



July 30, 2004

## MEMORANDUM

**FOR:** Mission Director, USAID/Kosovo, S. Ken Yamashita

**FROM:** Regional Inspector General/Budapest, Nancy J. Lawton /s/

**SUBJECT:** Report on the Risk Assessment of USAID/Kosovo (Report No. B-167-04-003-S)

This memorandum transmits our final report on the subject risk assessment. In finalizing the report, we considered your comments on our draft report and have included your response as Appendix II.

This is not an audit report and does not contain any recommendations for your action.

I appreciate the cooperation and courtesy extended to my staff during the risk assessment.

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### Background

USAID/Kosovo was established in July 1999 after peace was restored to the area by a NATO-led coalition and Kosovo came under United Nations authority. The highest priorities at the end of the conflict were to provide emergency assistance and establish a secure environment. Today, USAID/Kosovo's mission is to help transform Kosovo into a self-governing economically sustainable entity in which all citizens have equal rights.

Development work in Kosovo occurs in a very complicated political environment, making the work at times more difficult and risky. The United Nations Mission in Kosovo (UNMIK) is the ultimate authority, although many government functions have been transferred to Kosovo's nascent government, the Provisional Institutions of Self-Government (PISG). To provide assistance, USAID interacts with both institutions as well as with other donors.

USAID/Kosovo includes a Controller's Office, an Executive Office (EXO), a Program Office, and two Program-related Offices:

- the Economic Growth Office (EGO) focuses on strengthening the basic institutions needed for a vibrant economy, promotes the integration of

Kosovo's economy into the region, and encourages investment to create a dynamic private sector, and

- the Democracy and Governance Office (D&G) supports the development of an independent judiciary, a citizenry informed by independent media, vibrant civil society organizations and political parties, and government institutions that respond to citizens' needs.

The following table shows program obligations, in millions, during fiscal years 2001 through 2003, along with the current strategic objectives (SOs) and the proposed budget for fiscal year (FY) 2004.

<b>USAID/Kosovo Programs</b>	<b>FY 2001</b>	<b>FY 2002</b>	<b>FY 2003</b>	<b>FY 2004 (budgeted)</b>
<b>Economic Growth:</b> <i>Strategic Objectives - 1.2: Improved Policy and Institutional Climate for Productive Investment and 1.3: Accelerated Growth of the Private Sector</i>	\$26.1	\$24.3	\$17.1	\$11.8
<b>Democracy and Governance:</b> <i>Strategic Objectives - 2.1: A Civil Society and Government That Are More Effective Partners In Achieving Good Governance and 2.2: A More Capable, Transparent and Responsive Government Acting According To The Rule Of Law</i>	5.7	8.8	9.0	13.4
<b>Program Office:</b> <i>Strategic Objectives – 4.1: Special Initiatives and 4.2: Cross-cutting Programs</i>	13.1	2.6	2.4	6.1
<b>Total Program Funds</b>	\$44.9	\$35.7	\$28.5	\$31.3

The Government Accountability Office, formerly the General Accounting Office (GAO), has stated in the *Standards for Internal Control in the Federal Government* that internal controls are an integral component of an organization's management. They should provide reasonable assurance that the following objectives are being met: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. GAO has stated that internal control should provide for an assessment of the risks the agency faces from both external and internal sources. This survey focused on the risk assessment component of internal controls.

The purpose of this risk assessment is to identify significant areas of vulnerability within USAID/Kosovo's administrative and program operations and to assist RIG/Budapest in planning future audits.

Appendix I contains a discussion of the scope and methodology for this assessment.

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## Discussion

One overriding risk factor regarding the effective management of USAID's assistance activities in Kosovo has been the Agency's difficulty in recruiting and retaining U.S. Direct Hire (USDH) and U.S. Personal Service Contractor (USPSC) personnel. While the Mission's FY 2001-2003 strategy called for ten USDH employees, USAID's Europe and Eurasia Bureau advised USAID/Kosovo that Agency personnel shortages would preclude the Mission from reaching that staffing level. Furthermore, USAID/Kosovo has suffered from extremely high turnover and a reliance on temporary or intermittent U.S. managers in many key functions.

Many factors also have had a negative impact on USAID's ability to provide staff to the Mission in a timely manner. Until recently, because of the dangerous security situation in Kosovo, employees had not been able to bring adult dependent family members to post, making the Mission unattractive for many employees. In addition, several USAID/Kosovo personnel were selected for assignments to support USAID operations in Afghanistan and Iraq. As the Mission Director recently reported, USDH numbers are only slowly being rebuilt after being "nearly completely decimated" in 2003; the Mission plans to have six USDH positions in FY 2004. During one three-month period in FY 2003, there were no USDH personnel at the Mission. Consequently, these disruptions resulted in very high costs, both in dollar terms and in the loss of continuity in program implementation.

In 2000, the Mission received a waiver for the strategic requirement for a fully articulated results framework (such as cause-and-effect linkages between Intermediate Results and Strategic Objectives) and related performance measurement system requirements, including a Performance Management Plan (PMP). The PMP is a tool used by an operating unit to plan and manage the process of assessing and reporting its progress towards achieving strategic objectives. The absence of formal activities to monitor and validate performance measures and indicators increases the risk that programs will not achieve their objectives. This risk will be mitigated with the implementation of a formal PMP, currently under development, to support the Mission's revised strategy.

In judging the risk exposure for the offices in USAID/Kosovo, we also considered, where appropriate:

- the amount of funding the individual programs received relative to the overall Mission budget,
- the level of involvement and support provided by the Government of Kosovo,
- the experience of key staff members,
- the adequacy of written procedures and the level of compliance with procedures throughout the Mission,
- the adequacy and use of performance standards and internal audits,

- evidence of consistent implementation of activities that clearly support program objectives,
- the adequacy of controls over its data systems, equipment and vehicles, and
- correction of Mission-identified weaknesses from the Federal Managers' Financial Integrity Act (FMFIA) report for FY 2003.

Our assessment for the two program-specific offices and the controller and executive offices is described in the following pages. We did not assess the program office.

Function Description	Risk Exposure
<b>Economic Growth Office (EGO):</b> This office is responsible for SO 1.2: Improved Policy and Institutional Climate for Productive Investment and SO 1.3: Accelerated Growth of the Private Sector	Moderate
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• This area received \$17.1 million or 60 percent of the Mission’s FY 2003 funding.</li> <li>• This office interacts with UNMIK, the PISG, and the European Union, and other donors to provide assistance. Conflicts or differences in opinions among these organizations may sometimes impede the Mission’s progress to achieve timely results</li> <li>• Many reforms depend on the approval of UNMIK, which is beyond the Mission’s manageable control. In addition, as various powers are transferred to the PISG, USAID will need to coordinate closely with Kosovar counterparts to ensure that needed reforms are fully institutionalized in order to support an effective climate for investment.</li> <li>• The inability to attract key staff persons may negatively impact project monitoring, especially by creating gaps in the supervision of cognizant technical officers (CTOs).</li> <li>• The lack of a sub-grantee’s management oversight resulted in the termination of an agreement under the assistance program because the implementing partners did not meet program or administrative objectives.</li> <li>• The staff was knowledgeable and aware of their assigned responsibilities. Their level of competence and institutional knowledge has provided the Mission with the needed assurance that work requirements will be met without close supervision. The staff members in key positions had the necessary knowledge and experience relating to their job responsibilities.</li> <li>• Staff clearly understood USAID policies and procedures, and the area covering CTO responsibilities; however, contract oversight responsibilities regarding project site visits was not always documented in writing. As a result, the recipient’s progress in achieving the objectives stated under the terms and conditions of the award could not be reviewed or verified via documentation of visits.</li> <li>• The privatization process has been halted since October 2003. The Kosovo Trust Agency (KTA), UNMIK, and others have been working to resolve procedural, corruption, and immunity issues related to the privatization process. While a mutually-acceptable compromise appears to be on the horizon, there is no guarantee that the process will move forward because of the highly politicized nature of privatization, especially in Kosovo.</li> <li>• The Mission’s FMFIA report for FY 2003 did not disclose any material weaknesses.</li> </ul>	

Function Description	Risk Exposure
<p><b>Democracy and Governance Office (D&amp;G):</b> This office is responsible for SO 2.1: A Civil Society and Government That Are More Effective Partners In Achieving Good Governance and SO 2.2: A More Capable, Transparent and Responsive Government Acting According To The Rule Of Law</p>	<p>Moderate</p>
<p><b>Risk Assessment Factors</b></p>	
<ul style="list-style-type: none"> <li>• The Mission spent \$9 million on D&amp;G programs during fiscal year 2003, representing 31 percent of the USAID/Kosovo’s program budget for that fiscal year.</li> <li>• The D&amp;G budget is nearly 50 percent larger in FY 2004 because the Mission eliminated the Community Infrastructure SO and gave the D&amp;G new staff and program responsibilities. In addition, the D&amp;G personnel formed new SO teams and new CTO responsibilities were assigned to the staff. Agency reorganizations and change of strategic plans, goals and objectives and budget can have dramatic and pervasive organizational effects and lead to increased risk that organizational objectives will not be achieved. However, negative effects of reorganization may be mitigated through close collaboration with staff during the reorganization and strategy design and implementation processes.</li> <li>• The lack of consensus regarding Kosovo’s final political status, competing municipal structures, unresolved ethnic tension, and the need to coordinate with other donors may limit D&amp;G’s program success.</li> <li>• Turnover, staffing decisions made by USAID/Washington, and unsuccessful recruitment efforts can leave key positions vacant for extended periods and undermine effective organizational management that is essential to achieving results. The D&amp;G Director’s position was converted from USDH to USPSC in 2003, but the selected candidate is still awaiting his security clearance. The Senior Rule of Law Advisor position – vacant since September 2002 – has also remained unfilled because the selected candidate has not yet received the required security clearance.</li> <li>• The Mission recently created a D&amp;G Deputy Director position to provide greater management continuity for the organization.</li> <li>• D&amp;G personnel are actively engaged with the implementing partners to improve D&amp;G programs and results. Personnel have up-to-date job descriptions, receive required performance appraisals, and receive regular training opportunities. These human capital management factors reduce organizational risk.</li> <li>• D&amp;G personnel are aware of the potential for fraud, corruption and mismanagement, and have taken steps to prevent it. For example, a CTO recently identified and reported a potential vulnerability to Mission</li> </ul>	

management and the OIG. The identification and mitigation of such risk helps ensure that organizations meet their objectives

- D&G has utilized management tools such as portfolio reviews, sector assessments, and contractor evaluations. Such management reviews at the functional level are important control mechanisms that help limit risk.
- The Mission’s FMFIA Report for FY 2003 did not disclose any material weaknesses related to D&G operations.

<p><b>Executive Office:</b> This office manages administrative functions such as personnel management, general services, motor pool, and property management.</p>	<p>Low</p>
<p>Risk Assessment Factors</p>	
<ul style="list-style-type: none"> <li>• The Mission’s Operating Expense budget for FY 2003 was \$4.4 million. This provides for the basic support of the Mission. The EXO also spends a small amount of program funds each year.</li> <li>• Key managers within the Executive Office – including the Executive Officer (EXO), the Deputy EXO, and Computer System Manager – have extensive training and experience with USAID policies and procedures. Organizations can reduce risk by having the right people on board with the appropriate skills.</li> <li>• The EXO is responsible for administration and internal management activities of the Mission and must work with numerous laws, regulations and standard operating procedures, including, procurement and local labor laws, State Department regulations for travel and education, funding regulations, and computer security. Such multiple requirements demand significant staff attention.</li> <li>• The EXO maintains appropriate internal controls related to personnel management. Personnel have up-to-date job descriptions and receive regular performance appraisals. Employees are provided with training to improve performance. These human capital management factors reduce organizational risk.</li> <li>• Employee files are generally well organized in accordance with applicable guidance. In addition, the risk of unauthorized use or loss is controlled by restricting access to employee records.</li> <li>• The EXO maintains appropriate internal controls related to physical inventory and EXO property management personnel have received a commendation for their service to other U.S. agencies under an International Cooperative Administrative Support Services agreement. Residential furniture, office furniture and equipment items are bar-coded and assigned a control number.</li> <li>• The EXO maintained appropriate use of internal controls related to computer access controls and security. A recent scan of the computer system by USAID/Washington showed that vulnerability is low.</li> </ul>	

- A computer disaster recovery plan has been developed and is periodically tested for general support and major applications.
- The EXO maintains documentation regarding daily motor pool operations. Vehicle mileage, fuel consumption and maintenance records are regularly updated. The Mission maintains daily vehicle operation reports which are signed by the motor pool supervisor and authorized passengers.
- The USAID/Kosovo Mission Order 536, Motor Vehicle Use was not consistent with the Foreign Affairs Manual (FAM) 228.2-4 requirement to collect charges for most non-business uses of official vehicles. In October 2003, the EXO drafted a revised Mission Order requiring such charges, but at that time of our review, the new Order had not yet been approved by the U.S. Office, Pristina. If mission orders are not consistent with regulations, the general control environment may become vulnerable to fraud, waste and abuse.
- The Executive Office has not completed an evaluation of the Mission's vehicle and driver requirements that is consistent with guidance in Automated Directives System (ADS) 536.3.4 or 6 FAM 228 1-2. In the past, the Mission had purchased some vehicles based on the availability of funds, not based on documented Mission needs. Although the Mission spent \$51,000 of year-end funds to purchase two pick-up trucks in September 2003, the Executive Office had not justified the purchase through an analysis of Mission needs.
- The Mission's FY 2003 FMFIA report disclosed no material weaknesses related to EXO operations.

Function Description	Risk Exposure
<b>Controller's Office:</b> This office is responsible for the financial management of the Mission's programs and operations.	Low
<b>Risk Assessment Factors</b>	
<ul style="list-style-type: none"> <li>• This area received \$617,000 or 14 percent of the Mission's FY 2003 operating expense funding.</li> <li>• The instability of the Government of Kosovo and the continued incidents of political violence and disputes may increase the Mission's financial liabilities, and in return may limit budgeted resources.</li> <li>• The staff was knowledgeable and well informed about their respective responsibilities. The staffs' level of competence and institutional knowledge should provide the Mission with the needed assurance that work requirements will be met with minimum supervision.</li> <li>• Unannounced cash counts were conducted and documented as required by the Foreign Affairs Handbook Volume 4 Handbook 3.</li> </ul>	



- Various vouchers and schedules from prior fiscal years had not been retired as required by ADS 502. During our assessment the office began work to retire its records as appropriate.
- The Mission’s FMFIA report for FY 2003 did not disclose any material weaknesses related to the Controller’s operations.

**Conclusion**

We examined the risk associated with the various aspects of the USAID/Kosovo Mission. The table below summarizes the conclusions.

USAID/Kosovo Functions	Risk Exposure		
	High	Moderate	Low
Economic Growth Office		✓	
Democracy and Governance Office		✓	
Executive Office			✓
Controller’s Office			✓

We believe that much of the risk associated with USAID/Kosovo’s program objectives not being met are due to the uncertainty of political and economic reforms as well as the continued incidents of political violence and disputes which greatly limit program success. In some instances, additional management action and improved procedures are needed to ensure adequate program controls.

Based on our observations, interviews and limited review of documentation, we are offering the following suggestions for Mission management’s consideration. These suggestions are not formal audit recommendations and do not necessarily represent deficiencies, but involve possible improvements or enhancements to activities which could already be in progress. Specifically the Mission should:

- maintain standards for records management and retirement,
- cite the difficulty of recruiting and retaining staff as an internal control weakness for its FMFIA report,
- complete an annual needs assessment of drivers and vehicles that is consistent with FAM and ADS guidance, and
- assure that site visit reports are documented in writing.

**Evaluation of Management Comments**

USAID/Kosovo Mission officials agreed with the conclusions we reached during the risk assessment and concurred with our suggestions. As noted by the Mission, many of the suggestions included in the risk assessment have already been implemented, including the appropriate retirement of records and the adoption of a motor vehicle policy that is consistent with the FAM.

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**Scope and  
Methodology****Scope**

The Regional Inspector General/Budapest (RIG/Budapest) conducted this risk assessment to gain an understanding of the programs and activities of USAID/Kosovo. This was not an audit and does not contain any formal recommendations. The risk assessment was conducted at USAID/Kosovo in Pristina, Kosovo from April 26 through May 14, 2004. Due to time constraints, we did not assess the program office. The purpose of this assessment was to identify the more significant areas of vulnerability within USAID/Kosovo's administrative and program operations that would assist RIG/Budapest in planning future audits. The risk assessment focused primarily on FY 2003 data and, as necessary, data from previous years.

**Methodology**

To perform this risk assessment, we interviewed USAID/Kosovo personnel and examined documentation to obtain an understanding of the Mission's objectives, programs and activities. We judged risk exposure by considering the likelihood of: significant abuse, illegal acts, and/or misuse of resources, failure to achieve program objectives, and noncompliance with laws, regulations or internal policies. We assessed overall risk exposure as low, moderate, or high. A higher risk exposure simply indicated that the particular function is more vulnerable to not achieving its program objectives or to experiencing irregularities.

Our overall risk assessments did not make definitive determinations of the effectiveness of internal controls. As a part of the scope of our review, we (a) obtained an understanding of the internal controls related to the programs and operations selected, and (b) assessed what was already known about the internal controls. Also it should be noted, we did not, (a) assess the adequacy of the internal control design, (b) determine if controls had been properly implemented, nor (c) determine if transactions were properly documented.

Our risk assessment of USAID/Kosovo considered the following limitations:

- Higher risk exposure assessments are not definitive indicators that program objectives were not being achieved or that irregularities were occurring. A higher risk exposure simply implies that the particular function is more vulnerable to the occurrence of such events.
- Comparison of risk exposure assessments between organizational units and implementing partners is of limited usefulness due to the fact that the assessments consider both internal and external factors, some being outside the control of management.

- Risk exposure assessments in isolation are not an indicator of management's capabilities due to the fact that the assessments consider both internal and external factors, some being outside the control of management.

We judgmentally determined a risk level of low, moderate, or high for the Mission's various programs and offices. The final assignment of the risk level to an office was judgmentally determined considering the external factors which could have had an effect on the programs in some cases. We also assessed how sufficiently we believed the Mission had met the prescribed regulations, operating guidelines and internal control procedures in its program, financial, accounting and administrative management.

**Management  
Comments**



***United States Agency for International  
Development  
USAID/Kosovo, Pristina***

MEMORANDUM

FOR: Nancy J. Lawton, RIG/Budapest

FROM: S. Ken Yamashita, Mission Director, USAID/Kosovo /s/

DATE: August 2, 2004

SUBJECT: Response to the Draft Report on the Risk Assessment of USAID/Kosovo (Report No. B-167-04-00X-S)

Thank you for the opportunity to comment on subject report. We worked closely with your office on the risk assessment review, provided written comments to the discussion draft report and discussed concerns and issues with your office. We appreciate that our comments were addressed and incorporated into the report.

The Mission has implemented some of the initial report suggestions. Please see the attached schedule for our final proposed report changes.

USAID/Kosovo recognizes and appreciates the effort and guidance your office provided during the risk assessment review. We look forward to further implementing the report's suggestions.

## **Attachment - Proposed Report Changes**

On page 5 under **Economic Growth Office**, fifth bullet, please add: ...resulted in the “appropriate” termination of... and at the end of the sentence: ... or administrative objectives “showing that oversight procedures functioned effectively.”

On page 8 under **Executive Office**, fourth bullet, please remove the paragraph covering not collecting for vehicle usage since an Administrative Notice on Post Policy On The Use Of Official Vehicles was issued on May 25, 2004 and this suggestion has now been fully implemented.