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Dear Mr. Chairman:

I am pleased to submit A.I.D.'s first Semiannual Management Report pursuant to the Inspector General Act Amendments of 1988. I am also officially transmitting the Inspector General's Semiannual Report to the Congress for the period October 1, 1989 - March 31, 1990.

After serving only three months as A.I.D. Administrator, I fully appreciate that A.I.D. has a unique challenge as a U.S.G. agency. That challenge is to improve, indeed often save, the lives of millions of people living in third world countries characterized by poverty, social disruption and weak government institutions. These are noble and worthy national objectives which are an integral part of the United States' foreign policy goals. By assisting these countries we also help ourselves. Their economic and social well being is increasingly tied to ours in this rapidly shrinking world.

Among recipient governments and other donor organizations, A.I.D. has a strong reputation for designing and implementing successful programs, for strict accountability, and for providing intellectual leadership in the development field. A.I.D.'s success is due in part to our unique field mission structure, staffed with highly qualified and dedicated A.I.D. personnel. Because our field staff are sited "closer to the action" and understand the cultures where programs operate, A.I.D. is in a better position than most donors to quickly identify and work with counterparts to rectify development problems. I believe the quality and effectiveness of our programs have remained enviable in recent years, even though staffing has been constrained by Operating Expense budget levels and increased costs in Washington and overseas.

Nevertheless, I agree with the Inspector General's Semiannual Report that A.I.D. has operating deficiencies. The Inspector General's Foreword indicates that problems identified in previous I.G. reports persist. He feels we should be more aggressive in reducing the vulnerabilities inherent in foreign aid and the difficult, sometimes chaotic overseas environment.

I have taken serious note of the Inspector General's report. There is no room in A.I.D. for complacency or indifference in making the most effective use of the U.S. taxpayers' dollar overseas. A.I.D. is aware of and actively addressing many of these shortcomings; we will, however, need time to institutionalize these improvements.

This report describes eight major areas where A.I.D. has improvements underway in response to problems identified by our staff or by the Inspector General. These improvement areas are:

- Internal Controls
- Audit Procedures and Follow-up
- Financial Management
- Host Country Contracting
- Local Currency Accountability
- Allocation of Staff Resources and Budget Integration
- Automation
- Streamlining A.I.D. Operations

Over the course of the next year, I plan to continue work in these important areas and will systematically review and take action in other areas where management problems are identified. I know that I can count on your help and the collaborative assistance of the Inspector General in this effort.

Sincerely,

Ronald Roskens

Administrator,
Agency for International
Development

I. INTRODUCTION

This is the first Semiannual Report submitted to Congress by the Administrator of A.I.D. as required by the Inspector General Act of 1978, as amended. Pursuant to Inspector General Act Amendments of 1988 (Public Law 100-504), we are required to report to Congress on the status of final action(s) taken on audit report recommendations. This report is accompanied by a report prepared by the Agency's Office of Inspector General (IG) that summarizes audits conducted between October 1, 1989 and March 31, 1990 and management decisions made on those audits.

During the time period covered by the Inspector General's report, A.I.D. took final action on 68 audit reports. The Inspector General issued 75 new reports; and there were 60 audit reports pending final action at the end of the period. Management decisions were made on 92 reports during the same interval.

The following table summarizes audit reports issued that had financial implications and A.I.D. management decisions made on such audits for the period October 1, 1989 to March 31, 1990.

Audit Decision Summary

1. Reports with no management decision(s) as of the beginning of the period	80
2. Inspector General reports issued during the period	75
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SUBTOTAL	155
3. Less: Reports with management decision(s) made during the period	92
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4. Reports for which management decision(s) had not been made by the close of the period	63
5. Percent change in audit reports pending decisions	21.2% Decrease

As noted in the Inspector General's report, A.I.D. has a number of weaknesses that will continue to require management attention. Some of these weaknesses relate to general policies, some to management and financial systems, and the balance generally to the operations of recipient country programs which A.I.D. helps finance.

Because A.I.D. has a unique role as Federal agent for supporting U.S. foreign policy initiatives by administering economic and food assistance overseas, it carries a special burden of having to apply U.S. management, regulatory, and audit concepts in often less than hospitable environments. Most of the \$10 billion worth of activities A.I.D. finances in eighty-odd countries are managed by other governments or nongovernmental organizations which have their own rules and systems to follow. They, for the most part, make the decisions and implement the programs. The U.S., through A.I.D., gives them technical and financial assistance to get the job done, but the programs are basically theirs to manage. The frailties of their institutions, politics, and frequent disruptions from natural or manmade calamities make the task of maximizing outcomes a challenging one to say the least. "Vulnerability" takes on a different definition. In this hybrid and cooperative relationship, A.I.D. must have extensive oversight systems to make U.S. assistance secure and effective.

Reports issued by the Inspector General for this period identify a number of weaknesses and indicate that "Disallowed Costs" and "Funds to be Put to Better Use" each represented about 3% of the \$3 billion value of the activities audited. Even though the overseas development environment is difficult to operate in, A.I.D. can reduce these vulnerabilities and percentages further.

A.I.D. managers and technical staff identified many of the weaknesses cited in the Inspector General's report and requested the IG to carry out most of these audits. They, with the help of recipient government entities, deserve a good deal of the credit for putting tens of millions of dollars of assistance to better use. Assistance of the Inspector General and his staff has also been invaluable for clarifying issues and fleshing out the hows and whys of what might have gone wrong. Inspector General staff have also been helpful in identifying other problems that might not have surfaced via established channels. The identification and definition of these program shortcomings will feed into A.I.D. management's improvement agenda.

Section II of this report discusses eight major areas where significant management improvements are presently underway in response to problems identified by A.I.D. or by the I.G. Sections III, IV and the Appendix provide statistical data on the status of audits and audit resolution required by law.

II. SIGNIFICANT MANAGEMENT IMPROVEMENTS

A. Internal Control Program

A.I.D. operates a comprehensive internal control program, covering its Washington operations as well as its overseas missions. Through the Internal Control Oversight Committee (ICOC), made up of senior Agency managers, the internal control program is a first line effort to guard against waste, fraud, and abuse of resources. This effort promotes the concept of proactive, rather than reactive, initiatives to deal with internal control problems. It has been effectively utilized by Agency managers to highlight significant internal control weaknesses in such areas as financial management, audit, manpower support and data processing. Through its internal control process, the ICOC has been able to initiate corrective actions on many of the same problems cited in the Inspector General's report.

The Agency's recently completed three-year assessment program for the overseas missions indicates a significant decrease in the number of internal control deficiencies reported since 1987. Through this assessment program A.I.D. has been able to identify areas where improvements have been made, as well as areas where problems persist in overseas operations. Weaknesses remain in several areas, such as control of nonexpendable property and contract closeout procedures, and Agency managers are conducting reviews and taking necessary actions to correct these areas of significant concern before major complications arise.

There is room for improvement in the ICOC operation and the Agency's internal control program. A.I.D. is now upgrading and expanding the role of the ICOC, under new Office of Management and Budget (OMB) guidelines. These guidelines mandate a strengthening of internal control with an emphasis on setting up effective "early warning" systems. A.I.D. is actively following this directive and will be implementing key elements including:

- descriptions of material weaknesses will be more specific, responsibility for improvements assigned to individuals and accomplishments evaluated in annual performance reviews;
- a quarterly reporting system will be initiated to indicate to the Deputy Administrator the status of material weaknesses and audit recommendations; and

- A.I.D. will request the Inspector General to issue flash reports to management when the IG discovers a potentially serious problem.

A.I.D. is confident that these changes, when fully implemented, will strengthen overall agency management and will result in an "early warning" system identifying potentially serious problems.

B. Audit Follow-up

In addition to its internal control program, A.I.D. utilizes Inspector General, GAO, and non-federal audit assistance as tools to improve the overall management of programs. For example, recognizing the political sensitivities and the high risk operating environment associated with Congressionally-mandated assistance to the Contra forces living in Honduras, A.I.D. took the initiative to contact the IG to set up a close working relationship from the beginning of the program and worked closely with the IG throughout the programming and implementation phases. This joint effort had a cost not replicable in all A.I.D. undertakings, but did give a smoother running program and control in a volatile environment.

The Inspector General Act Amendments of 1988 made significant changes to the audit resolution, follow-up and reporting process. In December 1989, A.I.D. issued new policies and procedures for its audit follow-up system. We are continuing to upgrade our capabilities and have undertaken a program to improve and expand our audit follow-up process with emphasis on the following:

- senior managers will become more actively involved in the direction of the audit follow-up program through a formal review committee;
- a new audit tracking system will be developed;
- responsibility for corrective action and audit closure will be assigned to an individual and included in the employee's performance plan; and
- coordination and cooperation with the Inspector General will be strengthened.

C. Financial Management

A well-publicized \$1.2 million embezzlement scheme uncovered in 1988 highlighted major internal control weaknesses in A.I.D./Washington financial management operations. The root cause of this embezzlement can be attributed to drastic staff reductions and inadequate segregation of duties within the Office of Financial Management. A.I.D. took immediate action to redress the situation. The Office of Financial Management was reorganized to improve the span of supervisory control and additional positions were approved. Progress has been made in correcting problems identified in certain operational areas. Significant internal control weaknesses remain and are currently being addressed; but their resolution will require a multi-year level of effort.

Field-level accounting for A.I.D. projects overseas, utilizing the A.I.D.-developed Mission Accounting and Control System (MACS), is fully operational, and has been noted in several Inspector General audits to be properly and accurately operating. However, paramount among the Agency's internal control weaknesses is that A.I.D./Washington has not been able to fully implement its primary Financial Accounting and Control System (FACS). A decision has been made to replace FACS and a task force has been organized to oversee the work. A scope of work to contract for a needs assessment and conceptual design of the replacement was issued with proposals due this summer. The successful bidder is expected to initiate work later this year.

Other financial management improvements that have been implemented or are well underway include:

- organizational restructuring and systems improvements provide more efficient operations in payroll and payment documentation controls;
- additional staff were assigned to financial management areas where weaknesses in segregation of duties had been identified; and
- policies and guidance on the periodic reviews of unliquidated obligations have been strengthened and implemented.

The Agency is continuing to review and improve its financial management activities to ensure full accountability and the efficient use of its limited resources.

D. Host Country Contracting

Host country contracting procedures are used extensively by the World Bank and regional multilateral banks for projects financed in developing countries. A.I.D. uses host country contracting more selectively, trying to limit this mode of contracting to activities where recipient agency capabilities are projected to be adequate. The advantages of utilizing host country contracting include shifting greater project responsibility to the host government to strengthen their institutional capacities, and reducing A.I.D. direct-hire staff requirements. However, these procedures can present difficulties if responsible institutions don't later have the required resources, because A.I.D. has less control over contractor selection and subsequent contract administration.

A.I.D. has long recognized host country contracting as an area of high vulnerability, and has consistently reported it as a material weakness in its annual Federal Managers Financial Integrity Act reports. A.I.D. has conducted a review of contracting procedures and problems over the past year and is taking several actions to correct deficiencies associated with host country contracting. Among other things, A.I.D.'s Procurement Policy Advisory Panel has issued more stringent guidance to our field missions that require:

- the mission director to certify in writing, after review by appropriate financial, contracting and legal staff, that the host government implementing agency has the capability to undertake the procurement before host country contracting procedures can be used to implement a project;
- A.I.D. approvals of interim steps in the host country contracting process when contracting actions are estimated to result in awards that exceed \$100,000; and
- a mission representative to be an observer or resource person on the host country's proposal evaluation panel to assure the evaluation is done fairly and in accordance with criteria set forth in the solicitation document.

The Agency's Procurement Policy Advisory Panel will continue to closely monitor implementation of these new requirements to assure host country contracting operates in an effective and proper manner.

E. Local Currency Accountability

A.I.D. management is committed to improving accountability over host country-owned local currency associated with U.S. assistance. Over the past several years there has been increased overseas mission awareness of their local currency oversight responsibilities, and these missions have taken actions to improve their monitoring and verification procedures. This increased awareness can be attributed to the issuance of new guidance in October, 1987 and an increased number of Inspector General audits of local currency accounts that have taken place over the recent past. However, A.I.D. believes more can be done to improve accountability while at the same time preserve some degree of flexibility in programming these local currencies.

The resolution of problems associated with local currency accountability is a top-priority item on A.I.D.'s management agenda. We are working with the Inspector General to develop acceptable accountability guidelines for local currency generated by U. S. assistance. We will consult with Congressional staff on our progress as required by the 1990 Senate Appropriation Committee report. This work will expand upon the October, 1987 guidance that established minimum accountability standards and defined mission responsibilities for monitoring local currency activities. Specifically, this expanded guidance will:

- establish standards on which local currency programming decisions, from an accountability standpoint, can be based;
- define mission responsibilities in monitoring local currency activities relative to the capabilities of the host government;
- establish more stringent requirements in the areas of financial assessments, reporting, and audit for certain local currency activities; and
- establish minimum accountability standards and certain other requirements for local currency programmed for various types of budget support programs.

We believe the approach we are taking, after considering staff resource limitations and sensitivities of recipient country governments, will satisfy the concerns of all parties involved.

F. Allocation of Staff Resources and Budget Integration

During the past year A.I.D. senior management began a major effort to improve the utilization of its workforce and operating expenses. Over the years, A.I.D. has reviewed the support resource implications of new or expanded programs on a case-by-case basis. There are wide variances in the cost of doing business in the many countries where we operate. We know that support resources cannot be allocated by a strict formula. Rather it is necessary to understand the management and accountability issues that exist at each post and at headquarters if we are to improve the way we allocate our support resources.

A working group has been established to describe and analyze how A.I.D. currently allocates its program funds, workforce and operating expenses. The results of the working group's analysis will give top Agency management a much better picture of how and why it deploys staff and support costs in relation to programs and a clearer picture of the effect that various operating expense adjustments would have on program operations.

In addition, the previously separated budgeting functions for program funds and support resources have recently been combined under a single manager. This organizational integration has facilitated the development of an agency-wide budget request for 1992 that explicitly relates program requests to the workforce and operating funds required. The combined budget function will ensure that the budget formulation, review and approval of the two aspects will be carried out in a coordinated fashion.

A.I.D. is working on a system to give operating managers more flexibility and incentives to allocate their resources within approved overall totals. For the 1991 operating year budget, managers of some headquarters units will receive authority to reallocate operating expenses among various categories of expenditures based on program requirements.

Career staff have declined significantly in recent years, driven in part by OMB constraints and reductions in the real levels of our operating expense budgets. Increased costs in Washington and overseas have added to this squeeze. At the same time, programmatic responsibilities have changed little and new programs are being introduced in the emerging democracies of Eastern Europe, Africa, and Central America. better understanding of the basic dynamics of staffing,

combined with an integrated budget approach and the study of possible central/regional bureau redundancies, is expected to improve the way A.I.D. uses support resources and should help A.I.D. determine whether it can continue to "do more with less."

G. Automation

A.I.D. has been actively addressing potential vulnerabilities in ADP areas by implementing recommendations based on a review conducted as a result of the Computer Security Act of 1987. The area of computer security has been identified by A.I.D. as one of its four "high risk" areas, and A.I.D. is taking action to resolve this weakness. Among actions completed are the following:

- enhanced physical security for the central computer facilities;
- development of computer access policies;
- training for over 700 employees on computer security and awareness; and
- the establishment of security investigation policies for all IRM contractors having ADP access.

In addition, an Information Management Committee, a senior level intra-agency automation policy and steering committee, was established in December, 1988 to assist A.I.D. management in setting standards for corporate data and to provide information consistency across Agency data systems. The Committee has defined five broad information management strategies for A.I.D. and has approved the funding of specific information technology projects to streamline the Agency's business and management practices. Projects in support of these strategies were initiated between October, 1989 and March, 1990 and include the following:

- improved management of Agency information by ensuring consistency and accuracy of data and improved decision-making;
- reduction or elimination of duplicate data entry, as required by OMB Circular A-127;

- automation of the Annual Budget Submission (ABS) and improved accuracy of budget data through automated data validation;
- strengthened bureau and mission information management to improve productivity and allow more timely responses to the Congress and the public; and
- improved communications and automated services for Bureaus and Missions.

Taken together, these initiatives reflect an aggressive Agency-wide commitment to achieving significant operational efficiencies using modern information technologies. Completion dates for these investments are scheduled for FY 1990 and FY 1991.

H. Streamlining A.I.D. Operations

A.I.D. has taken a series of steps in recent years to improve the efficiency of program operations. In doing so we have attempted to take advantage of A.I.D.'s resident overseas missions, a unique resource which allows us to have greater knowledge of the practical problems of designing and implementing projects in the third world. These overseas missions give A.I.D. an ability to monitor project performance on a daily basis, unlike most other donors.

Although there is some variation between bureaus and between missions, after receipt and approval of initial project documentation, A.I.D./Washington usually delegates authority to Missions to approve the final design and project documentation in the field. Field missions also normally have authority to make project adjustments without Washington approval. A systematic external study performed by Checchi and Co in 1987 found that LAC projects authorized by the field under the decentralized process were of consistently high quality. The ability of Missions to respond quickly to changing implementation requirements of ongoing projects has been enhanced by the delegation of authorities to execute agreements, extend dates for the host country to meet project conditions and covenants and to grant certain procurement waivers. The net effect of these authorities is to streamline A.I.D.'s program approval and implementation processes.

A.I.D.'s ability to most efficiently manage its program resources is, however, significantly affected by Congressional division of the Development Assistance budget into functional accounts and the difficulty in moving funds between accounts and projects. A major breakthrough did occur when the Development Fund for Africa (DFA) was created in FY1988 without these functional accounts. The removal of budgetary rigidities associated with functional accounts has had a direct and significant effect on efficiency in budgeting DFA funds both in Washington and in the field. Prior to the DFA, a small Africa budget had to be split among 6 functional accounts and 40 some countries. Establishing these annual budgets was time consuming and modifications were very difficult. If a project did not evolve as expected through the design and negotiation stages, finding another place to obligate and properly use the funds was often difficult, particularly as the end of the fiscal year drew near. Untold numbers of person-hours had to be devoted to dealing with these budgetary rigidities. The DFA has allowed the Africa Bureau and its missions to spend more time tailoring the portfolio to specific country circumstances and less time in trying to "force-fit" low priority projects. Under the DFA, the Africa Bureau is functioning more smoothly and, we believe, getting better results for its limited resources. The Africa Bureau is now in position to focus more sharply on program outputs and whether our assistance is achieving a meaningful and lasting impact. The elimination of functional accounts for the Agency as a whole, which AID has requested, would provide similar programmatic and management benefits for our worldwide efforts.

Finally, the new Administrator has initiated a senior-level review of A.I.D. programming and documentation requirements that reduce operational efficiency. He has also outlined a major management review, focused on streamlining and improving utilization of personnel in Washington. A comprehensive review by an outside consulting firm will examine whether there are programmatic and staffing redundancies between A.I.D.'s central bureaus (PPC, S&T, PRE and FVA) and the regional geographic bureaus (AFR, LAC and ANE). The consultant will be asked to make specific recommendations for eliminating redundancies identified by their analysis.