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MEMORANDUM AUDIT REPORT ON

YEAR-END OBLIGATIONS

AUDIT REPORT NO. 84-36

September 27, 1984

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MEMORANDUM

TO: C/AID, Frank B. Kimball
AA/PPC, Richard A. Derham

FROM: for RIG/A/W, E. John Eckman

SUBJECT: Audit Report No. 84-36
Report on Year-End Obligations

INTRODUCTION

The Office of the Inspector General performed an audit of fiscal year 1983 year-end obligations. The audit was made to evaluate AID's compliance with Office of Management and Budget (OMB) requirements concerning year-end spending practices.

BACKGROUND

Each year OMB has been instructing U.S. Government agencies to eliminate wasteful year-end spending. OMB's concern is directed towards preventing the obligation of funds merely to prevent their lapsing at the end of the fiscal year. Of equal importance is that obligations should not be made without taking sufficient time to ensure reasonable cost and accountability.

Our prior review of year-end spending, Audit Report No. 0-000-83-73, dated June 20, 1983, covered only operating expense obligations for fiscal year 1982. In that report, we concluded that year-end obligations exceeded OMB guidelines but were made for approved essential support objectives.

Scope of Audit

The scope of our review was limited to program funds amounting to $4.9 billion which accounted for 93 percent of AID's fiscal year 1983 obligations. Our review included ascertaining the amount of fourth quarter obligations, determining why heavy year-end obligations occurred, and evaluating planning, funding, monitoring, and procurement procedures.

We performed work at the Office of the Administrator, Office o. Legislative Affairs, Bureau for Program and Policy Coordination, Bureau for Science and Technology (S&T), Bureau for Africa (AFR), and the Offices of Financial Management and Contract Management in the Bureau for Management. The examination included discussions with cognizant officials, analyses of planning and monitoring documents, and limited testing of a sample of 5 S&T and 10 AFR project and contract files.

Our review of sample files consisted of verifying that fourth quarter obligations were for previously approved projects. We also determined whether or not proper grant and contract obligating procedures had been followed, but we did not assess how well these procedures were performed. The audit of 5 AFR overseas obligations was restricted to a review of the records and information available in AID/W.

Related internal control systems covering guidance, procedures and performance were reviewed and evaluated. The resulting compliance review was conducted in accordance with the Comptroller General's Standards for Audit of Governmental Organizations, Programs, Activities, and Functions. Our work was done during April through August 1984.

RESULTS OF AUDIT

A.''s year-end obligations for the past several years exceeded OMB standards--topping $2 billion in the fourth quarter of fiscal year 1983. These heavy year-end obligation levels were caused by both external and internal factors such as uncertain funding associated with continuing resolutions and AID's lengthy program development process. AID officials have acknowledged that heavy year-end workloads can reduce their ability to properly carry out obligation requirements. As a result, AID initiated a program to reduce year-end obligations. We concurred with the general thrust of this attack on an old and intractable problem. However, we concluded that AID's current efforts could be refined and additional steps could be taken to reduce year-end obligations.

OMB Guidelines Discourage Heavy Year-End Spending

OMB issues an annual memorandum to the heads of executive departments and agencies to emphasize the importance of preventing waste and inefficiency in Federal programs due to heavy year-end spending. The key element of this guidance is a performance standard which states that obligations for the fourth quarter of the fiscal year should be no higher than the average for the first three quarters, except where seasonal requirements, essential program objectives, circumstances unique to the fiscal year, or lead-times justify a higher level.

AID Regularly Incurs Heavy Year-end Obligations

As shown in the following table, AID's year-end program obligations in the fourth quarter of fiscal year 1983 exceeded $2 billion or over twice the average for the first three quarters. Of this amount $1 billion was obligated by three bureaus: Africa, Asia, and Latin America and the Caribbean.

Program Obligations
For FY's 1980 to 1983
($ million)

Fiscal Year	Total Fiscal Year	Average of First 3 Qtrs.	4th Qtr.
1980	$3,467	$677	$1,435
1981	3,536	678	1,502
1982	4,658	993	1,679
1983	4,896	959	2,018

The late obligation pattern is further illustrated by the following analysis which shows the percent of obligations by quarter.

Quarterly Program Obligations
For FY's 1980 to 1983
(Percent)

Fiscal Year	1st	2nd	3rd	Average of First 3 Qtrs.	4th
1980	31%	15%	13%	20%	41%
1981	30%	17%	10%	19%	43%
1982	17%	32%	15%	21%	36%
1983	15%	23%	21%	20%	41%

It can be seen from the above obligation patterns that since fiscal year 1980, fourth quarter obligations exceeded the average for the first three quarters by a large margin. Further, in three of the last four years, fourth quarter obligations exceeded 40 percent. For example, Africa's fiscal year 1983 fourth quarter obligation rate was 59 percent. Increased obligations in the first three quarters are needed if AID expects to comply with OMB guidance.

Heavy Year-End Obligations are Caused by External and Internal Factors

Both external and internal factors contribute to the high level of obligations occurring in the fourth quarter. External factors, such as the following, have a significant impact but are largely outside of AID's control:

-- Uncertain funding. AID began fiscal year 1983 under a continuing resolution without knowing the total amount of funds available for the year. AID's initial full year funding was not known until a second continuing resolution was passed in December 1982. Further, a supplemental appropriation was received on July 30, 1983.

-- One year funding. Most of AID's funds must be obligated during the year in which they are appropriated. Consequently, there is considerable incentive to obligate all funds before they expire at year-end.

-- OMB's apportionment of Economic Support Funds (ESF). In fiscal year 1983, OMB made over 100 individual apportionments of ESF funds totaling about $3 billion. This apportioning by individual project or activity detracted from AID's ability to plan and execute obligations in an orderly fashion.

-- The "congressional notification" procedure. Congress requires that it be separately advised of new projects, changes in project purposes or amounts, and re-programming of funds in instances that affect country limits, funding sources, or shifts in grant and loan allocations.

-- National policy considerations. OMB, State, Treasury, and AID itself often have major concerns that may defer obligation dates until other political or economic objectives are successfully negotiated with U.S., host country, and multilateral organizations.

AID's internal procedures add to the problem of year-end obligations, but also offer opportunities to alleviate the problem:

-- Project development process. One of the more significant problems is AID's long project development process. This is a major exercise and must be carried out in close coordination with the host country. Because of the extensive commitment by both parties and AID's inability to set aside funds early on, personnel of both AID and the host country are hesitant to move ahead substantially on new project planning and negotiation until fund availability is more definitive. Consequently, the major design and negotiation efforts are often not accomplished until the fiscal year in which the funds become available.

Completing the project design is a time consuming process performed by personnel who have other equally important tasks such as preparation of the country development strategy statement, the congressional presentation, the annual budget submission, and many various program implementation duties. Also, AID/W must often review and approve the design document, i.e. the project paper. We observed that when the project paper is prepared after the start of the fiscal year, obligation usually occurs in the last quarter.

Consequently, we believe the programming process should be advanced on new projects of high priority so that related project papers could be completed by the beginning of the fiscal year. Naturally, there would be exceptions, but for projects included in the Congressional Presentation, it appears feasible to expect AID personnel to meet this target. Accomplishment of this goal and the subsequent earlier negotiation with grantees and contractors would help to ensure that related obligations are made during the first two quarters of the fiscal year.

- Operating year budget. Other deterrents to early obligation are delays in preparing operating year budgets (OYB). Issuance of an approved OYB is required before large scale obligation activity takes place. However, AID's OYB is not established until the full year's funding availability is known. In fiscal year 1983, this did not occur until January 1983--the fourth month of the fiscal year.

  The Bureau for Program and Policy Coordination (PPC) does not want to open the door for the funding of new projects until it has negotiated OYB requirements with each of the various Bureaus. This permits AID to meet its overall obligation objectives for new and ongoing projects in a prioritized manner. Due to this policy and limited OMB apportionments, PPC did not request the Bureaus to aggressively initiate obligation actions on new projects in the first quarter.

  However, we believe a limited number of new, high priority projects could be identified in advance and approved for funding before the OYB is prepared. Further, routine obligations for incrementally funded projects could also be scheduled earlier. Such new and ongoing projects could be earmarked for obligation during the first two quarters and limited only to those that would be funded if less than normal funding is received.

Problems Associated With Heavy Year-End Obligations Prompted Several Management Initiatives

As discussed earlier, AID obligated over $2 billion, or 41 percent, of its program funds in the fourth quarter of fiscal year 1983. This disproportionate workload in one quarter can lead to short cuts in performing sound obligation requirements designed to prevent fraud, waste, and abuse and ensure project success.

Our limited review of 15 fourth quarter obligations showed that although actions were made against previously approved projects, AID did not conduct a preaward survey of a Union of South Africa grantee's ability to properly account for a $3 million grant. However, this illustrates only a small part of the negative effects of excessive year-end obligations. Although outside the scope of our compliance review, bigger questions involve the quality and thoroughness of the work performed in completing the numerous steps in the obligation process. For example, the quality and thoroughness of obligation steps performed are obvious questions when 59 percent of the Bureau for Africa's 1983 program obligations were made in only 25 percent of the fiscal year.

Reducing end-of-year obligations is an important objective, but it is only one of several, sometimes conflicting objectives. However, AID officials have acknowledged that heavy year-end workloads can reduce their ability to adequately focus on the obligation process. They believe that last minute pressures to obligate can result in inefficiencies such as weakly designed projects, difficulties in achieving local policy reforms, lack of commitment by borrower/grantees or contractors, preparation of deficient agreements, and noncompliance with loan, grant, and contract procurement standards.

As a result of the problems that can occur with excessive year-end obligations, AID undertook several initiatives. The most important was the increased emphasis and attention given by the Administrator's office to overcome the problem of heavy year-end spending. The Counselor to the Agency, acting directly for the Administrator and working in coordination with PPC's Office of Planning and Budgeting, chaired periodic meetings which were attended by program representatives from each Bureau. These meetings began in January 1983 and were held at least monthly through the end of the fiscal year. The meetings resumed in January 1984 for another 9-month period.

During the meetings, each Bureau's performance and plans were reported and reviewed. The meeting also provided a venue for the Counselor and PPC to provide updated guidance on overall program direction, expected funding availabilities, and final year-end funding strategies. This escalation of concern by AID's top management made the operating Bureaus much more conscious of the year-end obligating problem. More significantly, the Counselor provided the level of leadership needed to accomplish basic changes in attitudes and procedures.

However, we believe this function would be even more effective if the Counselor's monthly monitoring was expanded from the last nine months of the year to include the first quarter. Also, we believe that AID personnel would be more responsive to his leadership if he were to utilize the agency's systems of recognition and rewards to encourage the accomplishment of planned obligation goals.

In another management initiative, PPC set new and more stringent obligation targets. The Bureaus were requested to obligate the funding for all ongoing projects during the first nine months of the fiscal year. All other projects were to be obligated no later than the eleventh month. The latter target was further refined so that 85 percent of all obligations would be made by July 31st and 100 percent by August 31st. None of these targets were achieved in fiscal year 1983. For example, July 31st and August 31st cumulative obligations were recorded at only 73 percent and 88 percent, respectively. However, the targets represented a change in AID policy and resulted in improved performance compared to previous fiscal years (excluding obligations against the July 1983 supplemental appropriation). We believe that once the previously discussed underlying internal causes of heavy year-end obligations are resolved, the chances for success in meeting these targets are good.

Another management initiative requires the AID/W technical offices to submit their procurement requests for new and on-going projects by June 1st and July 1st, respectively. However, we noted that 1,399 procurement requests, 30% of the year's activity, were submitted after July 1, 1983, the final cut-off date. In its efforts to obtain greater compliance with cut-off standards in fiscal year 1984, the Office of Contract Management established a new procedure whereby each late submission to Contract Management has to be approved by PPC.

PPC also advanced AID's management capabilities for controlling year-end obligations by devising a computerized method of monitoring the planning and performance of obligations. Under this initiative, each Bureau was able to monitor individual projects, submit Bureau summaries for an overall agency report, and identify planned and actual obligations for each month of the year. In fiscal year 1984 this capability was further expanded to separately monitor Development Assistance and Economic Support Funds as well as identify ongoing and new projects. Also, during fiscal year 1984, the Bureaus included major target dates integral to project implementation, such as completion of the project implementation document and project paper. The capability to target these interim implementation actions is important as it should provide a basis for the more realistic planning of interim and final target dates for the entire obligation process.

CONCLUSIONS

We concur with AID management's belief that its heavy year-end obligations can result in inefficiencies such as key steps in the procurement and grant processes being lightly addressed or ignored. The external causes of this condition, such as uncertain funding, are largely out of AID's control. However, the significance of these external factors highlights the need for AID management to take every opportunity to address internal causes of excessive year-end obligations.

Management initiatives to control year-end spending are promising, but they have not yet broken the persistent cycle of heavy fourth quarter obligations. More aggressive actions are needed.

Establishment of new policies, achievement of existing goals, and the improved implementation of internal procedures could result in a noticeable improvement in obligation rates. To effect these changes, we believe AID needs to establish new procedures to ensure the early obligation of both new and ongoing projects, advance the timing of selected project designs, expand its monitoring process, and accord appropriate recognition to the responsible employees and offices.

RECOMMENDATIONS

We recommend that the Bureau for Policy and Program Coordination establish policies and procedures to:

Recommendation No. 1

Require substantial obligations, in line with OMB apportionments, prior to the preparation of the operating year budget during periods of interim funding.

Recommendation No. 2

Schedule routine obligations for incrementally-funded ongoing projects during the first and second quarters of each fiscal year.

Recommendation No. 3

Identify and schedule the obligations of a limited number of new, high priority projects during the first and second quarters of each fiscal year.

Recommendation No. 4

Accomplish project paper preparation on these new, high priority projects prior to the beginning of the year in which funding is to take place.

We recommend that the Counselor for the Agency:

Recommendation No. 5

Expand his monitoring of bureau performance by conducting, along with PPC, review meetings during each month of the year.

Recommendation No. 6

Utilize the agency's systems of recognition and rewards for offices and employees to encourage the accomplishment of planned obligation goals.

MANAGEMENT COMMENTS

We provided copies of the draft report to the offices of the Counselor and the Bureau for Program and Policy Coordination. They agreed with the general thrust of the draft's findings, conclusions, and recommendations. We revised the final report where appropriate to incorporate their specific comments. Copies of their comments are included as attachments I and II.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

COUNSELOR
TO THE AGENCY

September 26, 1984

MEMORANDUM

TO: RIG/A/W, E. John Eckman

FROM: C/AID, Frank B. Kimball

SUBJECT: Draft Audit Report on Year-End Obligations

As I stated during a recent meeting with Pat Griffin in which we reviewed the audit, I have no problem with the general findings and recommendations of the report. As you know, I have taken a personal interest in promoting the timely obligation of funds.

In regards to some of the specific wording of the report, PPC will be communicating proposed alternative language to you for your consideration. While in general the report presents a balanced view, a few sections overstated their points.

I would like to comment on three of your recommendations:

a) Your second recommendation for PPC is too broad. Some obligations for ongoing projects actually require major project revisions, e.g., where a successful project is being expanded, and others require thorough evaluation for the sake of prudence. Thus, obligations for some ongoing projects may not be as routine as appears on the surface. I suggest the following language be used:

> Schedule routine obligations for incrementally-funded ongoing projects during the first and second quarters of each fiscal year.

b) Our Bureau for Management does issue guidance to AID employees on year-end spending as required by OMB. I have attached copies of such notices as distributed in FY 1982, 1983, and 1984.

c) Your last recommendation, that we "establish for offices and employees a system of recognition and rewards which will encourage the accomplishment of planned obligations goals" should be reworded to "utilize the agency's systems of recognition and rewards for offices and employees to encourage the accomplishment of planned obligation goals."

A new system is not necessary. The employee evaluation report (EER) system can be and is used to reward (or not reward as the case may be) an officer's performance in contributing to timely obligations. Project officers routinely are rated on whether they were able to successfully design and negotiate proposed projects. Program officers are rated on how well they manage a Mission's program budget, including the scheduling of obligations.

We also use unit citations to recognize the performance of offices or missions who perform particularly well and various awards, e.g. step increases and cash awards, for outstanding individuals. We will look into how we might use these systems to recognize outstanding performance in the design and timely obligation of quality projects.

MEMORANDUM FOR: RIG/A/W, E. John Eckman

FROM: PPC/PB, John [illegible]mmon

SUBJECT: Draft Audit Report on Year-End Obligations

Thank you for giving PPC the opportunity to comment on this report.

In general, the report is well prepared, we agree with the conclusions and will do our best to implement the recommendations.

We have the following specific suggestions for improving the report.

1. OMB recognizes there may be good reasons for obligating funds late in the year. They have established standards to help evaluate performance. But there are many good reasons for differing from those standards, and many of those reasons apply at AID. This point should be mentioned in the report.

2. Reducing end-of-year obligations is an important objective, but it is only one of several, sometimes conflicting objectives. In some cases those other objectives are more important. For example, we believe that missions should take the time necessary to ensure they have the best possible project, even if that means a delay in obligation of funds. The fact there are other worthwhile management objectives which must be served should be mentioned.

3. On page 2, the report includes a phase which reads "...we did not assess how well these procedures were performed." This comment seems gratuitous and should be deleted. If IG suspects there is a problem, then a separate audit should be conducted.

4. On page 4, in the heading, the word "routinely" should be changed to "regularly." Routinely suggests a lax effort which we do not believe is true.

5. On page 5, first paragraph, the last sentence should be deleted. OMB does not have "requirements" and they recognize there can be good reasons for exceeding their standards.

6. On page 8, bottom of the page, you should note OMB

apportioned only limited funds during the first quarter, so we were constrained in our ability to push for early obligations.

Further, PPC does not believe identification of high priority projects would jeopadize critical development or political objectives. (I have attached editorial suggestions on this point.)

7. On page 9, at the bottom of the page. It does not seem appropriate to raise questions outside of the scope of the audit. If the IG has questions about the quality of work being performed, then a follow-up audit should be performed.

We have no objectivion to stating the theoretical problems which can result from heavy end-of-year obligations, only to the unsubstantiated suggestion that here is in fact a problem.

8. On page 11, in the middle, I think the report should indicate that, even through our targets were not achieved, we feel they did contribute to improved performance compared to previous years (excluding supplementals).

9. You should let M comment on distribution of guidance on OMB's standards, since they have been assigned action.

10. On page 13, in the middle. You should drop the phrase "... adherence to OMB standards." Again, there are good reasons why there standards don't fit AID's circumstances, so we may not want to try to "adhere" to them.

11. On page 14., first PPC recommendation, should recognize our flexibility may be limited by the OMB apportionment process.

12. On page 14, second PPC recommendation, should recognize there may be good reasons for waiting to obligate an ongoing project until later in the year. For example, an evaluation may need to be conducted or a major project amendment proposed.

cc: A-AA/PPC, RA Derham

Drafted:PPC/PB:LRogers:sb:2431B:X29176:9/21/84

MEMORANDUM AUDIT REPORT ON
YEAR-END OBLIGATIONS

List of Report Recipients

Assistant to the Administrator for Management, AA/M	1
Counselor to the Agency, C/AID	5
Assistant Administrator, Bureau for Program and Policy Coordination, AA/PPC	5
Assistant Administrator, Bureau for Africa, AA/AFR	2
Senior Assistant Administrator, Bureau for Science and Technology, SAA/S&T	2
Associate Assistant to the Administrator for Management, M/AAA/SER	2
Office of Contract Management, M/SER/CM	2
Assistant to the Administrator for External Affairs, AA/XA	1
Office of Legislative Affairs, LEG	1
Office of General Counsel, GC	1
Office of Financial Management, M/FM/ASD	2
Audit Liaison Office, PPC/PDPR/PDI	1
Bureau for Program and Policy Coordination, PPC/EA	1
Center for Development Information and Evaluation, PPC/CDIE	2
Office of Inspector General, IG	1
RIG/A/Nairobi	1
RIG/A/Manila	1
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RIG/A/Karachi	1
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IG/PPP	1
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