PD-AAZ-600
62195

AUDIT OF IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT AT OVERSEAS MISSIONS

AUDIT REPORT NO. 9-000-89-009

AUGUST 14, 1989

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C 20523

August 14, 1989

MEMORANDUM FOR PFM/FM/C, Michael G. Usnick

FROM: IG/PSA, Mervin F. Boyer, Jr.

SUBJECT: Audit of Implementation of the Federal Managers' Financial Integrity Act at Overseas Missions

The Inspector General's Office of Programs and Systems Audits has completed the subject review. A draft of the report was provided to your Bureau for review and comments. A copy of the response is attached to the report as Appendix 1. Five copies of the report are attached for your action.

The report contains five recommendations. Recommendation Nos. 1, and 5 are considered unresolved. Recommendation Nos. 2, 3 and 4 are considered resolved and will be closed when the actions are completed.

Please provide to the Office of Programs and Systems Audits within 30 days the actions planned or taken to close the recommendations.

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

Executive Summary

In 1982, Congress passed The Federal Managers' Financial Integrity Act. The Act requires Agency heads to annually report to the President and Congress the extent to which Government resources are protected against fraud, waste and abuse. Requirements for implementing the Act are: assessing vulnerability; establishing assessable units; preparing an internal control plan; and performing internal control and quality control reviews.

The primary objective of the audit was to determine implementation of the Act by A.I.D.'s 71 overseas Missions which manage a $22.2 billion portfolio located in 82 countries.

The audit showed that A.I.D. had made progress by establishing an Internal Control Oversight Committee, establishing assessable units, preparing a three year plan for internal control reviews, selecting an alternative internal control review process and initiating quality control reviews.

However, the audit also showed that A.I.D.'s 1987 report to the President and Congress dated January 22, 1988 inaccurately portrayed A.I.D.'s vulnerability at its 71 overseas Missions because no significant vulnerabilities were reported while concurrent Inspector General audit reports showed significant weaknesses in Mission programs and projects valued at over $1.7 billion. Further, A.I.D. implemented the short cut method of reviewing internal controls (allowed only when system documentation is adequate) even though system documentation was known to be inadequate. Audit tests at six Missions revealed that $28.9 million of deficiencies went undetected because event cycle reviews were not performed.

Internal control assessments at the overseas Missions were also inadequate because: a) review documentation requirements (type, scope, responsible official, pertinent data and facts, key findings and corrective action) were not followed, resulting in documentation that did not support the internal control assessments; and b) Internal Control Committees were not formally established, resulting in no evidence that managers were significantly involved in the process as required. At those Missions where committees were established, their activities could not be evaluated because committee agendas and minutes were not documented.

Although a quality control review system was to be established to evaluate the internal control assessment process, quality reviews were not made. The reviews that were made included only the Mission Controller function, did not specifically review internal controls and were not documented as required for an effective quality control review.

We recommended that the Agency make better use of audit reports to improve the internal control review process; perform comprehensive internal control event cycle reviews; issue internal control assessment documentation guidelines to Missions; require all Missions to establish formal internal control committees; include all Missions as candidates for quality control reviews; and include all Mission functions in quality control reviews and document the results.

The Office of Financial Management while agreeing with some of the recommendations did not agree with a number of overall conclusions and several of the resulting recommendations. Their specific comments are discussed at the end of each section of the report. A copy of the comments is attached as Appendix 1.

Office of the Inspector General

AUDIT OF IMPLEMENTATION OF THE
FEDERAL MANAGERS' FINANCIAL
INTEGRITY ACT
AT OVERSEAS MISSIONS

TABLE OF CONTENTS

		Page
PART I -	INTRODUCTION	1
	A. Background	1
	B. Audit Objectives and Scope	2
PART II -	RESULTS OF AUDIT	3
	A. Findings and Recommendations	5
	1. A.I.D.'s Reasonable Assurances Certification Was Inaccurate	5
	2. The Alternative Approach to Internal Control Reviews Was Inappropriate	11
	3. Missions Internal Control Review Documentation Was Insufficient	16
	4. Internal Control Committees Were Needed at A.I.D. Missions	19
	5. Quality Control Reviews Were Inadequate	21
	B. Compliance and Internal Control	24
PART III -	EXHIBITS AND APPENDICES	
	A. Exhibits	
	1. Listing of Selected Audit Reports	
	B. Appendices	
	1. Management Comments	
	2. List of Recommendations	
	3. Report Distribution	

AUDIT OF IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT AT OVERSEAS MISSIONS

PART I - INTRODUCTION

A. Background

In 1982, Congress passed the Federal Managers' Financial Integrity Act (FMFIA). The Act requires agency heads to annually report to the President and the Congress the extent to which Government resources are protected against fraud, waste, mismanagement or misappropriation and that both existing and new program and administrative activities are effectively and efficiently managed to achieve the goals of the agency.

Office of Management and Budget Circular A-123, which implements the FMFIA, requires agencies to establish a system for reviewing its internal controls as a basis for the annual report. Requirements for implementing the Act include assessing vulnerability, establishing assessable units, preparing an internal control plan and performing internal control and quality control reviews. Consequently, A.I.D. established an Internal Control Oversight Committee (ICOC) which segmented the agency into assessable units, assessed its vulnerability, prepared a three year review plan, selected an alternative internal control review process, initiated quality control reviews and summarized the results for the agency's annual report.

As part of this process, each A.I.D. Mission was designated as an assessable unit and the ICOC provided internal control assessment forms to each overseas Mission with instructions for completion. Each internal control assessment form furnished by the ICOC to the 71 overseas Missions/A.I.D. offices contained 11 internal control functions, such as funds control and project management. Under the control functions are several objectives and 154 internal control techniques, such as: 1) were personnel adequately trained and 2) was the validity of obligations reviewed every six months. The Missions were to mark each internal control technique as satisfactory, unsatisfactory, or not applicable and provide resolution and testing dates. A compilation of control techniques rated by the 71 overseas Missions/A.I.D. offices in 1987 showed that 78 percent were reported with satisfactory ratings.

Schedule of Internal Control
Technique Ratings by 71 Overseas Missions/A.I.D. Offices
For 1987

Rating	Number	Percentage
Satisfactory	8,566	78
Unsatisfactory	1,062	10
Not Applicable	1,306	12
Total	10,934	100%

B. Audit Objectives and Scope

The Inspector General's Office of Programs and Systems Audits made an audit of A.I.D.'s implementation of the Federal Managers' Financial Integrity Act (FMFIA). The primary objectives of the audit were to determine if A.I.D.'s Missions were complying with the FMFIA and whether internal control reviews were properly organized and implemented.

Audit work was conducted in Washington, D.C. and at six A.I.D. Missions. The audit in Washington, D.C. was to determine how the Agency organized its internal control review process. To determine how internal control reviews were implemented, audit work was performed at USAID/Dominican Republic, USAID/Guatemala, USAID/Indonesia, USAID/Kenya, USAID/Pakistan and USAID/Zaire. Additionally, the Inspector General's audit recommendation follow-up system was reviewed to determine the extent of A.I.D. program deficiencies during the 1987 reporting period.

The audit examined pertinent documentation maintained by the AID/Washington Internal Control Oversight Committee and the six A.I.D. Missions. Discussions were also held with responsible officials at both A.I.D./Washington and the six Missions visited.

The audit was performed from May through December, 1988. The audit covered internal control assessments made by the A.I.D. Missions during calendar year 1987. Excluded from the review were the internal control assessments made by the nine A.I.D./Washington offices and Bureaus. The audit was made in accordance with generally accepted government auditing standards.

AUDIT OF IMPLEMENTATION OF THE
FEDERAL MANAGERS' FINANCIAL
INTEGRITY ACT
AT OVERSEAS MISSIONS

PART II - RESULTS OF AUDIT

The audit disclosed that A.I.D. needed to further comply with Office of Management and Budget guidance in order to properly implement the Federal Managers' Financial Integrity Act (FMFIA). A.I.D. had made progress, but failure to properly identify internal control weaknesses incorrectly portrayed to the President and Congress that there were reasonable assurances that Government resources were properly safeguarded and effectively used.

Currently, A.I.D.'s internal control review process is organized and directed by the Internal Control Oversight Committee. This Committee is comprised of the Deputy Assistant Administrators of principal Bureaus and is chaired by the Agency Controller. The Committee was instrumental in segmenting the Agency into 34 components such as program, financial management and administrative operations. The Committee identified the program area as having the highest risk and made it the focus during 1987. During 1987, 80 internal control assessments were performed and a total of 1,165 weaknesses were reported to the Committee. These assessments were made by A.I.D.'s 71 overseas Missions/A.I.D. offices and 9 A.I.D./Washington offices. The data from the assessments was entered into an internal control tracking system. The Committee Chairman discussed and analyzed the results of the internal control assessments with each Regional Assistant Administrator. From the data and discussions, the Agency prepared its report to the President and Congress.

The Agency's report to the President and Congress provided reasonable assurance that the Agency's system of internal accounting and administrative controls when taken as a whole were adequate. However, the audit at six Missions and selected audit reports did not support the conclusion that was made. The audit showed, for example, that funds were wasted because of excess advances, that funds were not effectively used, that host country contributions were not being controlled, that funds were disbursed before needed, etc. These are some of the potential vulnerabilities that require further review and should have been identified for reporting purposes.

We recommended that the Agency improve its process to: (i) identify A.I.D. Missions requiring intensive oversight; and

(ii) include weaknesses disclosed in audit reports for inclusion in future internal control reviews. We also recommended that the Internal Control Oversight Committee: (i) require selected overseas Missions to perform comprehensive internal control reviews (event cycle approach); (ii) issue specific guidance to the Missions on the documentation required when doing internal control reviews; (iii) require Missions to establish an Internal Control Committee and to define the Committee's agenda and results; and (iv) require that quality control reviews include all Missions/A.I.D. offices and all Mission functional areas and that the reviews be documented in accordance with Office of Management and Budget guidance.

A. Findings and Recommendations

1. A.I.D.'s Reasonable Assurances Certification Was Inaccurate

In 1987, A.I.D. certified to the President and Congress, that there was reasonable assurance that the Agency was not significantly vulnerable to fraud, waste and abuse, in large part because A.I.D.'s 71 overseas Missions/A.I.D. offices, responsible for a $22.2 billion portfolio, reported limited vulnerabilities. Inspector General audit reports, however, showed concurrent weaknesses in programs and projects valued at over $1.7 billion. The Federal Managers' Financial Integrity Act (FMFIA) requires that agency heads certify to the President and Congress that its internal controls provide reasonable assurances that the agency's vulnerability was minimized. The Office of Management and Budget (OMB) Circular A-123, which implements the Act requires that available information such as audit reports be used in making the certification. The Agency's certification process did not identify serious weaknesses shown in Inspector General audit reports. As a result, A.I.D.'s 1987 certification on internal controls did not identify serious vulnerabilities.

Recommendation No. 1

We recommend that the Office of Financial Management revise the certification process to:

a. match Missions internal control assessment and review results with audit report findings to identify those Missions which reported no significant material weaknesses but have had significant deficiencies identified in audit reports and target those Missions for more intensive review or follow-up; and

b. fine tune future assessments or reviews to assure that control weaknesses disclosed in audit reports will be addressed.

Discussion

The FMFIA requires annual statements to be submitted by the head of each executive agency to the President and Congress on the status of the agency's system of internal controls. The General Accounting Office internal control standards for implementing the FMFIA states that agencies are required to establish and maintain a cost-effective system of internal controls to provide reasonable assurance that:

(i) obligations and costs are in compliance with applicable law;

(ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation;

(iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets; and

(iv) programs are efficiently and effectively carried out in accordance with applicable law and management policy.

OMB Circular A-123 defines reasonable assurance as a judgment by an agency head based upon all available information that the systems of internal control are operating as intended. OMB policy is that Inspector General audit reports should be an integral part of the agency's internal control process and be included within the sum of all information available to managers for making the reasonable assurance determination.

In its certification for the year ended December 31, 1987 the Agency reported two material weaknesses: (i) newly-instituted agency policy and procedures to meet legislative requirements for tracking Economic Support Fund cash transfer dollars and local currency as well as other A.I.D.-managed local currencies had not been assessed nor tested for adequacy of controls; and (ii) a number of field Missions had not established adequate internal guidance, particularly in the areas of project evaluation, procurement, funds control, non-expendable property, and general administrative management.

However, the audit showed vulnerabilities not reflected in the report to the President and Congress. We attribute this to: (1) A.I.D. Missions not accurately reporting their vulnerabilities; (2) A.I.D. relying upon its internal control assessment form which did not adequately address numerous repetitive audit deficiencies; and (3) A.I.D. not correcting deficiencies known since 1983 to comply with OMB requirements.

Audit Reports Showed Inaccurately Reported Vulnerabilities - A.I.D.'s 71 overseas offices, responsible for managing a $22.2 billion project portfolio, did not provide accurate internal control assessments to the Internal Control Oversight Committee. The Missions reported satisfactory responses to control techniques (specific internal controls) for which Inspector General audits showed significant weaknesses. This was determined by a review of 22 audit reports selected from a

list of 100 where fieldwork was performed at about the same time or shortly after the the Missions had prepared their internal control assessments. (See Exhibit 1 showing the 22 audit reports selected and a description of the findings.)

The review showed that for 22 identified control weaknesses the Missions had rated 19 corresponding control techniques as satisfactory, 2 as unsatisfactory, and 1 as unknown because there was no feedback provided by the concerned A.I.D. office (See exhibit 1, item 22.) Examples of controls rated satisfactory but found to be unsatisfactory were:

1. Project Management - At USAID/India, there were no assurances that $17 million paid to the Government of India was efficiently and effectively spent because amounts were disbursed without inspection of the work performed.

2. Project Counterpart Contribution - At USAID/Sri Lanka there was no system to assure that the Government of Sri Lanka contributed $203.2 million to a project as required.

3. Project Planning - At USAID/Swaziland, the impact of a project's $8.6 million dollar investment was significantly limited because research results were not getting to small scale farmers due in part to the project design which failed to focus on organizational linkages between researchers and farmers.

4. Financial Management - At USAID/Thailand, funds were provided before they were needed. A total of $29.5 million dollars was provided, resulting in $900,000 of unnecessary interest costs to the U.S. Treasury.

In conclusion, to ensure that all material weaknesses are reported to the President and Congress, the Agency must utilize all available information which indicates vulnerability to fraud, waste and abuse. As such, audit reports are a readily available source for identifying vulnerabilities which Missions may have overlooked in their review process. Missions which did not report deficiencies but were subsequently cited in audit reports as having significant unidentified deficiencies should receive closer scrutiny. By relying only on Mission self assessments, significant vulnerabilities are going undetected.

<u>A.I.D. Internal Control Assessment Forms Inadequately Addressed Numerous Repetitive Audit Deficiencies</u> - Audit reports showed long term, repetitive and continuing vulnerabilities to fraud, waste and abuse which were not addressed in the internal control assessment forms. The auditors analyzed lists of report deficiencies and individual reports issued by the Inspector General since 1981. The analysis showed important management areas that were not assessed. For example:

-- A 1984 audit report entitled, "A.I.D. Needs to do More to Comply with the Federal Managers' Financial Integrity Act", found that the PL-480 title II and participant training activities were not assessed. These areas were subsequently included. A 1987 audit showed that disaster relief programs were not assessed. The audit report showed that this $81 million annual program was not always administered efficiently. The report also showed overseas offices were not complying with regulations which required country Disaster Relief Plans.

Many of the internal control techniques were too broad and general to readily direct Mission attention to vulnerable areas. The auditors concluded that many of the ratings were superficial. However, even more significant, Missions were not reviewing in sufficient depth many of the most vulnerable areas subject to fraud, waste and abuse.

For example, two of the techniques on the assessment form related to site visits (technique O) and end use checking (technique N). Eighty-nine percent (or 63) and 92 percent (or 65), respectively, of the total 71 Missions rated these two control techniques satisfactory. These techniques required the Mission to determine whether project site visits were made on a regular basis by all project officers and were an integral part of their project monitoring activities, and whether project officers monitored the receipt and use of project-funded commodities by A.I.D. or the Host Country. The ratings were supported by questionnaires answered by each project officer. Two of the questions were: 1) "How many field trips were made in the last 6 months?"; and 2) "Are you able to adequately monitor the receipt and use of project-funded commodities?" Nothing, however, in the internal control review process asks about the common and frequent deficiencies noted in audit reports such as 1) site visits were made without written agendas; 2) trip reports were not written; 3) no follow-up system was implemented for problems noted; 4) end use checking of commodities was not made; and 5) an inventory of commodities was not available.

Another example is the control objective entitled Payments (technique H) which required the Mission to review established procedures to ensure that advances made were for the immediate disbursing needs of government and non-profit organizations. A total of 53 Missions (or 75 percent) reported satisfactory for this technique. Yet, the Inspector General just recently reported on frequent and repetitive unnecessary cash advances costing the U.S. Government $10 million in interest.

A reason why these vulnerabilities were not surfaced in the internal control assessments was because they were self assessments and those involved were rating how well they were

doing their job. Although self assessments may heighten managers and employees awareness of internal controls, heightened awareness may diminish and become counter-productive if the reviews do not substantively detect and correct areas of vulnerability. Consequently, the ICOC must use reported vulnerabilities such as audit reports and evaluations to develop internal control techniques, to ensure that the scope and depth of internal control reviews are adequate to identify areas of potential fraud, waste and abuse. Instructions on the need for in-depth, realistic reviews is also needed. If the process is not improved, reasonable assurances cannot be provided to the President and Congress.

Deficiencies in Compliance With OMB Requirements Known Since 1983 Went Uncorrected - During the initial implementation of the FMFIA, the Inspector General's Office identified numerous areas needing improvement. Some of these areas were (i) more active participation by senior officials; (ii) quality control reviews; (iii) supervision throughout the process; and (iv) documentation. Although the Inspector General did not make specific recommendations at that time, because the first year was recognized as a learning experience, the reasonable assurance standard required management to correct known deficiencies during future evaluations. However, this did not always happen as indicated by subsequent Inspector General audits which resurfaced some of the same problems previously identified.

For example, during the second year of implementation, report #85-07 dated December 7, 1984, stated that many deficiencies outlined in the previous report (#84-14 dated November 1983) had still not been corrected. In this current audit, some of the same previously disclosed discrepancies such as insufficient documentation, testing of control techniques, and participation by senior managers are again addressed. The 1984 audit report previously reported these same issues.

Management Comments

The Office of Financial Management (FM) requested the recommendation be closed. FM contends that Inspector General audit reports were considered in preparing the Annual Certification and that documentary evidence exists to support this contention. FM has developed an audit tracking system that not only reports on worldwide activity but classifies audit recommendations by management and internal control techniques. Further, the audit tracking system was an important part of the overall analysis of A.I.D.'s system of internal controls. A program was being developed that would interface the audit tracking system with the internal control tracking system to identify apparent discrepancies between audit recommendations and what a Mission reported in its internal control assessment.

Office of Inspector General Comments

During the period when A.I.D. Missions made their assessments, there were potentially significant vulnerabilities that were not identified and reported. For example, excessive drawdowns on letters of credit and cash advances in excess of stated policy were reported as weaknesses before, during and after the 1987 report. Identified weaknesses must be subjected to close review to insure the Agency's reasonable assurance certification is accurate. Many Inspector General reports reflect weaknesses in individual projects which are merely symptoms of broader problems that permeate other Mission activities. Thus, an audit finding should be considered a potential vulnerability requiring further review rather than an isolated weakness that once corrected for that project eliminates all potential vulnerability at that Mission. Our recommendation is designed to focus attention on apparent weaknesses in the vulnerability assessments as shown by audit reports. The internal control tracking system is the beginning of an effective system to identify deficiencies but action needs to be taken to identify the causes of the deficiencies and to correct the weaknesses and the potential for erroneous reporting. The recommendation remains open and unresolved.

2. The Alternative Approach to Internal Control Reviews Was Inappropriate

A.I.D.'s internal control review process omitted the review and documentation of event cycles. Although the Office of Management and Budget (OMB) encouraged agencies to use alternative internal control reviews instead of the event cycle approach, the alternative approach should be used only when system documentation (policies, procedures, personnel performing the procedures and the forms and records developed and maintained) is adequate to control the agency's organizational structure and procedures. In 1985, A.I.D. recognized that a number of Missions had not established fully adequate internal guidance in areas such as evaluation, procurement, property, etc. This audit, which included more detailed event cycle reviews at six A.I.D. Missions, identified $28.9 million dollars where control weaknesses had gone undetected using the less detailed review process. These control weaknesses continue because A.I.D. determined that for its Missions the event cycle approach was too time consuming compared to the more expedient alternative reviews. As a result, material weaknesses were unreported.

Recommendation No. 2

We recommend that the Office of Financial Management through the Internal Control Oversight Committee periodically select Missions on a random or other basis to perform comprehensive internal control reviews (event cycle approach) to assure the adequacy of the alternative internal control review methodology.

Discussion

Event cycles are the detailed controls which describe how a specific program/administrative area should function as established by its system documentation (controls, policies, procedures, and personnel job descriptions). OMB 1982 Guidelines recognized event cycles as the cornerstone for conducting internal control reviews. The logic was that for internal control reviews to be effective, it was necessary to obtain a thorough understanding of how a program/administrative activity functioned. During 1982, OMB recognized event cycles as the only method for doing internal control reviews. However, in 1986, OMB acknowledged alternative internal control reviews as a more expedient approach if system documentation was adequately maintained.

-- Internal control reviews are detailed examinations that use the methodology specified in the OMB 1982 Internal Control Guidelines. The guidelines recognize event cycles as the focal point for conducting internal control reviews and require event cycles to be documented in order to obtain a thorough understanding of how program/administrative functions operated. Each program and administrative function was said to contain one or more event cycles. An example would be the contracting function, which might include three cycles: solicitation, award and administration. OMB's 1982 Guidelines specified that event cycles should be documented by interviewing persons involved in the cycles, reviewing documentation, observing the activity, and then preparing either a narrative explanation or flow chart, accompanied by pertinent narrative information in sufficient detail to permit an in-depth analysis of the existence and adequacy of internal controls.

-- Alternative internal control reviews do not follow the event cycle methodology. These reviews make use of existing processes in order to identify high-risk elements of a program/administrative function. Some examples of alternative internal control reviews are management and consulting studies, and computer security reviews. OMB made it clear that compliance with the 1982 Internal Control Guidelines was not mandatory provided that U.S. agencies adopted alternative procedures of equivalent efficiency. These procedures should determine the relative risk of fraud, abuse, and other losses in agency programs and administrative activities, and also identify and correct material weaknesses in agency internal control systems. OMB Circular A-123 encouraged agencies to use alternative internal control reviews to streamline the internal control review process. Nonetheless, if the alternative approach does not comply with the intent of OMB Circular A-123, full event cycle examination and documentation is required.

A.I.D. used the alternative method but, it does not comply with OMB requirements because the Mission's system documentation was not adequate. The Circular defines internal control documentation as written materials of two types, one is system documentation and the other is review documentation.

System documentation includes policies and procedures, organization charts, handbooks, memoranda, flow charts, mission orders and related written materials which describe organizational structure, operating procedures, and administrative practices. Such documentation is necessary to establish operating control.

Review documentation supports the results of the review and shows the type and scope of review, the responsible official, the pertinent dates and facts, the key findings, and the recommended corrective actions. Documentation is adequate if the information is understandable to a reasonably knowledgeable reviewer.

A.I.D.'s past internal control reviews identified system documentation as control weaknesses at overseas Missions. For example:

-- A.I.D. reported in 1985 that "... a substantial number of overseas missions felt that their efficiency and control was hampered by lack of a clear concise body of policies, operating procedures, organizational charts, and assignment of duties and responsibilities among Mission staff despite (or perhaps compounded by) the plethora of regulations, directives and instructions received." As a corrective action, the Agency reported that:

> "Each mission reporting this weaknesses felt it was one which could be corrected locally by pulling together material available in various forms, analyzing this data, formulating policies and procedures to cover omitted areas and compiling an organized body of internally consistent mission policies and procedures."

-- The Agency again reported in 1987 that:

> "A number of field missions have not established fully adequate internal guidance particularly in the areas of project evaluation, procurement, funds control, non-expendable property, and general administrative management. This weakness had previously been identified as an Agency material weakness in 1985. In 1986, due to the number of corrective actions taken by the overseas missions, it was no longer considered to be material. However, the results of the Overseas Missions Internal Control Assessments performed during 1987 revealed a widespread failing among the field missions to have adequate written policies and procedures in specified areas."

Audit work at six Missions substantiated there was inadequate system documentation. The audit of five control techniques listed on the Mission's internal control assessment form showed that management operations were hindered by lack of system documentation.

Control technique (F) under section V entitled Funds Control required that unliquidated commitments and obligations be reviewed and the results documented at least every 6 months to ensure that all outstanding obligations were valid. Only two of the six Missions visited had rated this area as unsatisfactory. The audit showed that the four satisfactory ratings were not indicative of the actual situation since the validity of $12,191,255 in unliquidated obligations was questionable.

Control technique (K) under section I entitled Payments required that, when local currency was provided to an Intermediate Credit Institution or to any other organization responsible for controlling and reporting on the use of such funds (e.g. indigenous Private Voluntary Organizations), the USAID must first assess the organizational financial management procedures and related internal controls of that organization. Five of the six Missions reviewed gave themselves a satisfactory rating on this category and stated that the certification of the Private Voluntary Organization and subsequent reviews by independent certified public accounting firms were valid assessments that the Private Voluntary Organization had adequate financial management procedures and internal controls. The audit found that at three of the five Missions who reported a satisfactory rating, $16.5 million dollars was disbursed without assessing the organization's financial management procedures.

Control technique (N) under Section VI entitled Contracting required that personnel service contractors salaries be commensurate to their responsibilities and be based on a verifiable salary history. A.I.D. Handbook 14 prescribes the various factors to be applied when setting the salaries for personal services contractors. Although all six Missions visited reported that this was being satisfactorily done, the audit disclosed that A.I.D. Handbook policies and procedures were not being followed. The audit found that salary histories were used to establish contract rates rather than the responsibilities of the work, salaries were not verified, excessive annual increases were authorized, etc.

Control technique (T) under section VII entitled Management and Administration requires that an Internal Revenue Service Form 1099 be filed for all non-wage payments to individuals, including those funded through purchase orders. The audit showed that four of the six Missions visited had not or would not have reported $237,470 of reportable wages to the Internal Revenue Service despite the fact that three of the four Missions had previously reported satisfactory ratings in this area.

Control technique (U), Section VIII entitled Project Monitoring and Evaluations, required the USAID to prepare project assistance completion reports. The technique specifically

required the USAID to ensure that counterpart contributions were actually made. The audit of this technique was performed at four Missions and showed that the project completion reports did not disclose the extent to which the host governments met their commitment to provide funds to the projects.

Management Comments

The Office of Financial Management does not concur in this recommendation. From the outset it was determined by the ICOC that the ICA would be performed by the overseas Missions annually for a period of three years from 1987 through 1989. The performance of the ICAs during this period can be likened to a vulnerability assessment where controls are assessed, weaknesses are identified, and more formal internal control reviews for the more vulnerable areas can be arranged. When this three-year evaluation cycle is completed at the end of this year, the ICOC will have to analyze the results of these evaluations, identify persistent problems or weaknesses, and plan a course of action or actions for correction. It is at this time that the ICOC would recommend that certain overseas Missions perform more comprehensive internal control reviews using event cycle methodology for areas determined to be highly vulnerable.

Office of Inspector General Comments

Three of the five internal control techniques audited related to project implementation, an area which is most vulnerable to fraud, waste and abuse. It is at this level that host governments, private voluntary organizations, project managers, shippers, and vendors are interwoven to accomplish the project's goals. Considering the large number of audit findings involving project management, it is evident that deficiencies in the internal control review process extend to most A.I.D. Missions. The Project Management area as well as other areas of Mission management lack the proper level of documentation, implementation, supervision and management. The recommendation was revised to use event cycle reviews on a random basis to test the effectiveness of the use of the alternative internal control review method which in our opinion is not identifying significant control weaknesses. This recommendation is considered resolved and will be closed when more comprehensive reviews using event cycles are made in the future as recommended.

3. Missions Internal Control Review Documentation Was Insufficient

Internal control assessments were not properly documented because A.I.D./Washington had not instructed the Missions in sufficient detail on the extent of documentation required. The Office of Management and Budget requires that documentation show the type and scope of the review, the responsible official, the pertinent dates and facts, the key findings, and the recommended corrective actions. Failure to follow review documentation requirements resulted in documentation that was usually not useful for reviewing the validity of conclusions reached, nor for determining the extent responsible officials participated in the alternative internal control review process.

Recommendation No. 3

We recommend that the Office of Financial Management through the Internal Control Oversight Committee issue specific guidance to the Missions on the documentation that is required for internal control assessments or reviews, including as a minimum, documentation that:

-- establishes the objective of the review;

-- defines the scope and type of review;

-- explains the methodology used to arrive at conclusions;

-- identifies matters that are materially important and relevant;

-- shows the responsible official, pertinent dates and facts, key findings and the recommended corrective actions; and

-- contains evidence of supervisory reviews.

Discussion

General Accounting Office (GAO) standards and Office of Management and Budget (OMB) guidelines require that documentation for internal control reviews be maintained so that the validity of conclusions reached can be evaluated and the performance of individuals involved in the internal control review can be measured. The documentation should provide a permanent record of the methods used, the personnel involved and their roles, the key factors considered and the conclusions reached.

All overseas Missions were provided an internal control assessment form by A.I.D./Washington containing 154 internal control techniques to be rated. The audit showed that (i) satisfactory ratings were given by the Missions without adequate supporting documentation; (ii) for those rated unsatisfactory, documentation was inadequate and (iii) when documentation was available there was no evidence of supervisory review.

Inadequate Review Documentation - A.I.D./Washington did not require testing for 93 of the total 154 internal control techniques on the Mission Internal Control assessment form and consequently satisfactory ratings were assigned without any supporting documentation. A.I.D./Washington felt that these techniques were difficult to test and document because they involved subjective matters. While some of the techniques may have appeared to be subjective, most were objective and could have been tested and documented for compliance. For example, technique (T) under Payments required that imprest funds be verified and reconciled to the control account at least monthly. An objective test would be to review the control account for reconciliation compliance and test the imprest funds for accuracy. Another example is technique (B) under Procurement which calls for adequate training for procurement personnel consistent with their responsibilities. An objective test in this instance would be to establish the training needs and then verify whether the training was met. According to OMB requirements, review documentation for those control techniques rated as satisfactory by the Missions without any testing being required merit the same review documentation as those rated under a testing mode. Otherwise, ratings may be assigned on a perfunctory basis. To eliminate the tendency to assign ratings on a perfunctory basis, AID/Washington should require review documentation for controls not tested but given a satisfactory rating.

Inadequate Testing Documentation - A.I.D./Washington policy for calendar year 1987 and 1988 was that 61 of the 154 internal control techniques were to be tested at least once during the 1986-1989 period. Although recommended areas for testing were included at the end of each program/function section, Missions could expand beyond those areas if they so desired. When testing was performed, Missions were instructed to maintain and keep on file adequate documentation to support the testing results.

All of the six Missions visited did not properly document those control techniques which were to be tested. In all cases, the A.I.D. Missions were uncertain as to how the documentation needed to be prepared because A.I.D./Washington failed to issue

specific documentation instructions explaining OMB requirements. A.I.D./Washington should assure that Missions know and follow OMB documentation standards. Anyone using the documentation should be able to readily determine the objective, data sources, the nature and scope of the tests conducted, and the preparer's conclusions.

Supervision Not Documented - Supervisory participation was not adequately documented to show evidence of supervisory reviews. OMB Circular A-123 requires performance appraisals to address internal control accomplishments and that appropriate actions be taken for violations of internal controls. This applies to each Senior Executive Service and Merit Pay or equivalent employee with responsibili y for internal controls. Normally, a separate job element solely for internal control is not necessary. Instead, the internal control responsibility is part of other job elements and the inclusion of performance standards recognizing this link between internal controls and key job elements is made. Nonetheless, in order to evaluate an employee's accomplishment in promoting internal controls, documentation must be compiled to show evidence of supervisory reviews and subsequent overall accountability.

Management Comments

A.I.D./Washington Financial Management officials stated that they did not believe that there was a widespread failing to maintain review documentation as presented by the auditors. They further stated that most of their Controller Assessments made to date found that a majority of Missions had maintained adequate review documentation. They also disagreed that the same level of documentation was needed for controls which were not tested as those that were tested. Nonetheless, they agree with the recommendation and will issue guidance on documentation requirements. This recommendation is considered resolved and will be closed when documentation guidance is issued.

4. Internal Control Committees Were Needed at A.I.D. Missions

Internal Control Committees were often not established at A.I.D. Missions and in those cases where committees were appointed, committee activities were not documented to show how senior management was involved, what issues were discussed and how issues were resolved. A.I.D. Handbook 19, Appendix 1D established an Internal Control Oversight Committee (ICOC) at A.I.D./Washington, but no requirement existed for such a committee at the Missions. A formal Committee is needed at the Missions in order to ensure compliance with the Office of Management and Budget policy which states that all levels of management should be involved in ensuring the adequacy of internal controls. Prudent management also requires that committee meetings be documented in order to establish accountability. The absence of a formal committee at A.I.D. Missions resulted in insufficient participation of Mission managers and lack of documentation on what the Committee did and the judgments made.

Recommendation No. 4

We recommend that the Office of Financial Management require the establishment of Mission Internal Control Committees and issue instructions on documentation requirements for the Committee such as agendas, minutes of meetings, conclusions, etc.

Discussion

Three of the six Missions visited had not established an Internal Control Committee for 1987. The remaining three said that a committee had been established, but there were no committee minutes or other documents to substantiate Committee activities. Appendix 1D to A.I.D. Handbook 19 requires the establishment of an Internal Control Oversight Committee to be composed of a combination of program, financial, and administrative management personnel. It is the Committee's responsibility to direct and monitor the execution of the Agency's internal control policies and prescribe standards for the purposes of ensuring the performance of internal control reviews at all A.I.D. levels. The Committee accomplishes its responsibilities by (i) prescribing the formats for reporting breakdowns in internal control procedures, financial losses resulting from deficiencies in internal controls, and corrective actions taken to eliminate these occurrences and (ii) by reviewing the methodology and results of the internal control assessments and reviews.

A.I.D./Washington established an ICOC which organized the basic framework by which the internal control process would be initiated. For example, this Committee prepared an internal control assessment questionnaire, issued guidance on how the internal control reviews were to be conducted and maintained a system that identified deficiencies and recommendations resulting from the reviews and tracked follow-up actions.

A similar Committee was also needed at the Mission level to ensure senior management involvement. At all of the six Missions visited, there were no Internal Control Committees formally implemented during 1987. Consequently, there was no evidence to substantiate the involvement of senior Mission personnel, nor could determinations be made as to what issues were discussed and what the final decisions were. For example Mission officials at USAID/Indonesia, USAID/Guatemala and USAID/Pakistan, told us that they took an interest in and were involved in the internal control assessment process. However, an Internal Control Committee was not established and there was no documentary evidence of direct participation by A.I.D. senior managers. Instead, the majority of the internal evaluations were done by contractors or local personnel. Senior managers are to be responsible for the internal control review process to assure adequate controls exist.

Officials at the remaining three Missions (USAID/Dominican Republic, USAID/Zaire and USAID/Kenya) told the auditors that senior management personnel were active participants in the review process and documentation showed the appointment of an Internal Control Committee. However, there were no recorded minutes of meetings to show when and how this participation occurred. The audit further disclosed that unsatisfactory ratings (at USAID/Dominican Republic) were initially given to some control techniques but were later revised to satisfactory. Mission personnel stated that the revision was a result of senior management participation. However, there was no documentation to support why or who made the changes. Involvement of senior management needs to be documented to show what was discussed, the agenda the results, conclusions, etc.

Management Comments

A.I.D./Washington Financial Management officials agreed that Mission Internal Control Committees should be established. This recommendation is considered resolved and will be closed when Committees are formed and guidance is provided on documentation.

5. Quality Control Reviews Were Inadequate

The Office of Management and Budget (OMB) guidelines require that a monitoring system be developed to ensure that internal control reviews are adequately performed. Although A.I.D./Washington had established a quality control review system in 1987, as of December 31, 1988, the Agency had not performed quality control reviews. Instead, the reviews that were made (14) included only Mission Controller functions rather than all Mission functions required of a quality control review. Documentation requirements of the Office of Management and Budget (OMB) were not met for these reviews.

Recommendation No. 5

We recommend that the Office of Financial Management through the Internal Control Oversight Committee establish a system to ensure that quality control reviews are performed and that intended objectives and results are documented as prescribed by the Office of Management and Budget.

Discussion

OMB guidelines require that a monitoring system be developed to ensure that internal control reviews are adequately performed. One suggestion is to use an individual or small group to test the reviews as deemed necessary. During the Agency's first year of implementation (1982), the Office of Inspector General commented that quality control reviews were needed. Although the Inspector General made no specific recommendations regarding quality control reviews, the audit report stated that the primary monitoring responsibility was with the ICOC. A subsequent audit report (#85-07 dated December 1984) stated that quality control reviews should be made to disclose whether adequate written documentation was maintained to substantiate the validity of conclusions reached. It was at this time that the Inspector General formally recommended that the ICOC establish quality control reviews. The Agency responded that quality testing of future internal control reviews was to be included in its 1985 work plan. Yet, quality control reviews per se have not been made. Instead limited reviews of the Mission Controllers function were made.

The audit showed that as of December 31, 1988 the Agency performed reviews at 14 Missions. Only 47 of the 71 A.I.D. Missions had been included in the list of Missions which might be scheduled for reviews. The remaining 24 Missions were not identified for reviews because these Missions accounting

functions were performed by some of the other 47 Missions and a quality control review of the servicing Mission would, therefore, include the remaining 24 Missions. At the end of the audit, A.I.D./Washington had identified seven more Missions which would be subject to reviews, but none of these Missions had as yet been scheduled for quality control reviews.

All Missions which prepare their own internal control assessments should be subjected to quality control reviews, regardless of whether accounting functions were shared with other Missions because internal control reviews include all Mission functions not just the Controller function.

Controller officials responsible for the internal control review process told us that the quality reviews were a combination of an assessment of the controller operations and a review of the internal control assessments. They further stated that only controller functions were reviewed. The other nine internal control functions were not included in the quality control review. While it might be appropriate to combine quality reviews with other activities, such as the Controller operations assessment, it is inappropriate to exclude all other mission functions.

Documentation of the quality control reviews should show how each of the specific objectives were reviewed and the overall conclusion reached. OMB guidance requires review documentation to show the type and scope of review, responsible officials, pertinent dates and facts, the key findings and the recommended corrective actions. The three reviews provided to the auditors, were primarily a summary of the review teams conclusions and did not appear to be a standardized form of review.

Management Comments

The Office of Financial Management does not concur in this recommendation. Despite attempts to explain to the auditors, both orally and in writing, the purpose of the Controller Assessments, the auditors insist on calling these assessments "quality control reviews," and continue to call for an expanded role of these assessments in the overseas Missions beyond their original purpose.

We will repeat again what we stated in our response to the Record of Audit Finding (RAF). The purpose of a Controller Assessment is to assess the financial management practice, including internal controls, of an overseas Mission within a controller function. Its principal purpose is not, as the draft audit suggests, to monitor the performance of internal control assessments at every overseas Mission. Instead, a review of a Mission's internal control evaluation process is

included in the Controller Assessment team's plan, and includes a review of the internal control process, the internal control assessment, and the adequacy of documentation.

Office of Inspector General Comments

We have revised the finding and no longer have given the agency credit for attempting to do quality control reviews, since FM indicates the controller assessments are not intended to be quality control reviews. We therefore, have retained our recommendation that a system of quality control reviews be established. The recommendation is considered unresolved.

B. Compliance and Internal Control

The review of compliance and internal controls was limited to the Agency's implementation of the FMFIA.

Compliance

The were two compliance exceptions that dealt with the implementation of the Federal Managers' Financial Integrity Act. They were that:

-- review documentation criteria was not complied with when doing internal control reviews; and

-- event cycles were not based on the existence of adequate system documentation.

Internal Control

We noted the following internal control weaknesses:

-- Missions gave themselves satisfactory ratings, but were shown to have weaknesses by audit reports;

-- internal control assessments were not adequately documented to support work done;

-- Internal Control Oversight Committees were not established at the Mission level to oversee the assessment process; and

-- quality control reviews were not made to provide independent assurance that assessments were accurately made.

AUDIT OF IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT AT OVERSEAS MISSIONS

PART III - EXHIBITS AND APPENDICES

Listing of Selected Audit Reports

Audit Report & Country	Finding	Corresponding Control Technique and Mission Rating
1. Audit Report No. 3-279-88-03, January 22, 1988 Country - USAID/Yemen	Procedures and internal controls were inadequate to determine the amount of funds to be deposited or to assure that withdrawn funds were used for project purposes. Although deposits into the Fruit Tree Improvement Fund exceeded the equivalent of $1.5 million, the exact amount which should have been deposited was unknown because procedures and internal controls were inadequate. Consequently, the fund was vulnerable to abuse, and funds withdrawn from the account could have been diverted for non-project related purposes. Total project valued at $137.8 million.	Section VIII, Technique (V): Unsatisfactory
2. Audit Report No. 6-263-87-8, May 31, 1987 Country - USAID/Egypt	The host country government (Ministry of Education) did not maintain proper accountability records of $20 million worth of A.I.D. financed instructional materials and equipment. Total project valued at $190 million.	Section VIII, Technique (N): Satisfactory
3. Audit Report No. 5-383-87-6, September 3, 1987 Country - USAID/Sri Lanka	There was no assurance that the Government of Sri Lanka contributions equivalent to about $203.2 million would actually be provided. Consequently, the efficiency of A.I.D. funds were not being maximized. Total projects valued at $453.4 million.	Section VIII, Technique (V): Satisfactory
4. Audit Report No. 2-492-88-09, July 12, 1988 Country - USAID/Manila	These was no assurance that local currency equivalent to $47.5 million for Economic Support Fund went to support development projects.	Section X, Technique (E): Satisfactory

Listing of Selected Audit Reports

Audit Report & Country	Finding	Corresponding Control Technique and Mission Rating
5. Audit Report No. 7-686-88-06, January 29, 1988 Country - USAID/Burkina	Project purpose indicators were not used to measure progress for sub-projects estimated at $9.5 million; $13.5 million; and $2.6 million. The USAID did not identify this as a vulnerable area in its yearly assessment. Total project valued at $25.6 million.	Section VIII, Technique (D): Satisfactory
6. Audit Report No. 3-695-88-27, September 23, 1988 Country - USAID/Burundi	The audit covered $1 million of the total $7.8 million dollars obligated and concluded that $222,000 of project funds were improperly used to support USAID/Burundi operating expenses. Also, $1.3 million being billed by technical assistance contractors were promoting the project because a large amount of the technical assistance team members time was spent other than at the project site. Total project valued at $7.8 million.	Section VIII, Techniques (D): Satisfactory
7. Audit Report No. 5-388-88-4, January 15, 1988 Country - USAID/ Bangladesh	Accountability of $113 million of commodities was inadequate because USAID/Bangladesh did not adequately monitor A.I.D. financial project commodities.	Section VIII, Technique (D): Unsatisfactory
8. Audit Report No. 5-383-88-5, May 27, 1988 Country - USAID/ Sri Lanka	Of the $8 million worth of A.I.D. financed commodities, at least $1.6 million had not been effectively utilized and maintained.	Section VIII, Technique (N): Satisfactory

Listing of Selected Audit Reports

Audit Report & Country	Finding	Corresponding Control Technique and Mission Rating
9. Audit Report No. 3-611-88-13, May 10, 1988 Country - USAID/Zambia	USAID/Zambia's $12.5 million grant agreement to assist agricultural research and extension had the following problems: A.I.D. had been overbilled by $741,367; accountability for $210,000 could not be established; and project commodities were not being properly controlled.	Section VIII, Technique (Q): Satisfactory
10. Audit Report No. 1-532-88-19, June 4, 1988 Country - USAID/Jamaica	IG auditors could not review the end-use of $26.9 million in a PL 480 program valued at $69.9 million because auditors were denied audit rights.	Section VIII, Technique (N): Satisfactory
11. Audit Report No. 1-522-87-16, February 20, 1987 Country - USAID/Honduras	The diversion of vehicles valued at about $142,275 impeded the project efforts. Total project valued at $16.7 million.	Section VIII, Technique (N): Satisfactory
12. Audit Report No. 5-386-88-6, June 15, 1988 Country - USAID/India	USAID/India monitoring and administrative approval of vouchers were not adequate to ensure that outputs had been completed in accordance with approved plans and specification and that A.I.D. payments of $17 million to the Government of India were efficiently and effectively spent.	Section VIII, Technique (E): Satisfactory
13. Audit Report No. 2-482-88-10, August 1, 1988 Country - USAID/Burma	There were no assurances that $4.3 million in U.S. owned local currency was expended for project purposes. USAID/Burma did not review or sample project documentation.	Section VIII, Technique (E): Satisfactory

Listing of Selected Audit Reports

Audit Report & Country	Finding	Corresponding Control Technique and Mission Rating
14. Audit Report No. 5-391-88-8, July 11, 1988 Country - USAID/ Pakistan	Up to $14 million equipment funded by A.I.D. was inappropriate, having no specific project need and accordingly was not effectively utilized.	Section VIII, Technique (E): Satisfactory
15. Audit Report No. 5-388-88-9, September 19, 1988 Country - USAID/ Pakistan	USAID/Pakistan provided technical assistance to the Government of Pakistan at a cost of $29 million, but the work provided by the technical assistance contractors had limited success due to insufficient monitorship of the contractors work.	Section VIII, Technique (E): Satisfactory
16. Audit Report No. 7-698-89-01, October 20, 1988 Country - USAID/ Dakar	A.I.D. grant expenditures totaling $15.4 million towards project implementation could not be measured for effectiveness because A.I.D. offices did not have the necessary information to measure the results of project activities against project objectives. Project valued at $23.4 million.	Section VIII, Technique (E): Satisfactory
17. Audit Report No. 3-698-88-18, July 28, 1988 Country - Nairobi-REDSO	Cash advances were made to cover 90 day disbursement needs rather than 30 days as required by regulations. Project officials were not effectively monitoring cash advances and related internal controls were not being followed. Adhering to 30 day advances would result in about $13,748 savings to the Government over two years.	Section VIII, Technique (E):

Listing of Selected Audit Reports

Audit Report & Country	Finding	Corresponding Control Technique and Mission Rating
18. Audit Report No. 3-645-88-05, March 14, 1988 Country - USAID/ Swaziland	The Mission did not identify or act on about $2.8 million of excess funds because the Mission did not assess project needs and project financial reports were inaccurate. (Project valued at $11.4 million.)	Section VIII, Technique (E):
19. Audit Report No. 2-493-88-11, September 9, 1988 Country - USAID/ Thailand	Contrary to A.I.D. cash management procedures, funds were provided before they were needed. A total of $29.5 million were provided and consequently, the U.S. Treasury incurred an unnecessary interest cost of about $900,000.	Section VIII, Technique (E): Satisfactory
20. Audit Report No. 1-517-89-06, December 30, 1988 Country - USAID/ Dominican Republic	$207 million of obligations for projects and operating expenses as of September 30, 1987, showed that in some cases obligations had not been established and maintained in accordance with A.I.D. Handbook requirements.	Section VIII, Technique (E): Satisfactory
21. Audit Report No. 1-520-89-04, December 16, 1988 Country - USAID/ Guatemala	$270 million of obligations for projects and operating expenses as of September 30, 1987, showed that the Mission had not maintained documentation for their 1311 reviews.	Section VIII, Technique (E): Satisfactory
22. Audit Report No. 2-498-88-06, May 5, 1988 Association of South East Asian Nations (ASEAN) Organization RDO	The countries contributions for long term scholarship participation and research activities was below planned expectations. Total project valued at $3 million.	Section VIII, Technique (U): Unknown

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

MAY 17 1989

MEMORANDUM

TO: IG/PSA, Mervin Boyer

FROM: PFM/FM/C, Michael G. Usnick

SUBJECT: Draft Audit Report - A-123 Compliance

We appreciate the opportunity to respond to the draft audit report on A.I.D.'s compliance with OMB Circular A-123, and request that this response be appended in its entirety to the final report.

Executive Summary

While we concur in some of the recommendations contained in the draft report, we generally do not agree with a number of statements made and the overall conclusions reached by the IG. The report contains a number of inaccuracies and does not adequately describe for the reader A.I.D.'s internal control process and actions taken by A.I.D. management to improve the process over the past several years. Generally, we believe the arguments presented in our responses to the Record of Audit Findings (RAFs) were not given full consideration by the auditors in preparing this draft report.

We believe that the current Agency process is a reasonable, well-planned approach to identify vulnerable areas in our overseas operations. True, it has taken several years to accomplish but the results, we believe, will be worth the wait. Most importantly, by carefully analyzing the results of the internal control assessments for the past three years we will be able to identify those persistent problems which the missions have been unable to resolve and take appropriate action to address them. Other than being critical of the Agency's internal control review process, we don't believe the recommendations contained in this report offer any viable alternatives to revise or improve the process.

The following are the principal findings found in the draft report and our positions which are more fully discussed later in this response:

1). The IG argues that the Agency did not use IG audit reports when preparing the Annual Certification. Therefore, the credibility of the 1987 Annual Certification was questionable.

We contend that IG audit reports were considered in preparing the Annual Certification, and documentary evidence exists to support our contention.

2.) The IG contends that the use of alternative internal control reviews were inappropriate because of inadequate system documentation.

We maintain that the use of AICRs was appropriate and in accordance with OMB guidelines. We believe that the Agency's system documentation is adequate and therefore is not precluded from using AICRs.

3.) The IG asserts that a number of weaknesses have not been identified because formal internal control reviews have not been conducted.

We argue that formal internal control reviews have been conducted at the missions' discretion. We also point out that at the end of the three-year internal control assessment cycle, areas of high vulnerability will be identified and more formal internal control reviews will be required by the Internal Control Oversight Committee.

4.) The IG contends that A.I.D.'s internal control quality review process is not adequate because Controller Assessments do not cover all operations in every mission.

We maintain that the internal control quality review process is adequate and is in accordance with OMB requirements. We point out that over the past year staff resources devoted to the quality review process has been dramatically increased, an effective audit recommendation tracking system has been implemented, and Controller Assessments at selected missions assess the internal control review process at those missions.

Some examples of the inaccuracies contained in the draft report are the following items:

-Throughout the report, internal control assessments or AICRs are incorrectly referred to as internal control reviews.

-Controller Assessments are incorrectly referred to as internal control quality reviews.

-On page 2, the internal control assessments contain 12 functions, not 12 internal control objectives.

-On page 2, testing dates are to be supplied whether or not a control technique is rated unsatisfactory.

-On page 3, last sentence should read: "The objective of the audit was to determine if A.I.D.'s internal control process complied with the FMFIA and whether alternative internal control reviews were properly organized and implemented".

-Top of page 6, "was the most highly vulnerable" should be changed to "had the highest risk".

The following are our comments to the specific recommendations:

Recommendation No. 1

We recommend that the Agency improve its process for determining reasonable assurance by revising its system to:

a) match internal control reviews with audit reports to identify those missions which reported no significant material weaknesses, in controls in which Inspector General audits showed as having significant deficiencies and schedule those missions for intensive A.I.D./W oversight;

b) include in future reviews an assessment of control weaknesses disclosed in audit reports which were not included in prior reviews; and

c) take follow-up action to assure that Inspector General audit recommendations on the FMFIA are implemented.

While we could easily concur in this recommendation and suggest closure upon issuance of the final report, we believe that the there is little or no basis for the recommendation itself. Particularly disturbing is the discussion section (pages 10-23) where not only the credibility of the Administrator's Annual Certification is questioned, but the ratings given by the overseas missions were termed by the auditors to be "superficial", and there is nothing to support the auditors' claim that previous audit deficiencies went uncorrected.

There is no basis to the claim that the Administrator's 1987 Annual Certification is "questionable" because the Agency did not take into account IG audit reports when preparing the Certification. Since early 1986, steps have been taken to ensure that IG audit reports and recommendations are an integral part of the Agency's internal control process.

Attachments 1 and 2 document a portion of the dialogue between FM and the IG in early 1986 concerning the identification of internal control deficiencies in audit reports. The ICOC staff used both the results of their own audit tracking system and the IG's Deficiency Report in preparing the 1987 Annual Certification which was cleared by the Inspector General.

In addition, IG audit recommendations were considered in the initial design of the ICA as well as subsequent revisions. Attachments 3 and 4 are examples of such additions of control techniques to the ICA as a result of audit recommendations. In fact, no fewer than fifteen control techniques were added to the 1987 ICA directly resulting from audit recommendations by the IG. In 1988, a significant number of control techniques were added in the non-project assistance area to address IG concerns.

The draft audit claims that missions did not accurately report their vulnerabilities in their internal control assessments and that many of the ratings were "superficial". To support this claim, the auditors produced Exhibit 1 which reflected that a majority of 22 audit findings were not rated as unsatisfactory in the internal control assessments. However, Exhibit 1 has two major flaws. First, a majority of the 22 audit reports were issued either a full six months before the ICAs were performed or up to a full year after. The analysis did not take into account those recommendations that had been subsequently closed prior to the performance of the ICA and thus a satisfactory rating may be justified.

Secondly, in most cases the corresponding control technique was not properly identified. For example, the corresponding control technique for item 4 for USAID/Manila should be X(e), not VIII(e), the corresponding control technique for item 17. for Nairobi-REDSO should be I(h), not VIII(e). There are other examples where the corresponding control technique was not properly identified, particularly in the project management area. The two specific examples above concerned cash management and non-project activity issues which are unquestionably addressed in Section I and Section X of the ICA, and were rated as unsatisfactory by the missions.

In support of their argument that the ICA does not address those deficiencies found in IG audit reports, the auditors state that the following deficiencies are not addressed in the ICA (pages 18-20):

-site visits, trip reports, and follow-up

-end-use checking for commodities was not made

-inventory of commodities was not available

-contract payments

However, we contend that items III(d), VIII(m), VIII(n), I(d), VI(h), VI(k), and VI(p) in the ICA address the above deficiencies in one form or another.

On page 19 the auditors cite the fact that 75% of the missions reported that their cash advance systems were satisfactory. We fail to understand what point the auditors are trying to make. A.I.D. saw the same results but considered 25% of the missions having unsatisfactory advance systems as a major weakness as reflected in the attached Cash Management Internal Control Assessment (Attachment 5). We would also like to point out that IG audits were indeed considered when preparing this report.

We are somewhat confused by the discussion on page 21 which contends that deficiencies in compliance with OMB requirement have gone uncorrected since 1983. The auditors are correct that no formal recommendations were made in the 1983 report, however, recommendations were made in the 1984 report and all those recommendations have been closed. Specifically, we dispute the contention that senior officials have not actively participated in the process and that the quality control reviews are not adequate. The 1986 OMB A-123 revision required that senior level managers become more involved in the internal control process. To meet this requirement, A.I.D., through its resegmentation plan identified responsible officials, up to the Assistant Administrator level, for each component. Since 1987, these senior officials have actively participated in the process, from approving components' Risk Assessments to identifying material weaknesses based on results of follow-on internal control assessments. All meetings with and decisions made by these officials have been adequately documented. We see no basis whatsoever for the auditors' claim that senior level officials are not involved in the process. The adequacy of our quality review process has been discussed in our response to a previous RAF and will be discussed again later in this response.

Since December, 1988 we have implemented a more comprehensive Audit Tracking and Classification System (Attachment 6) which among other things will identify discrepencies between ICA ratings and audit recommendations.

We state again that we feel there is no basis for this recommendation because of actions taken to date. However, if the IG feels that the recommendation is still warranted we request that it be closed upon issuance of the final report and that the discussion section be revised to reflect our concerns stated in this response.

Recommendation No. 2

We recommend that the Internal Control Oversight Committee require overseas missions to perform comprehensive internal control reviews (event cycle approach).

We do not concur in this recommendation as stated nor do we agree with the conclusions reached by the auditors in their discussion of the recommendations contained in pages 25-40 of the draft report. Specifically we do not agree that 1) internal control reviews were not utilized, and 2) that the alternative internal control reviews (AICR) were not appropriate.

Perhaps at this point it would be useful to describe in more detail the Agency's internal control process in regards to its overseas operations, since we don't believe this process has been adequately described in the draft report. In 1987, due to the 1986 revision in OMB Circular A-123, A.I.D. revised its internal control process. The Agency was resegmented from a total of 745 assessable units in 1985 to a total of 37 components in 1987 along the lines of program, financial management, and A.I.D./W administrative operations. The ICOC determined that because of the inherent high risk of the program area, the Agency's internal control efforts would be focused on this area during the first year of the revised process. Alternative internal control reviews were widely used. For the overseas missions a comprehensive internal control assessment (ICA) was developed. For 1987, the ICA consisted of 11 sections and included a listing of control objectives for each function and a total of 154 control techniques to be assessed. For 1988, in response to IG and GAO concerns over monitoring of non-project assistance dollars and local currency, the ICA was expanded to 12 sections and to a total of 196 control techniques.

From the outset it was determined by the ICOC that the ICA would be performed by the overseas missions annually for a period of three years from 1987 through 1989. The performance of the ICAs during this period can be likened to a vulnerability assessment where controls are assessed, weaknesses are identified, and more formal internal control reviews for the more vulnerable areas can be arranged. When this three-year evaluation cycle is completed at the end of this year, the ICOC will have to analyze the results of these evaluations, identify persistent problems or weaknesses, and plan a course of action or actions for correction. It is at this time that the ICOC would recommend that certain overseas missions perform more comprehensive internal control reviews using event cycle methodology for areas determined to be highly vulnerable.

The draft audit report does not mention the fact that since 1987 a number of formal internal control reviews have been performed by overseas missions. During the three-year ICA evaluation cycle the ICOC did not want to preclude a mission from conducting a more formal internal control review for an area which the mission considered itself particularly vulnerable. At the end of each section in the ICA the mission is asked if it felt that a more formal, comprehensive internal control review was necessary for that area. In 1987, a total of 35 areas were identified as needing an internal control review. As of April, 1988 we have confirmed that 29 of these internal control reviews had been performed. In 1988, an additional 15 areas were identified. We are currently following up with the missions to determine how many internal control reviews were actually performed for those areas identified in 1988.

We again strongly disagree with the IG contention that the Agency's use of alternative internal control reviews does not comply with OMB requirements. As stated in our response to the RAF, we contend that the Agency as a whole has adequate policies and procedures, and related written materials necessary to describe its organizational structure and to communicate responsibilities and authorities for accomplishing programs and activities. We believe the Agency is in compliance with OMB Circular A-123 systems documentation requirements and qualified to use alternative internal control reviews.

We are confused as to what the IG wants us to do. The auditors claim that using alternative internal control reviews is inappropriate. Are they recommending that we scrap the entire ICA process? If so, what are their recommended courses of action and methodologies to be employed to determine areas of vulnerability? Should we be relying only on IG reports to determine vulnerable areas or should we require an internal control review for every facet of our overseas operations? Should we be restricting the use of alternative internal control reviews across the Agency, including the IG components? If not, then what alternative process is the IG proposing to determine when an AICR is appropriate? These are legitimate concerns being raised by us, and the answers cannot be found in this draft report.

We believe that the current Agency process is a reasonable, well-planned approach to identify vulnerable areas in our overseas operations. True, it has taken several years to accomplish but the results we believe will be worth the wait. Most importantly, by carefully analyzing the results of the ICAs for the past three years we will be able to identify those persistent problems which the missions have been unable to resolve and take appropriate action to address them.

We suggest that this recommendation be worded as follows:

We recommend that the Internal Control Oversight Committee, at the end of the 1989 evaluation cycle, identify areas in overseas missions where more comprehensive internal control reviews need to be performed.

Recommendation No. 3

We recommend that the Internal Control Oversight Committee issue specific guidance to the missions stating that documentation is required for all internal control techniques and that the documentation should:

-establish the objective of the review;

-define the scope and type of the review;

-explain the methodology used to arrive at a conclusion;

-restrict information to matters that are materially important and relevant;

-state the responsible official, pertinent dates and facts, key findings and the recommended corrective actions; and

-contain evidence of supervisory reviews.

Recommendation No. 4

We recommend that A.I.D. provide instructions for mission Internal Control Committee's activities to include that:

-Internal Control Oversight Committees be formally established at all A.I.D. missions;

-committee agendas be defined; and

-committee results be documented in minutes of meetings.

We concur in the above recommendations as stated and we are currently drafting guidance that will be issued to the missions this summer for the preparation of their 1989 ICA. Upon issuance of this guidance will request that these recommendations be closed.

Recommendation No. 5

We recommend that quality control reviews:

-allow all missions to be candidates for review;

-include all mission functions;

-describe the intended objectives of the review;

-ensure that review documentation is made in accordance with OMB requirements.

We do not concur in this recommendation. Despite attempts to explain to the auditors, both orally and in writing, the purpose of the Controller Assessments, the auditors insist on calling these assessments "quality control reviews", and continue to call for an expanded role of these assessments in the overseas missions beyond their original purpose.

We will repeat again what we stated in our response to the RAF. The purpose of a Controller Assessment is to assess the financial management practices, including internal controls, of an overseas mission within a controller function. Its principal purpose is not, as the draft audit suggests, to monitor the performance of internal control assessments at every overseas mission. Instead, a review of a mission's internal control evaluation process is included in the Controller Assessment team's plan, and includes a review of the internal control process, the internal control assessment, and the adequacy of documentation.

Page II-6 of OMB's 'Internal Control Guidelines' dated December, 1982 states the following:

A monitoring system should be developed to assure that assessments and reviews are performed adequately. One way should be to use an individual or small group to test assessments and reviews as deemed necessary (emphasis added). Another way would be to coordinate with the Inspector general's limited reviews of the process.

We believe the Agency's quality review process is adequate and meets the intent of OMB's guidelines. Generally, the Agency's internal control evaluation monitoring system consists of the following:

-FM/FPS quality reviews

-Controller Assessments

-Inspector General audits

A full discussion of our quality review system is included in our reponse to the RAF.

We request that this recommendation be deleted from the final report.

Attachments (as stated)

cc: Internal Control Oversight Committee

LIST OF RECOMMENDATIONS

Page

Recommendation No. 1 5

We recommend that the Office of Financial Management revise the certification process to:

a. match Missions internal control assessment and review results with audit report findings to identify those Missions which reported no significant material weaknesses but have had significant deficiencies identified in audit reports and target those Missions for more intensive review or follow-up; and

b. fine tune future assessments or reviews to assure that control weaknesses disclosed in audit reports will be addressed.

Recommendation No. 2 11

We recommend that the Office of Financial Management through the Internal Control Oversight Committee periodically select Missions on a random or other basis to perform comprehensive internal control reviews (event cycle approach) to assure the adequacy of the alternative internal control review methodology.

Recommendation No. 3 16

We recommend that the Office of Financial Management through the Internal Control Oversight Committee issue specific guidance to the Missions on the documentation that is required for internal control assessments or reviews, including as a minimum, documentation that:

-- establishes the objective of the review;

-- defines the scope and type of review;

-- explains the methodology used to arrive at conclusion;

-- identifies matters that are materially important and relevant;

-- shows the responsible official, pertinent dates and facts, key findings and the recommended corrective actions; and

-- contain evidence of supervisory reviews.

LIST OF RECOMMENDATIONS (Cont)

Page

Recommendation No. 4 19

We recommend that the Office of Financial Management require the establishment of Mission Internal Control Committees and issue instructions on documentation requirements for the Committee such as agendas, minutes of meetings, conclusions, etc.

Recommendation No. 5 21

We recommend that the Office of Financial Management through the Internal Control Oversight Committee establish a system to ensure that quality control reviews are performed and that intended objectives and results are documented as prescribed by the Office of Management and Budget.

REPORT DISTRIBUTION

	No. of Copies
Assistant to the Administrator for Personnel and Financial Management (AA/PFM)	5
Assistant Administrator, Bureau for Africa (AA/AFR)	1
Assistant Administrator, Bureau for Asia and Near East (AA/ANE)	1
Assistant Administrator, Bureau for Food for Peace and Voluntary Assistance (AA/FVA)	1
Assistant Administrator, Bureau for Latin America and the Caribbean (AA/LAC)	1
Assistant Administrator, Bureau for Private Enterprise (AA/PRE)	1
Assistant Administrator, Bureau for Program and Policy Coordination (AA/PPC)	1
Senior Assistant Administrator, Bureau for Science and Technology (SAA/S&T)	1
Assistant Administrator, Bureau for External Affairs (AA/XA)	1
Office of Financial Management (PFM/FM/C)	2
Office of Legislative Affairs (LEG)	1
Office of the General Counsel (GC)	1
PPC/CDIE	3
IG	1
D/IG	1
RIG/A/Nairobi	1
RIG/A/Manila	1
RIG/A/Cairo	1
RIG/A/Dakar	1
RIG/A/Tegucigalpa	1
RIG/A/Singapore	1
RIG/A/W	1
IG/PPO	2
IG/LC	1
AIG/I	1
IG/ADM/C&R	16