PD-ABI 571

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

July 30, 1990

THE ADMINISTRATOR

MEMORANDUM FOR THE SENIOR STAFF

SUBJECT: Strengthening A.I.D.'s Internal Control and Audit Follow-up Processes

Today I approved a series of recommendations aimed at strengthening A.I.D.'s internal control and audit follow-up processes.

The Savings and Loan and HUD scandals of last year have led OMB, the Congress, and the Inspector General community to take a much harder look at how agencies identify management control weaknesses and take actions to correct them. In addition, the Inspector General Act Amendments of 1988 now require agencies to report to the Congress on the status of audit recommendations outstanding for more than six months. Although A.I.D. is in compliance with both internal control and audit follow-up requirements, both processes need to be strengthened in order to give A.I.D. managers a better sense of the weaknesses that require attention, as well as demonstrate to OMB, the IG and Congress that we are correcting these weaknesses.

The following changes to A.I.D.'s internal control and audit follow-up processes shall take effect immediately:

-- The Deputy Administrator is now designated as the Agency's internal control manager and principal official responsible for audit follow-up.

-- The existing Internal Control Oversight Committee is hereby designated as the Management Control Review Committee (MCRC) and will assume responsibility for oversight of audit follow-up, as well as internal controls.

-- Attendance at the quarterly MCRC meetings shall be at the DAA or higher level.

-- Internal control weaknesses will now be more specific, and each reported weakness will include a corrective action plan.

-- Responsibility for the correction of material weaknesses and follow-up of audit recommendations will be assigned to senior staff by the MCRC.

-- Specific responsibilities for the correction of material weaknesses and audit follow-up will be incorporated into senior managers' performance plans.

-- The Deputy Administrator will receive quarterly reports from the MCRC on the status of material weaknesses and outstanding audit recommendations.

The Office of Financial Management will provide staff support for the Committee, as it currently does for the Internal Control Oversight Committee. Additional guidance on the new policies and procedures outlined above is being developed by FM and will be issued shortly. I am asking that the first meeting of the MCRC be held as soon as possible.

As you know, my management style is to delegate authority, but to hold people accountable for getting the job done. Strengthening these management control processes is a key step in ensuring that problems are identified, people are assigned responsibility for fixing them, and corrective action takes place. I ask each of you to take an active role in these processes.

Ronald W. Roskens

Agency for International Development
Washington, D.C. 20523

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JUL 24 1990

ACTION MEMORANDUM FOR THE ADMINISTRATOR

FROM: FM/CONT, Michael G. Usnick

SUBJECT: Strengthening A.I.D.'s Internal Control and Audit Follow-up Processes

Problem:

New OMB guidelines on internal controls and the passage of the Inspector General Act Amendments of 1988 require A.I.D. to strengthen its internal control and audit follow-up processes. In addition, the IG and the Congress have become more vocal in their criticism of A.I.D.'s failure to correct recurring management and accountability problems. We outlined our plans to strengthen these processes in the Management Report that you transmitted to the Congress on July 9. This memorandum proposes seven recommendations to implement these improvements. If you concur, a memorandum to the Senior Staff announcing these changes is attached to this memorandum for your signature.

Discussion:

The Savings and Loan and HUD scandals of last year have led OMB, the IG community, and the Congress to take a much greater interest in the identification and correction of agency internal control weaknesses, and the maintenance of effective audit follow-up systems.

Internal Control

Last July, OMB Director Richard Darman asked each agency to conduct a mid-year review of their internal controls and to report back to OMB what they considered to be their highest risk areas. The areas identified by A.I.D. as its highest risk areas -- financial management, lack of direct-hire staff, inadequate audit coverage, and ADP security -- were concurred in by OMB and published along with the highest risk areas of other departments and major agencies. At the same time OMB issued new guidelines on strengthening the internal control process, with an emphasis on setting up effective "early warning" systems to identify potentially serious operational weaknesses. (See Tab A). The guidelines cite the following key elements:

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- The deputy agency head should be the principal official responsible for internal control and audit follow-up.

- A quarterly report to the deputy agency head on the progress to correct critical problems should be instituted.

- The IG should be requested to provide periodic reports on adverse trends noted during audits and investigations.

- Internal control and audit follow-up responsibilities should be a critical element in management performance appraisals.

- An appropriately staffed evaluation component should be established to verify that reported corrective actions on major problems have been taken.

- Correction of major weaknesses should be identified in agency budget and operating plans to assure appropriate allocation of resources to correct the problems. (This is now required by OMB Circular A-11).

In addition, OMB issued new guidance in June which will require detailed, semi-annual reports to OMB on the status of correcting material weaknesses. A.I.D.'s first response to this new requirement was transmitted July 13 by the Deputy Administrator.

While A.I.D. is in general compliance with current internal control guidelines set forth in Circular A-123, its internal control process is not rigorous enough and does not meet the above standards for an effective "early warning" system. To meet these standards the Agency's internal control process needs to be modified.

Until recently, A.I.D.'s internal control process was directed by the AA/PFM and implemented by the Internal Control Oversight Committee (ICOC) represented by the DAAs and chaired by the Controller. There are, however, some major deficiencies in the current process, outlined as follows:

- The ICOC meetings are not attended by the DAAs, but instead by lower level representatives.

- The Agency does not have an effective "early warning" system to alert OMB and A.I.D. management to potentially serious problems.

- Material weaknesses as now presented are too broad and general.

- No direct assignment of responsibility is made to correct material weaknesses.

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Over the past months, FM has conducted a survey of how other agencies (specifically Agriculture, Commerce, Interior, State, Transportation, and NASA) have carried out their internal control processes and how they have developed their "early warning" systems. The most impressive internal control systems were employed by NASA, Interior, and Transportation which have a high degree of senior level management involvement in the process, close coordination between internal control and audit follow-up processes, and active participation of their Inspectors General in the internal control process.

Audit Follow-up

The Inspector General Act Amendments of 1988 made significant changes to the audit resolution, follow-up and reporting process. Management is now responsible for reporting directly to Congress on its management decisions and final actions regarding audit recommendations. In December 1989 A.I.D. issued the policy and procedures for its audit follow-up systems. These procedures culminated in the preparation of our first Management Report. However, much more needs to be done to improve and institutionalize the audit follow-up process within A.I.D. Among other things, management needs to become more actively involved in the establishment and maintenance of the Agency's audit tracking system, which is currently being maintained by the IG, and to implement reporting systems which keep senior management apprised of the status of significant audit recommendations and monetary findings as well as assigning responsibility for corrective action. In addition, missions must be given instructions on how to respond to audit recommendations in the new audit follow-up environment.

Recommendations:

The following recommendations flow from recent OMB directives relating to internal control and audit follow-up, as well as recommendations made by various interagency groups focusing on the requirements of the IG Act Amendments of 1988. If approved, the recommendations will focus more senior-level attention on these processes, particularly the correction of identified weaknesses. In addition, the recommendations marry the two processes and put them under one oversight committee, since there is an important linkage between internal controls and audits. They also institutionalize a quarterly reporting procedure and bring the IG much more into the management oversight process.

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Recommendation No. 1:

The Deputy Administrator should be designated as the Agency's internal control manager and principal official responsible for audit follow-up.

Discussion: The AA/PFM had been A.I.D.'s principal official responsible for the overall coordination of the internal control and audit follow-up processes. With the abolishment of the AA/PFM position and the new importance attached to the identification and correction of programmatic and administrative/management weaknesses, the Deputy Administrator should now direct these processes.

Approve: B
Disapprove:
Date: 7-28-90

Recommendation No. 2:

The current Internal Control Oversight Committee (ICOC) should be renamed the Management Control Review Committee (MCRC) and assume responsibility for audit follow-up as well as internal controls.

Discussion: The ICOC is an established committee that coordinates the internal control process. It is chaired by the Controller and consists of DAAs from both the regional and central bureaus. Since the same DAAs will be involved in the audit follow-up process, it makes sense to redesignate this committee as the Management Control Review Committee, consistent with OMB guidelines. Staffing for both the internal control and audit follow-up processes will be within the Financial Policy and Systems Division of FM. The Deputy Administrator will chair the Committee, or delegate the responsibility to the Counselor or the Controller.

Approve: B
Disapprove:
Date: 7-28-90

Recommendation No. 3:

The Deputy Administrator should mandate DAA or higher level attendance at Management Control Review Committee meetings.

Discussion: Although the ICOC is comprised of the Deputy Assistant Administrators from the Agency's principal bureas, ICOC meetings have been attended, with very few exceptions, by lower level representatives. In a 1984 audit of the Agency's internal control process the IG pointed out that the ICOC meetings needed higher level representation. To date, this situation has not improved. With the creation of a new review committee, it is appropriate to mandate DAA attendance at the anticipated quarterly meetings.

Approve: R
Disapprove:
Date: 7-28-90

Recommendation No. 4:

Internal control material weaknesses should be more specific.

Discussion: The Agency's material weaknesses as now presented are much too broad and general. In fact, by OMB definition they are described as "risk areas" rather than specific material weaknesses. We need to make the weaknesses more specific. For example, the "financial management" weakness could easily be broken down into several discrete weaknesses such as: redesign of primary accounting system, the A.I.D./W payments deficiencies vulnerabilities within the master disbursing account, the undistributed account reconciliation problem, and outstanding travel advances.

The "audit" weakness could be broken down by IG coverage of program and administrative operations, and by use of non-federal audits by mission management. By making the weakness more specific it would allow for better planning for corrective action, better establishment of milestones, and aid in the reporting process.

We should also consider elevating bureau material weaknesses to the Agency material status, or at a minimum establish a new "significant concern" category which would be reported to OMB, and tracked and reported to senior management until resolved. Two examples of this type of weakness would be the overseas non-expendable property problem and the contract close-out problem. (Tab B outlines the recommended material weakness breakdown for AID's current weaknesses.)

Approve: R
Disapprove:
Date: 7-28-90

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Recommendation No. 5:

Assign responsibility for correction of material weaknesses and significant concerns, as well as follow-up on audit recommendations.

Discussion: As of now, Agency material weaknesses are not directly assigned to a responsible Agency official who would be responsible to develop a corrective action plan, establish milestones, and report progress on correction. The same is true of audit follow-up. Direct assignment of responsibility by the Management Control Review Committee for correction of material weaknesses and the active follow-up of certain audit recommendations should be required. An illustrative assignment roster for current internal control material weaknesses and significant concerns is also included at Tab B.

Approve: B
Disapprove:
Date: 7-28-90

Recommendation No. 6:

Incorporate specific responsibilities for material weakness correction and audit follow-up into senior managers' performance plans.

Discussion: The Management Control Review Committee will advise the Deputy Administrator by letter regarding the material weakness corrections which should be incorporated into the responsible DAA's EER or PAR. The Deputy Administrator will notify the AAs that correction of a material weakness or follow-up on an open audit recommendation should be included in their DAA's performance evaluation as a critical element or specific objective. It is anticipated that material weakness and audit correction responsibilities would filter down the chain of command.

Approve: B
Disapprove:
Date: 7-28-90

Recommendation No. 7:

Institute a quarterly reporting system to the Deputy Administrator on the status of material weaknesses and audit recommendations that are long-outstanding.

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Discussion: A quarterly reporting system providing information to the Deputy Administrator on correction of material weaknesses and actions on long-outstanding audit recommendations should be instituted. Successful implementation of this system requires the identification of officials responsible for correcting weaknesses and closing audit recommendations, and a clearly-defined reporting mechanism and format. FM will be the coordinating point for responses from responsible officials and will prepare the comprehensive report to the Deputy Administrator. The quarterly report will also incorporate significant areas of internal control weaknesses highlighted in Inspector General memoranda and reports. These quarterly reports will form the basis for both the internal control certification letter and the semi-annual Management Reports.

Approve: 7-28-90
Disapprove: _____
Date: _____

Next Steps:

If you concur in the recommendations, the attached memorandum to the senior staff announcing these changes should be signed. The first meeting of the Management Control Review Committee will be convened as soon as possible.

*Clearances:*

*C/AID, Alexander R. Love* _____ *DATE:* 7/28/90
*IG, Herbert L. Beckington* _____ *DATE:* 7/28/90

*FM/FPS:RKramer:7/17/90:Doc. No. 2318N:X663-2245*

ENCLOSURE C

# INTERNAL CONTROL AND AUDIT FOLLOWUP

## KEY ELEMENTS

The standards and criteria for internal control and audit followup programs are contained in OMB Circulars A-123 (Internal Controls), and A-50 (Audit Followup.) The following are considered key elements in achieving early identification and correction of serious problems.

### ORGANIZATIONAL STRUCTURE

The deputy agency head should to be the principal official responsible for internal control and audit followup. The Deputy should monitor and engage the agency's line program managers in the most important internal control reviews and audits. A program/review process to establish priority actions to address material weaknesses and audit followup should be established by program managers and monitored by the deputy. This process should provide for an "early warning" reporting system by senior managers and the Inspector General. Internal control and audit followup responsibilities should be a critical element in manager performance appraisals.

### IDENTIFICATION OF POTENTIAL PROBLEM AREAS

The assignment of risk ratings to the agency's assessable units required by OMB Circular A-123 should be reviewed at the agency level to insure that all "high risk" areas have been identified and appropriate reviews/audits have been performed to confirm that adequate controls are in place and functioning as intended. Reassessments should be made whenever major changes occur in programs.

### TRACKING AND REPORTING ON CORRECTIVE ACTIONS

Circulars A-50 and A-123 require audit recommendations and material weaknesses to be tracked until the required corrective action is taken. The Deputy should institute a reporting system that advises him or her on progress to correct critical problems. These reports, which should be prepared at least quarterly, should highlight and explain delays and provide for focus on long-standing uncorrected problems.

Items in the tracking system should be analyzed along program and functional category lines to determine whether reported weaknesses are isolated, widespread and/or collectively indicate a serious impairment of a program objective or functional area. The Inspector General should be requested to provide periodic reports on major program and functional areas indicating any adverse trends noted during audits and investigations.

## EVALUATIONS

Both the internal control and audit followup programs should have an appropriately staffed evaluation component at the agency level to verify that reported corrective actions have actually been taken and that programs are operating in accordance with agency policies. This is especially important where the programs are decentralized. The evaluations should be coordinated with the Inspector General's reviews and audits.

## LINK TO PROGRAM PLANNING AND BUDGETING

The correction of major weaknesses should be identified in agency budget and operating plans to assure appropriate allocation of resources to correct the problems. This will also assist the agency in establishing priorities for problems.



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## A.I.D. Material Weaknesses and Significant Concerns

RISK AREA: Financial Management

Material Weakness: A.I.D.'s Primary Accounting System
Responsible Official: Michael Usnick, FM

Material Weakness: A.I.D./W Payments Operation
Responsible Official: Michael Usnick, FM

Significant Concern: Reconciliation of Undistributed Account
Responsible Official: Michael Usnick, FM

Significant Concern: Master Disbursing Account
Responsible Official: Michael Usnick, FM

Significant Concern: Travel Advances not Liquidated Promptly
Responsible Official: Michael Usnick, FM

RISK AREA: Audit Coverage - Programs and Administrative Operations

Material Weakness: Insufficient IG Staffing to Audit Programs
Responsible Official: Herbert Beckington, IG

Material Weakness: Lack of IG Functional Audits
Responsible Official: Herbert Beckington, IG

Material Weakness: Use of Non-Federal Auditors
Responsible Official: Michael Usnick, FM

RISK AREA: ADP Security

Material Weakness: Management of Sensitive Information
Responsible Official: Michael Doyle, MS

RISK AREA: Staffing Levels for Administrative Management

Material Weakness: Insufficient Staffing - Overseas
Responsible Official: Reginald Brown, PPC (R. Nygard)

Material Weakness: Insufficient Staffing - A.I.D./W
Responsible Official: Reginald Brown, PPC (R. Nygard)

RISK AREA: Contracting

Material Weakness: Evaluation of Host Country Contracting Agencies
Responsible Official: Carol Adelman, ANE

Significant Concern: Contract Close-outs
Responsible Official: Michael Doyle, MS

RISK AREA: Local Currency

Material Weakness: Accountability of Local Currencies
Responsible Official: Reginald Brown, PPC

RISK AREA: Non-Expendable Property

Significant Concern: Lack of Procedures to Control NXP in Missions
Responsible Official: Michael Doyle, MS

RISK AREA: Procurement

Significant Concern: Majority of Operating Expense Purchases Made in the Final Three Months of the Year
Responsible Official: Reginald Brown, PPC (R. Nygard)

Significant Concern: Internal Mission Procedures for Procurement
Responsible Official: Michael Doyle, MS

RISK AREA: Project Management

Significant Concern: Mission Order Outlining Evaluation Process
Responsible Officials: Regional AAs

RISK AREA: Food Aid

Significant Concern: No Written Guidance on Food Aid Responsibilties for Mission Offices
Responsible Official: Phil Christensen, FVA

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D C 20503

June 4, 1990

MEMORANDUM FOR DEPUTIES OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Frank Hodsoll
Executive Associate Director

SUBJECT: Improving Management Control Program Operations

This memorandum provides guidance for your continuing implementation of the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and OMB Circular No. A-123, Internal Control Systems.

Recent assessments of the management control program have indicated that improvements are necessary. The General Accounting Office, in a November 1989 study (GAO/AFMD-90-10), reported that inadequate management controls and deficient accounting systems remain prevalent. The Internal Control Interagency Coordination Council, in a July 1989 report to the President's Council on Management Improvement, identified opportunities for streamlining and enhancing agency programs. OMB's own review of the 1989 FMFIA reports also concluded that further refinements are needed.

I know you share my concern that each department and agency have a comprehensive management control program that identifies material weaknesses promptly, develops effective corrective actions, targets the necessary resources for resolution, and validates elimination or reduction of the severity of the weaknesses. This memorandum presents six policies that will help ensure you have such a program. To the extent that the policies are not already part of your management control program, I would appreciate your causing them to be implemented on a priority basis.

A. Integrate the FMFIA Management Control Review and Reporting Process with the Budget

OMB is revising Circular No. A-11, Preparation and Submission of Budget Estimates, to enable you to identify, in your 1992 budget request, funds required to address high risk areas and other selected material weaknesses in your operations. Agencies should:

(1) require that internal budget formulation recognizes the resource needs of the management control program in setting budget priorities; and

(2) require that the budget submission identifies the needed corrective actions, as well as the incremental funds and the budget reprogramming that are necessary to accomplish them.

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B. Establish an Early Warning Reporting Capability

In addition to its traditional purposes, the management control process needs to serve as an early warning system for emerging problems that could seriously affect agency plans and/or operations. In order to ensure this, agencies should:

(1) modify existing FMFIA management directives to include an early warning reporting capability that requires immediate notice of a mission-critical problem or a deterioration of an existing weakness without regard to the normal annual reporting cycle;

(2) designate appropriate senior management officials as points of contact for the receipt of the early warning notification; and

(3) ensure that the agency head and the Inspector General are apprised of the early warning notification. These officials should in turn determine the materiality of the problem and inform the Congress and OMB as appropriate.

C. Establish an Agency Management Control Review Committee

The active participation of senior level management officials is absolutely essential to an effective management control program. Agencies should establish senior level management policy committees, or add to the responsibilities of existing committees, to provide strong and consistent direction of the program, as well as accountability by agency personnel. Responsibilities of the management control policy committee should include:

(1) ensuring that reports of material weaknesses and system non-conformances are accurate and complete;
(2) ensuring the adequacy of early warning reporting mechanisms;
(3) ensuring the adequacy of corrective action plans;
(4) establishing and overseeing a validation process for reduction or elimination of weaknesses;
(5) setting budget priorities for funding corrective actions in management control programs; and
(6) holding periodic meetings with the Inspector General.

D. Establish FMFIA Training Programs for Managers

There is a compelling need to establish cost-effective FMFIA training aimed at improving program managers' awareness and acceptance of FMFIA responsibilities. To ensure that this need is being met, agencies should assess the adequacy of their management control training programs for program managers, and include this assessment and improvement plan in

their 1990 FMFIA reports.

For your information, the Office of Personnel Management will be incorporating changes in its own curriculum and in government-wide training policy guidance for program managers to emphasize FMFIA responsibilities.

Identify Relative Significance of Weaknesses

In the process of allocating resources to correct material and system weaknesses, it will be essential that OMB and the agencies have a clear understanding of the relative significance of those weaknesses. Therefore, in the FY 1990 FMFIA reports, agencies should:

(1) ensure that all problem areas on the OMB "high risk" list are included in the FMFIA report, and are highlighted in the Secretary's assurance letter as the deficiencies of greatest significance; and

(2) identify the relative significance of the other weaknesses and nonconformances reported under Sections 2 and 4, in terms of the priority for corrective action.

Validate Corrective Actions

(1) Agencies need to establish a process to validate that corrective actions undertaken have achieved the intended results. The process should, at a minimum, include the identification of standards or criteria against which performance can be measured and a requirement that appropriate documentation be maintained.

(2) The 1990 FMFIA Report should: explain the validation process to be used for each weakness; identify the results expected from the proposed corrective action; describe the role the Inspector General will play in the validation process; and identify any other independent validation process to be used.

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For your information, OMB will issue several related agement control guidance documents in the coming months:

(1) An OMB Bulletin will call for corrective action plans for "high risk" areas. OMB will monitor progress of corrective actions through a mid-year report and a year-end report, which will use an expanded 1990 FMFIA report format. Issuance is expected in early June.

(2) Guidance for the preparation of the 1990 FMFIA Reports will incorporate the elements described above. Issuance is planned for the end of June.

(3) OMB Circular No. A-11, containing new management integrity material described in Section A, above, will be issued in June.

(4) Revised Circular No. A-123 (tentatively re-titled Management Control Systems) will be issued in September to be effective for the 1991 FMFIA reporting period.