circular A-133, USAID’s ADS 303-*Grants & Coop Agreements to NGOs*, and 22 CFR § 226.26 - *Non-Federal audits*. For awards to other U.S. government agencies, we reviewed ADS Chapter 306 - *Interagency Agreements*, and Section 632 of the Foreign Assistance Act of 1961 (P.L. 87-195). For awards to Afghan government entities, we reviewed ADS 305 – *Host Country Contracting*, and ADS 350 - *Grants to Foreign Governments*. For awards to multilateral organizations, we reviewed ADS Chapter 308 - *Awards to Public International Organizations*. To determine close-out audit requirements, we reviewed ADS Chapter 621 – *Obligations*, USAID’s *Guidance on Closeout Procedures for A&A Awards*, and Contract Information Bulletin 90-12, *Guidance for AID Missions – Closing Out Contracts, Grants and Cooperative Agreements*. To determine financial audit requirements regarding sub-awards, we reviewed applicable sections from each of the sources mentioned above, as well as 22 CFR § 226.5 – *Subawards*. Based on this research, we prepared a chart of the various financial audit requirements which is presented in Appendix II.

To determine whether financial audits of USAID funds provided to contractors, grantees, and other entities for Afghanistan had been conducted as required for ongoing, expired, and subawards, we searched for evidence of audits in the program files for each of the 64 awards in our sample and traced each sampled award through USAID’s annual audit planning process to verify whether and when financial audits had been conducted. We reviewed annual award inventories and annual audit plans prepared by USAID’s Kabul Mission to determine why financial audits were not conducted. For U.S. contractors, we obtained USAID’s database of the Defense Contract Audit Agency (DCAA) audits and reconciled that information with data provided by DCAA to determine whether DCAA had conducted incurred cost audits of the contractors in our sample. For U.S. nonprofit organizations, we verified whether those organizations had completed and submitted audits in accordance with the Office of Management and Budget’s Circular A-133 by accessing the Federal Audit Clearinghouse database on the internet and downloading data collection forms for the organizations in our sample. We also searched the USAID Office of Inspector General’s semiannual reports to congress and quarterly Pakistan and

Afghanistan booklet available on its website to determine whether any financial audits had been conducted of the awards in our sample.

To determine the extent to which close-out audits were conducted of expired awards, we reviewed the 41 expired awards in our sample of 64 to confirm whether they had received a close-out audit, or an annual incurred cost audit that met USAID's close-out audit requirements. For the 41 expired awards in our sample, we also determined how long they had been expired relative to our established cutoff date of September 30, 2011. Further, we determined whether those expired awards included any unliquidated obligations or unpaid cost share.

To determine the extent to which awards to sub-recipients of USAID implementing partners were audited, we interviewed USAID officials in Washington, D.C., and Kabul, Afghanistan, including five contracting and assistance officers responsible for signing contracts and grant agreements in Kabul, as well as ten of their technical representatives. In addition, we met with USAID financial management personnel in Kabul to understand the development of the mission's award inventories and annual audit plans. We also met with officials of USAID's Office of Inspector General based in Washington, D.C., and Kabul, Afghanistan, to gain an understanding of the OIG's role in reviewing financial audits of USAID recipients. Finally, we interviewed representatives from five of the USAID implementing partners in our sample with operations in Afghanistan to gain an understanding of how they fulfill their financial audit requirements regarding awards to sub-recipients.

We conducted work in Kabul, Afghanistan, and Washington, D.C., from March 2011 to March 2012 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted under the authority of Public Law No. 110-181, as amended, the Inspector General Act of 1978, and the Inspector General Reform Act of 2008.

APPENDIX II: USAID FINANCIAL AUDIT REQUIREMENTS BASED ON TYPE OF IMPLEMENTING PARTNER

The following table outlines the different financial audit requirements for various types of USAID recipients and awards.

Table II: Financial Audit Requirements by Type of Implementing Partner

Type of implementing partner	Type of award	Audit threshold	Frequency	Criteria	Auditor	Number in sample
U.S.-based for-profit organization	Contract or cooperative agreement	Incurred cost based on risk assessment	Assessed annually	FAR 52.215-2, FAR 52.216-7, 220 CFR 226, ADS 591.3.1.2	DCAA	21
U.S.-based non-profit organization	Grant or cooperative agreement	\$500,000	Annually, based on recipient's fiscal year	OMB Circular A-133	OIG-approved audit firm	21
Multilateral organization	Cost-type grant or general contribution grant (trust fund)	N/A	N/A	ADS 308.3.6	USAID relies on multilateral organization's audit policies	2
Host government entity	Grant	\$300,000 (\$500,000 cumulative for close-out)	Annually, based on recipient's fiscal year	ADS 591.3.2.1 and <i>OIG Guidelines</i>	SAI or OIG-approved audit firm	3
Non-U.S.-based non-profit organization	Grant or cooperative agreement	\$300,000 (\$500,000 cumulative for close-out)	Annually, based on recipient's fiscal year	ADS 591.3.2.1 and <i>OIG Guidelines</i>	OIG-approved audit firm	2
Non-U.S.-based for-profit organization	Contract or Cooperative Agreement	Incurred cost based on risk assessment	Assessed annually	ADS 591.3.2.1, <i>OIG Guidelines</i> , 220 CFR 226, ADS 591.3.1.2f	OIG-approved audit firm or DCAA	3
U.S. government agency	PAPA, PASA, or Interagency agreement (632(b))	N/A	N/A	ADS 306.3.2.21	USAID and participating agency OIG	12

Source: SIGAR analysis of USAID data.

APPENDIX III: COMMENTS FROM THE U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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MEMORANDUM

April 27, 2012

TO: Steven Trent, Acting Special Inspector General for Afghanistan Reconstruction (SIGAR)

FROM: J. Alexander Thier, Assistant to the Administrator and Director, Office of Afghanistan and Pakistan Affairs

SUBJECT: Draft SIGAR Report "USAID Has Disbursed \$9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, but Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources" (SIGAR Audit 12-xx)

REF: SIGAR Transmittal email dated 3/23/2012

Thank you for providing USAID with the opportunity to review and comment on the subject draft report. Presented below are USAID's general comments on the draft report as well as our responses to the recommendations contained in the draft report.

I. USAID'S GENERAL COMMENTS ON THE DRAFT REPORT

USAID appreciates SIGAR's audit to determine the extent to which financial audit requirements for contractors and assistance recipients have been met. We find the report informative and objective.

USAID fully recognizes the need to conduct more financial audits performed in a timely manner to ensure accountability for the funds channeled by USAID through its implementing partners. In this light, as mentioned in SIGAR's report, USAID/Afghanistan initiated in April 2011, the Accountable Assistance to Afghanistan (A3) audit program that aims to have 100% audit coverage of costs incurred locally by all of its implementing partners.

The new A3 audit program for local costs has been established and is now in the process of ramping up to cover the huge portfolio of 305 active and expired awards. Given the size of the portfolio, USAID/Afghanistan is unable to have financial audits of all those awards performed at the same time. Initial implementation of the A3 program revealed a lack of qualified local audit

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firms and the need to develop their capacity. A3 audits, therefore, are being conducted on a phased or staggered basis.

Due to a lack of qualified local audit firms, USAID/Afghanistan, therefore, is opting to contract with more regional and international audit firms, including U.S. firms, to conduct financial audits of USAID awards in Afghanistan. This approach is expected to significantly increase audit costs. Nevertheless, USAID/Afghanistan will continue to work toward improving accountability for USAID funds with more financial audits conducted.

To ensure cost-effectiveness, the balance of risk, reliance on the single audit program required under OMB A-133 and the cost of the program to be audited is being used by USAID/Afghanistan as determining factors whether an audit should be conducted. USAID/Afghanistan is also looking at bringing in an international firm to build the capacity of local audit firms thus possibly reducing future audit costs.

II. USAID’S RESPONSE TO THE RECOMMENDATIONS IN THE DRAFT REPORT

Recommendation 1:

To improve financial audit coverage of U.S.-based contractors, we recommend that the Administrator of USAID take the following action:

- 1. Increase the quantity and timeliness of incurred cost audits of U.S. contractors by (a) using appropriations for program funds to help finance those audits and (b) contracting with private audit firms for those instances in which DCAA cannot respond to audit requests.*

USAID Response: USAID acknowledges that significant delays have been encountered with the Defense Contracting Auditing Agency (DCAA) audits. Based on USAID/Afghanistan’s recent conversations with the DCAA Financial Liaison Advisor for Afghanistan, DCAA itself is cognizant of this issue and is working toward improving the timeliness of its audits of USAID awards.

In a memorandum dated February 23, 2012 , DCAA’s Assistant Director – Policy and Plans issued a policy guidance requiring audit teams to establish realistic completion dates “based on the risk assessment and audit scope as well as consideration of the Contracting Officer’s needs.”

In addition, DCAA issued in January 25, 2012, policy guidance “requiring the development and use of a milestone plan for audits of all high proposals, major contractor incurred costs submissions, business systems audits and other audits deemed significant by the FAO manager.” In this respect, there is reasonable expectation that the timeliness of incurred cost audits of USAID awards may improve.

In response to Part (a) of the recommendation, it should be noted that USAID/Afghanistan is already using program funds to finance audit costs. With respect to Part (b), USAID/Afghanistan, in compliance with FAR 42.102(b) and applicable ADS chapters and OIG Guidelines, will consider contracting with private audit firms when DCAA is unable to respond to USAID/Afghanistan’s award-specific audit requests in a timely fashion.

Recommendations 2-4:

To provide better accountability over funds provided to contractors and grantees for Afghanistan reconstruction, we recommend that the Administrator of USAID take the following actions:

2. *Develop a system to identify and prioritize awards to U.S. nonprofit organizations to determine whether USAID should (a) request that the awards be audited as major programs by the organizations’ OMB Circular A-133 auditors or (b) contract for award-specific financial audits of those awards.*

USAID Response: Part (a): The definition of a major program is defined by OMB Circular A-133 and a determination whether a USAID award is to be considered a major program relies on Sections 520 and 215. Section 520 states that it is the responsibility of the auditor to determine which Federal programs are major programs. Section 215 stipulates that an audit made in accordance with A-133 shall be in lieu of any financial audit required under individual Federal awards. It goes on to state that this does not prohibit an agency from carrying out additional audits if it chooses to do so. It also states that any additional audits shall be planned and performed in such a way as to build upon the work of other auditors.

Therefore, it is the auditor’s responsibility to determine whether an USAID project meets the requirement of being a Major Program in

accordance with the determination steps described in Section 520. USAID does not have the authority to direct an Implementing Partner's auditor to reclassify a USAID project as a Major Program. We can only challenge a program type determination if we have proof that the auditors did not comply with Section 520. Additionally, the cost of the A-133 audit is paid for by the Implementing Partner.

OMB A-133 does give USAID/Afghanistan the latitude to initiate a supplemental audit of a project which is already covered by an A-133 audit. Any supplemental audit is to be planned and performed in such a way to build upon the work of other auditors. Determination of the need of a supplemental audit of a project that is already covered by an A-133 audit is at the discretion of the Agreement Officer.

Part (b): USAID/Afghanistan is already implementing Part (b) of this recommendation. In developing the FY 2012 Audit Inventory and Audit Plan, the Office of Financial Management, the Office of Acquisition and Assistance and the technical offices worked together to identify and prioritize awards for which award-specific financial audits need to be conducted. The FY 2012 audit management plan includes 38 grants and contracts and six programs implemented through Afghan government mechanisms. Of the 44, four audits are ongoing; contracting for 19 audits is in progress; three audits will be contracted for by the recipients under the Recipient-Contracted Audit Program; and, the remainder will be contracted for by USAID/Afghanistan as audit firms become available.

3. *Expedite close-out audits for expired awards, especially for (a) the 90 expired awards with \$103 million in unexpended obligations and (b) the 13 expired awards with \$27.3 million in unpaid cost share as of September 30, 2011.*

USAID Response: USAID/Afghanistan acknowledges the need to audit all awards in a more timely fashion and is already pursuing more aggressive means to audit and close out these awards as described in our general comments on the draft report. USAID/Afghanistan has initiated close-out procedures and will take action on the unexpended obligations. USAID/Afghanistan will further review the awards for

which cost share requirements were not met and will take appropriate recovery actions.

4. *Amend USAID's awards for Afghanistan reconstruction to include a requirement that prime recipients develop and submit to the respective contract or agreement officer a plan for ensuring that financial audits of expenditures under sub-awards are conducted as required.*

USAID Response: Awards issued by USAID/Afghanistan include standard language for audits required by USAID's Office of Acquisition and Assistance for all Agency awards. Changes to this language require a review and approval by the Office of Acquisition and Assistance. USAID/Afghanistan and the Office of Afghanistan and Pakistan Affairs will request a review of the standard audit language by the Office of Acquisition and Assistance in Washington and will notify SIGAR of the review results when completed.

III. TECHNICAL COMMENTS:

1. Throughout the report, USAID/Afghanistan suggests changing the word "reconstruction" to "development" when referring to the work in Afghanistan.
2. On page 15, under the 2nd bullet, replace "an auditor from USAID's Contract and Audit Support Division" to "an auditor from Afghanistan's Control and Audit Office."
3. USAID/Afghanistan suggests distinguishing between USAID/Afghanistan and USAID/Washington in the report to provide clarity for the reader.

cc: CDDEA
OIG/Afghanistan

(This performance audit was conducted under the audit project code SIGAR-044A).

SIGAR's Mission

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

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

Obtaining Copies of SIGAR Reports and Testimonies

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

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

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

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

Public Affairs

Public Affairs Officer

- Phone: 703-545-5974
- Email: sigar.pentagon.ccr.mbx.public-affairs@mail.mil
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2530 Crystal Drive
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