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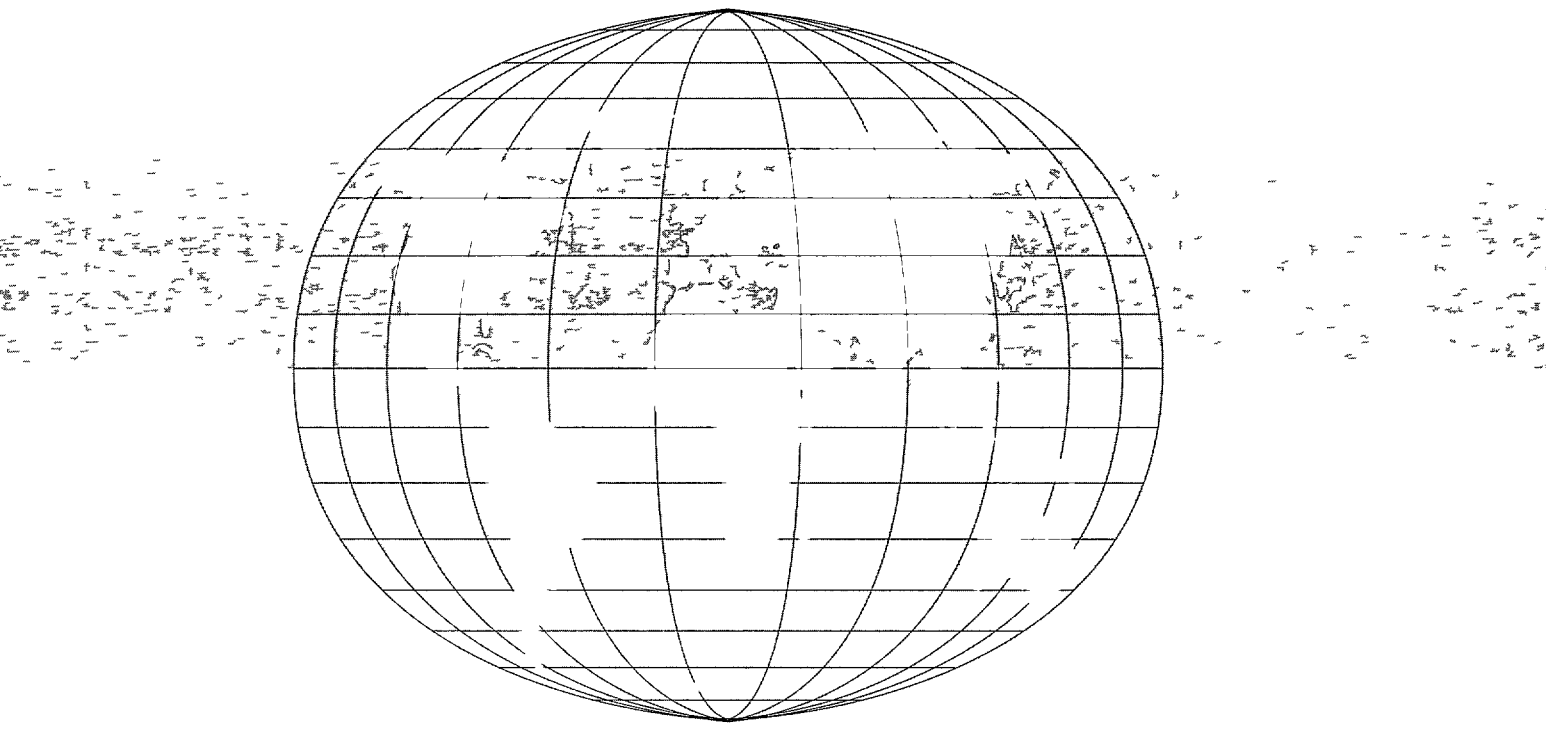
Report of Audit

Audit of USAID/Cambodia's Implementation of the Federal Managers' Financial Integrity Act

Audit Report No 5-442-99-005-P
July 22, 1999



Regional Inspector General
Manila

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July 22, 1999

MEMORANDUM

TO: Director, USAID/Cambodia, Willard J Pearson, Jr

FROM RIG/Manila, Paul E Armstrong

SUBJECT: Audit of USAID/Cambodia's Implementation of the Federal Managers' Financial Integrity Act, Report No 5-442-99-005-P

This is our final report on the subject audit We reviewed your comments to the draft report and included them in their entirety as Appendix II The report contains one recommendation (page 8) that is closed upon issuance of this report

I appreciate the cooperation and courtesies extended to my staff during the audit

Background

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) establishes requirements with regard to management accountability and controls This law encompasses program, operational, and administrative areas as well as accounting and financial management Under the authority of the FMFIA, the Office of Management and Budget (OMB) issued Circular No A-123[1] to provide detailed guidance for assigning federal managers the responsibility for designing management structures that helps ensure accountability and include appropriate cost-effective controls

OMB Circular No A-123 states that management controls are the organization, policies and procedures used to reasonably ensure that (1) programs achieve their intended results, (2) resources are used consistent with agency mission, (3) programs and resources are protected from waste, fraud, and mismanagement, (4) laws and regulations are followed, and (5) reliable and timely information is obtained, maintained, reported and used for decision making The Circular provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls

USAID has issued Automated Directives System (ADS) Chapter 596, Management Accountability and Control, which provides the Agency's policy and procedures for

[1] OMB Circular No A-123 is *Management Accountability and Control*

establishing, assessing, correcting, and reporting on management controls under FMFIA and OMB Circular No A-123 Additional guidance for assessing the adequacy of management controls and annual instructions for reporting the status of management controls is periodically provided by USAID's Bureau for Management's Office of Management Planning and Innovation (M/MPI)

USAID/Cambodia issued its FY 1998 FMFIA certification to AA/ANE on October 15, 1998 In the certification, the Mission noted one material weakness of physical security, two deficiencies (reduced and restricted funding levels[2], and source/origin problems) that cannot be corrected at the Mission level, and a unique continuing staff development and training requirement

Audit Objectives

The Office of the Regional Inspector General, Manila (RIG/Manila), audited USAID/Cambodia to answer the following three audit objectives

- **Has USAID/Cambodia established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

- **Has USAID/Cambodia reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

- **Has USAID/Cambodia taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

Appendix I includes a discussion of the scope and methodology for this audit

[2] In July 1997 Cambodia suffered through a violent internal military clash As a result the U S suspended two thirds of its $37 million annual Cambodian program USAID assistance in 1999 totaled $12 million

Audit Findings

Has USAID/Cambodia established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/Cambodia has established management controls and periodically assessed these controls to identify deficiencies in accordance with the FMFIA and related regulations and guidance

As stated above, FMFIA and OMB Circular No A-123 provides guidance for use by agencies and managers to, among other things, establish management controls and to periodically assess the adequacy of those controls Further, ADS Chapter 596, Management Accountability and Control instructs missions and cognizant managers to (1) appoint a Management Control Official (MCO) to oversee and coordinate management accountability and control issues within the mission, (2) ensure that appropriate and cost-effective management controls are established, (3) continuously perform management control assessments in accordance with instructions issued by USAID's Bureau for Management's Office of Management Planning and Innovation (M/MPI), and (4) establish a management control review committee (MCRC) to assess and monitor deficiencies in management controls

Moreover, M/MPI provides annual guidance to missions for conducting FMFIA reviews In conducting reviews, missions are instructed to use existing sources of information to supplement management's judgment in assessing the adequacy of management controls, including

1) management knowledge gained from daily operation of Agency programs and systems,

2) management reviews,

3) Office of Inspector General and General Accounting Office reports, and

4) Program evaluations

Missions are also instructed to review the Agency's ADS in determining mission compliance with Agency policies and essential procedures M/MPI provides a Management Control Checklist to assist in conducting the reviews The Fiscal Year 1998 Checklist contained 163 control techniques extracted from the ADS

In implementing the above criteria, USAID/Cambodia had designated the Controller as

the MCO to oversee and coordinate management accountability and control issues within the Mission The Mission had also established a MCRC—comprised of Office Managers and headed by the MCO—to provide oversight of its management control process [3]

The Mission primarily follows the policies and procedures stated in USAID's ADS and supplements the guidance with Mission Orders USAID/Cambodia stated that its Mission Orders must

1 Agree with the ADS, Foreign Affairs Manual, and Federal Regulations,

2 Respond to a defined or noted need for controls, written policy or guideline, and

3 Be minimal in number and length

For example, the Mission supplemented the ADS by issuing Mission Orders to delineate Mission-wide authority and responsibility In other cases, USAID/Cambodia's Office of Finance and Information Management (OFIM) established procedures for processes such as reconciling monthly transactions posted by the Mission to transactions of the U S Disbursing Office and examining vouchers including the Prompt Pay Act process

USAID/Cambodia took an organized and thorough approach in completing the Fiscal Year 1998 FMFIA Assessment The Controller provided the MCRC team[4] with the M/MPI checklist containing the 163 control techniques and instructions The following table highlights the areas addressed by these control techniques

[3] We noted that the designations of the MCO and the MCRC were formally made after the FMFIA process but were followed during the FY 1998 FMFIA review The Mission had formally established a MCRC in April 1996 comprised of a Chairperson with two Members—the Controller and the Executive Officer

[4] The Controller chairs USAID/Cambodia s Management Control Review Committee with the Chief Accountant Program Officer Contracting Officer Executive Officer and the two Office Chiefs as members

CONTROL TECHNIQUES	
CATEGORY	NUMBER
Program Assistance	37
Organization Management	7
Administrative Management	40
Financial Management	44
Acquisition and Assistance	27
Audit Management Resolution Program	5
Other	3
TOTAL	163

Upon receipt of the checklist, each MCRC member determined if controls in their assigned areas were satisfactory and noted any deficiencies Each member then presented their findings to a MCRC meeting in October 1998 and the MCRC achieved consensus on ratings for each of the 163 controls These ratings were presented to and reviewed by the Mission Director who, with the MCRC, determined what actions should be taken on deficiencies and whether any deficiencies should be considered material weaknesses

In addition to the annual FMFIA review, we determined that the Mission routinely assessed its controls For example, the Mission was concerned about its cashier function that has been rated as a high risk since 1994 To alleviate that risk, the Mission transferred its cashier function to the U S Embassy, Phnom Penh in May 1998

Has USAID/Cambodia reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/Cambodia accurately reported one material weakness—physical security—in its October 1998 FMFIA certification In addition, the Mission also reported two deficiencies that could not be corrected at its level because they were beyond the Mission's control to correct Finally, USAID/Cambodia pointed out a mission-unique requirement that it is addressing

OMB Circular No A-123 requires that a deficiency should be reported if it is or should be of interest to the next level of management This allows the chain of command structure to determine the relative importance of each deficiency Along these lines, USAID's ADS Chapter 596 and M/MPI's Fiscal Year 1998 FMFIA Instructions require that missions provide a FMFIA certification to the cognizant Assistant Administrator,[5] with a copy to M/MPI, on the overall adequacy and effectiveness of management controls This certification should identify deficiencies determined to be material weaknesses,[6] including those that are not correctable within the mission's authority and resources

In complying with M/MPI's guidance, USAID/Cambodia submitted a Fiscal Year 1998 FMFIA certification to the AA/ANE that identified one material weakness—physical security The Mission reported that physical security was a material weakness because (1) its ability to achieve objectives is significantly impaired and (2) resources are not used consistent with USAID's mission While the Mission established planned actions and target dates to correct this weakness, it noted that

> " *[t]his situation can be corrected only if authority and financial resources are provided by USAID/Washington* "

According to the Mission, after several visits from USAID/Washington officials and extensive Mission reporting, USAID/Washington and the State Department have concurred that the Mission's physical security is a material weakness As a result, we understand from the Mission that USAID/Washington may have set aside $500,000 in FY2000 security funding for USAID/Cambodia's portion of the move and plans to transfer the funds directly to the State Department The actual location of the new Mission remains unclear, however, as we were informed that the State Department has

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[5] For USAID/Cambodia, the cognizant Assistant Administrator is the AA/ANE

[6] A material weakness would (1) significantly impair the organization s ability to achieve its objectives (2) result in the use of resources in a way that is inconsistent with Agency mission (3) violate statutory or regulatory requirements (4) result in a significant lack of safeguards against waste loss unauthorized use or misappropriation of funds property or other assets (5) impair the ability to obtain maintain report and use reliable timely information for decision making or (6) permit improper ethical conduct or a conflict of interest

not yet approved the proposed site

In its FMFIA certification, the Mission also highlighted two deficiencies that it considered could not be corrected at the Mission level given policy and legislative constraints

First, USAID/Cambodia reported that funding for its program was dramatically reduced and restricted since July 1997 when political violence occurred within Cambodia As a result, the Mission felt impeded in achieving expected results, planning strategically, or addressing reform issues critical to sustainability

Second, USAID/Washington has advised the Mission that Cambodia is an approved source under source/origin rules [7] However, neither the Code of Federal Regulations (CFR) nor the ADS has been updated with this information We noted that 22 CFR 228 03 allows authorized source countries for code 935 to be any area or country excluding foreign policy restricted countries Cambodia is listed as a foreign policy restricted country This lack of an update could cause confusion for USAID partners who must follow these outdated rules in their grants and cooperative agreements The Mission requested an amendment to the CFR and the ADS in July and October 1998 As of July 1999, neither the CFR nor the ADS had been updated to include this information

Finally, USAID/Cambodia reported its unique staff development and training requirements

> *"As a relatively new Mission in a country which has experienced an overwhelming depletion in its human resource base, in-depth technical training for FSN staff is essential for an improved management control environment To address this issue, an active Mission training committee is working closely with each office to develop and carry out long-term staff training and development plans "*

Realizing the need to train staff and at the same time accomplish important functions, USAID/Cambodia hired nine long-term Third Country Nationals (TCNs) The Mission hired these nine TCNs to fill a need in important functions such as accounting, contracting, and information resources management The Mission requires each TCN to take an active daily role in the employee development and training of Cambodians In our opinion, the Mission's proactive approach in addressing problems—as shown in this example—is commendable initiative in complying with the intent of the FMFIA

[7] The regulation on source origin and nationality is available at 22 CFR 228 03

Has USAID/Cambodia taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

As described below, USAID/Cambodia has taken timely and effective action to correct deficiencies it identified during its Fiscal Years 1996[8] and 1998 reviews

OMB Circular No A-123 and USAID guidance state that agency managers are responsible for taking timely and effective action to correct identified deficiencies Furthermore, corrective action plans should be developed and tracked internally by each assessable unit

We reviewed Mission actions on deficiencies identified in its Fiscal Years 1996 and 1998 FMFIA reviews In its Fiscal Year 1996 review, the Mission identified four deficiencies, all of which it considered to be non-material weaknesses Missions are not required to report non-material weaknesses to the next level of management—the cognizant Assistant Administrator—but are still required to take timely and effective action to correct the deficiencies By December 1, 1997, the Mission had taken timely and effective action to adequately address all four deficiencies noted in its FY 1996 FMFIA certification In its Fiscal Year 1998 FMFIA review, the Mission listed one material weakness (physical security) and two deficiencies (funding and source/origin) The Mission cannot correct any of these three problems—USAID/Washington must correct them

Other Matters. Risk Assessments Would Further Strengthen the Mission's FMFIA Process

USAID/Cambodia has established the management controls outlined in the ADS and, in some cases, has supplemented those controls However, we believe the Mission could further strengthen the efficiency of its review of those controls, by performing a formal and systematic risk assessment of its operations and programs

<u>Recommendation No 1</u> We recommend that USAID/Cambodia determine if a formal and systematic risk assessment would strengthen the efficiency of its FMFIA process

Every Federal agency faces risks that could threaten the achievement of its objectives and USAID is no exception USAID as a whole, its field missions and even offices within those missions face a variety of risks from both external and internal sources Risk assessment is the identification and analysis of possible risks to meeting objectives and

[8] USAID/Cambodia was exempted from conducting a FY 1997 FMFIA review because of an evacuation yet still issued a letter to the Acting AA/ANE in July 1997 discussing its progress on improving controls Therefore we reviewed deficiencies noted under the Mission s FY 1996 FMFIA review

forming a basis for how those risks should be managed or controlled Primarily, risk assessment consists of managers asking themselves what positive outcomes need to occur and what negative outcomes need to be prevented in order for an operation/program to succeed The manager would then

1) Identify conditions that might inhibit positive outcomes and conditions that might foster negative outcomes (identifying risks),

2) determine the probability and impact of those risks (determining the level of risk - generally high, medium or low), and

3) based on the level of risk, set in place appropriate management controls to mitigate those risks

For example, inaccurate information in progress reports can lead to erroneous decisions Accordingly, inaccurate reporting from USAID contractors and grantees would be a risk that could have significant ramifications (a high risk) A manager might lessen that risk by verifying reported information during periodic site visits

The benefits of risk assessment are two-fold First, by conducting risk assessments, Mission managers can ensure that they have established management controls that are appropriate to their unique situation (ADS Section E596 5 1a requires that cognizant managers establish appropriate controls) Second, by identifying the level of risk in operations and programs, senior Mission management can focus more resources on high risk areas and less resources on low risk areas, thereby increasing its efficiency and effectiveness [9]

During our audit, we found that certain mission managers were already conducting "intuitive" risk assessments When a vulnerability came to their attention, they would set in place an appropriate control For example, in June 1998 the Mission's Chief Accountant noticed that voucher examiners had been expending considerable effort on telephone bills This effort detracted from the examiners' ability to conduct voucher review and processing and may have contributed to vouchers not being processed within their due dates The Chief Accountant suggested a more efficient method of handling the effort and that suggestion was accepted and an alternative method put into practice

We believe that the Mission as a whole could benefit from conducting a formal and systematic risk assessment and using that assessment as a component of their FMFIA review, a change which ultimately would make the review more effective and efficient

[9] The U S General Accounting Office (GAO) recognizes the benefits of risk assessment and states that Management should be comprehensive in its identification of risks at both the entity wide and activity level (GAO s May 1999 proposed revision of the Standards for Internal Control in the Federal Government)

Management Comments and Our Evaluation

In their response to the draft audit report, USAID/Cambodia's management concurred with the report's only recommendation The Mission stated that it understood that USAID/Washington would issue guidance on risk assessments in fiscal year 2000 When issued the Mission stated that it will review the guidance and determine a suitable course of action to ensure that Mission management controls are both appropriate and adequately ranked according to risk level Therefore, based on the Mission's planned future actions on risk assessments, Recommendation No 1 is closed upon issuance of this report

APPENDIX I

SCOPE AND METHODOLOGY

We audited USAID/Cambodia's implementation of the Federal Managers' Financial Integrity Act (FMFIA) The audit was performed in accordance with generally accepted government auditing standards and was conducted from May 10, through May 26, 1999 at USAID/Cambodia

We audited the Mission's Fiscal Year (FY) 1998 FMFIA assessment and deficiencies noted under its FY 1996 assessment [10] The audit was not designed to identify all the material weaknesses not reported by the Mission, however, if any previously unreported weaknesses came to our attention during the audit, we included these in our audit report Also, the scope of this audit did not include a detailed analysis of individual management controls to determine their effectiveness

The audit work included reviewing the Mission's system for establishing, assessing, reporting and correcting management controls To accomplish the audit objectives, we used the FMFIA, Office of Management and Budget Circular No A-123, General Accounting Office's (GAO) "Standards for Internal Control in the Federal Government," USAID's Automated Directives System (ADS) Chapter 596 on Management Accountability and Control, other ADS Chapters relating to Agency policies and essential procedures, and guidance for assessing the adequacy of management controls and annual instructions for reporting the status of management controls provided to missions by USAID

We developed and used a questionnaire in our dealings with the Mission's Management Control Official, members of its Management Control Review Committee and operating unit managers We also reviewed available documentation on the Fiscal Year 1998 FMFIA review, including the listing of management control deficiencies and management action plans for correcting those deficiencies We reviewed the Mission's Fiscal Year 1998 FMFIA certification to the AA/ANE, noted any material weaknesses identified, and reviewed the status of any material weaknesses or deficiencies identified in the Fiscal Year 1996 review

Finally, we reviewed recent Office of Inspector General and GAO audit reports performed at USAID/Cambodia to identify potential material weaknesses

[10] USAID/Cambodia was exempted from performing a FMFIA review in 1997

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July 8 1999

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20 JUL 1999
MANIL.

Mr Paul E Armstrong
Director
RIG/Manila
Manila, Philippines

Dear Mr Armstrong

We have reviewed the draft audit report for USAID/Cambodia s Fiscal Year 1998 Federal Manager s Financial Integrity Act (FMFIA) First of all I would like to thank the RIG Team for their professionalism and the excellent customer service provided during the audit. The Team offered invaluable suggestions and guidance to the Mission staff which will improve our regular internal control review and monitoring process

We concur with the one recommendation noted in the audit report, namely

"We recommend that USAID/Cambodia determine if a formal and systematic risk assessment would strengthen the efficiency of its FMFIA process "

We understand that M/MPI will be issuing guidance in FY2000 regarding risk assessments Once we have had a chance to review the guidance, the Mission will determine a suitable course of action to ensure that the Mission s management controls are both appropriate and adequately ranked according to risk level

Once again I would like to thank you and the RIG staff for the superb assistance provided during the FMFIA audit

Sincerely

Willard J Pearson
Mission Director