USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Assistant Inspector General for Audit

MAR 2 1998

MEMORANDUM FOR AA/M, Terrance J. Brown
AA/PPC, Thomas H. Fox

FROM: AIG/A, Everette B. Orr Everette B. Orr

SUBJECT: Reports on USAID's Financial Statements, Internal Controls and Compliance for Fiscal Year 1997 and 1996, Audit Report No. 0-000-98-001-F

Under the Government Management and Reform Act of 1994, 'the U.S. Agency for International Development (USAID) is required to prepare consolidated fiscal year end financial statements. The financial statements are required to be audited and submitted to the Office of Management and Budget and the Department of the Treasury by March 1 following fiscal year end. The Office of Inspector General is transmitting its reports on the Agency's fiscal year 1997 and 1996 consolidated financial statements, internal controls and compliance. The Agency's overview, principal statements and related notes, and supplemental information required under the Act have been included as Appendix I to our reports.

We do not express an opinion on USAID's financial statements, because USAID's financial management systems could not produce complete, reliable, timely and consistent financial information. With respect to USAID's internal controls, USAID's financial management systems could not generate the complete, reliable, timely and consistent financial information needed to (1) bring about more effective financial management practices, (2) improve information quality needed in decision-making, and (3) deter fraud, waste and abuse. Concerning USAID's compliance, we noted several material instances of noncompliance with United States government laws and regulations.

We received and considered your comments to the draft report. This report contains 10 recommendations to improve USAID's internal controls and better ensure compliance with laws and regulations. Based on your comments to the draft report, we have accepted your management decisions on Recommendation Nos. 1, 2, 4 6, 7.2, 8, 9, and 10. Please forward to me all information on your request to the Office of Management Planning and Innovation

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WASHINGTON, D.C. 20523

for acceptance of the final management actions related to the recommendations.

The response to Recommendation No. 3 did not, in our opinion, address the finding and recommendation. The responses to Recommendation Nos. 5 and 7.1 indicated that there are substantial differences in the positions between our respective offices. Over the next 30 days, the Audit staff will be in contact with your respective staffs to isolate and resolve these differences and possible misunderstandings.

Please provide this office with your final management decision on Recommendation Nos. 3, 5, and 7 and any other information you wish within 30 days of the date of the report.

I would like to express my sincere appreciation for the courtesies extended by your staffs to the auditors over the past year. The collaborative approach used by our staffs this year will help ensure a successful audit next year. The Office of Inspector General is looking forward to working with you on the audit of the Fiscal Year 1998 and 1997 financial statements.

Attachment: a/s

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REPORTS ON USAID'S FINANCIAL STATEMENTS, INTERNAL CONTROLS, AND COMPLIANCE FOR FISCAL YEARS 1997 AND 1996

Report No. 0-000-98-001-F
March 2, 1998

EXECUTIVESUMMARY

The Government Management and Reform Act of 1994 requires USAID to prepare consolidated financial statements and have them audited for inclusion in the government-wide financial statements. This law and applicable auditing standards require the Office of Inspector General to audit USAID's (1) financial statements, (2) related internal controls, and (3) compliance with applicable laws and regulations.

With regard to USAID's financial statements (Appendix I), we could not complete an audit of them because our audit was impaired. Among the most significant impairments were that (1) weak internal controls in the accounting and financial management systems precluded us from obtaining sufficient evidential matter to execute validity testing; and (2) the lack of complete, reliable, timely and consistent financial information precluded us from performing necessary audit testing by the statutory deadline for completing our audit.

With respect to USAID's internal controls, the accounting and financial management systems do not meet Federal standards. Accordingly, several significant internal control weaknesses impaired USAID management's ability to have reasonable assurance over the completeness, reliability, timeliness, and consistency of financial information. Three of the more significant of these internal control problems include:

> **Letters of Credit - The Office** of Financial Management's practices for recording disbursements made through Letters of Credit do not provide reasonable assurance that all disbursements made-about $1.69 billion in fiscal year 1997—were authorized, proper and correct, and were accurately recorded and reported. The Office's staff did not match disbursements with obligations at the time of the transactions (a potential problem government-wide). Furthermore, the staff did not track all Letter of Credit status reports to ensure the timely and complete accrual of expenditures at year end.
>
> **Fund Balance With Treasury -** At the time of our audit testing, USAID had material differences of over $1.94 billion between its Fund Balance With Treasury and the balance maintained by the Department of Treasury. The Office of Financial Management had not properly researched and reconciled the differences.
>
> **Reports to Regulatory Agencies -** The Office of Financial Management reported unobligated balances to Federal regulatory agencies and did not file quarterly reports on USAID's budget execution because of insufficient oversight or second party reviews. Consequently, the reports to the regulatory agencies contained errors totalling an absolute difference of over $143 million.

Concerning USAID's compliance, we noted material instances of noncompliance with the requirements of the Federal Financial Management Improvement Act of 1996; the Budget and Accounting and Procedures Act of 1950; and other United States laws and regulations. USAID's accounting and financial management systems do not substantially comply with Federal requirements.

Our report provides 10 recommendations to assist USAID's management in improving internal controls and compliance with laws and regulations. In addition, Appendix V contains 13 recommendations from prior audits where corrective action has not yet been completed or the action taken was not sufficient to correct the deficiency.

We provided USAID management a draft of this report in which we disclaimed an opinion on the financial statements because the Office of Financial Management was unable to provide complete, reliable, timely and consistent financial information. In response (Appendix II), USAID's management generally agreed with the report's findings and recommendations, and reported that it had already initiated corrective action on many of the recommendations.

Office of Inspector General
March 2, 1998

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INTRODUCTION

Background

The United States Agency for International Development (USAID) was created in 1961 to advance the United States' foreign policy interests by promoting broad-based sustainable development and providing humanitarian assistance. USAID has an overseas presence in 60 countries, 42 of which have fully operational and formal USAID missions. In fiscal year 1997, USAID had total obligation authority of $6.6 billion, supported by $500 million in operating expenses.[1]

Under the Government Management Reform Act of 1994, USAID is required to submit audited financial statements to the Office of Management and Budget and appropriate Congressional Committees. Pursuant to this Act, USAID has prepared statements of financial position, operations, changes in net position and related footnotes for the 1997 and 1996 fiscal years (Appendix I). Appendix I also includes an overview and supplemental information section, prepared by USAID management, which provides details on USAID's goals, objectives and accomplishments.

Objectives

The Office of Management and Budget's Bulletin No. 93-06 establishes the audit requirements for Federal financial statements. For fiscal year 1997, this Bulletin required us to:

- express an opinion on whether USAID's principal financial statements present fairly in all material respects the financial position, the results of operations and changes in net position, in accordance with applicable Office of Management and Budget Bulletins and applicable accounting principles;

[1] Per the accompanying "USAID Financial Report Overview".

- report on USAID's internal control structure related to these financial statements as well as to the internal control structure related to the performance measures contained in the "USAID Financial Report Overview" section; and

- report on USAID's compliance with laws and regulations that could have a direct and material effect on the principal statements, and any other applicable laws and regulations.

We were not able to fully implement these objectives because the scope of our work was impaired. Therefore, our report on the financial statements disclaims an opinion on whether they are presented fairly. Among the most significant impairments were that (1) weak internal controls in USAID's accounting and financial management systems precluded us from obtaining sufficient evidential matter; (2) the lack of complete, reliable, timely and consistent financial information precluded us from performing necessary audit testing; (3) the Office of Financial Management did not provide a comprehensive plan to explain how the financial statements would be compiled to ensure that they would be complete, reliable, timely and consistent; and (4) USAID's management did not provide a draft overview section in sufficient time for us to verify the reliability and completeness of the results reported.

The third objective above included determining whether USAID's financial management systems comply substantially with Federal requirements for financial management systems, applicable Federal accounting standards, and the United States Standard General Ledger at the transaction level, as required by Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA). The scope of our work included those financial management systems which were operational in USAID during fiscal year 1997. To make the determination, we followed the implementation guidance for FFMIA issued by the Office of Management and Budget on September 9, 1997. We reviewed audit reports covering financial management issues during fiscal year 1997, as well as USAID documents describing financial management system capabilities and deficiencies. We believe the evidence we obtained for this part of the objective is sufficient for us to make the determination.

In accordance with the Office of Management and Budget's audit requirements for Federal financial statements, this combined report provides our reports on USAID's financial statements, internal control structure, and compliance with applicable laws and regulations.

USAID INSPECTOR GENERAL'S REPORT ON FINANCIAL STATEMENTS

We Disclaim (Are Unable to Express) an Opinion on Whether the Financial Statements are Presented Fairly

We attempted to audit the accompanying Statement of Financial Position of USAID as of September 30, 1997, and the related Statement of Operations and Changes In Net Position for the year then ended. These financial statements are the responsibility of USAID's management.

With respect to the accompanying financial statements for fiscal year 1996, we had previously attempted to audit them, but we could not because of scope limitations concerning the completeness, reliability, timeliness and consistency of financial information. Accordingly, our report[2] disclaimed an opinion on those financial statements. Although, USAID's management has restated the financial statements from the prior year, they have not been audited. Thus, these financial statements may be unreliable. We cannot and do not give an opinion on whether they are presented fairly.

Concerning USAID's financial statements for fiscal year 1997, we are unable to give an opinion on these principal statements because of limitations on the scope of our work. Thus, these financial statements may be unreliable as well. The scope of our work was limited in the following ways:

- Material weaknesses in USAID's internal controls and the consequential risk of material misstatements in its financial statements precluded us from obtaining sufficient evidential matter to complete our audit. The amount of substantive testing required to express an opinion on the presentation of the financial statements would have been prohibitive and unattainable by the statutory deadline of March 1, 1998, for submitting the financial statements to the Office of Management and Budget.

- The lack of complete, reliable, timely, and consistent financial information precluded us from performing necessary audit testing.

[2] Report No. 0-000-97-001-C, dated February 24, 1997, Reports on USAID's Financial Statements, Internal Controls, and Compliance for Fiscal Year 1996.

- The Office of Financial Management did not provide a comprehensive plan to explain how the financial statements would be compiled to ensure that they would be complete. reliable, timely, and consistent.

- The Office of Financial Management did not provide timely access to documents that were critical to the audit at the time the documents were requested.

During fiscal year 1997, USAID staff tried to establish a new integrated accounting and financial management system, but it did not work as intended and our audit was impaired. The following sections discuss the problems with USAID's accounting and financial management systems that impaired the scope of our work.

Internal Controls

USAID's accounting and financial management systems do not have adequate internal controls, which precluded us from obtaining sufficient evidential matter to conduct our audit as required by applicable legislation. These weaknesses in USAID's internal accounting controls caused significant errors in the recording of transactions during fiscal year 1997.[3] Many of the weaknesses have existed for years, as identified in prior audit reports and USAID reports on internal controls. Presented below are the most significant weaknesses reported in USAID's report for fiscal year 1997 under the Federal Managers' Financial Integrity Act, and new weaknesses identified during our fiscal year 1997 work (our report on internal controls, Appendix III and Appendix IV discusses these weaknesses in more detail).

The material weaknesses in internal controls impair the Office of Financial Management from providing complete, reliable, timely, and consistent financial information. These weaknesses are due primarily to the lack of a compliant integrated accounting and financial management system. The following illustrate (Appendix IV discusses all previously reported weaknesses):

<u>Primary Accounting System</u> - The Office of Financial Management's primary accounting system does not comply with the requirements of the Federal Financial Managers' Improvement Act of 1996. Specifically, the primary accounting system does not comply with (1) Federal requirements for financial management systems, (2) applicable Federal accounting standards, and (3) the United States Standard General Ledger at the transaction level (See our report on compliance).

<u>Data Reconciliation</u> - The Office of Financial Management does not always timely reconcile financial data. This weakness occurred because USAID lacks an integrated

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[3] Although the Office of Financial Management made adjusting entries after the close of the fiscal year, we were not able to review the entries because the Office was late in closing its books and submitting the financial statements to us for audit.

accounting and financial management system, and has not established the necessary discipline for promptly recording and classifying transactions.

Accounts Receivable - Accounting for worldwide accounts receivable is not included in the general ledger of USAID, lacks coordination and integration of various systems. lacks adequate policy and procedural guidance and is not part of an integrated accounting and financial management system.

Financial Management Procedures - USAID's accounting and financial management systems lack sufficient formal policies and procedures.

Direct Loan Program - **The** Loan Management Division lacks an integrated accounting and financial management system. This deficiency exists because the New Management System has not worked as intended. As a result, unreconciled differences of $133 million continue to exist between the general ledger and the subsidiary ledger.

In attempting to audit USAID's financial statements for fiscal year 1997, we identified additional material weaknesses. The additional weaknesses include -the following (our report on internal controls discusses these and other material weaknesses in detail):

Reviewing Obligated and Unobligated Balances - USAID/Washington did not review the validity of its obligated and unobligated balances for appropriations as of September 30, 1997,[4] contrary to the requirements of the Department of Treasury for fund control.

Processing Letters of Credit - The Office of Financial Management's practices for recording and reporting advances disbursed through Letters of Credit-about $1.69 billion in fiscal year 1997—are inadequate.

Accruing Expenditures for Advances and Prepayments - USAID's account balances for advances and prepayments may be overstated and operating expenses may be understated by at least $68 million because of USAID's accrual methodology.

As a result of the material weaknesses in USAID's internal controls during fiscal year 1997 and the consequential risk of material misstatements in its financial statements, the amount of substantive testing required to express an opinion on the presentation of the financial statements would have been prohibitive and unattainable by the statutory deadline of March 1, 1998, for submitting the financial statements to the Office of Management and Budget.

[4] Per USAID's "Year-end Closing Statement" for fiscal year 1997, USAID reported $8.1 billion in obligations.

Financial information

The lack of complete, reliable, timely and consistent financial information impaired us from performing necessary procedures.

Although interim financial statements were prepared for each credit program-representing 39 percent of USAID's total assets-by the Loan Management Division, deficiencies in the core accounting system prevented the Office of Financial Management from preparing agency-wide interim financial statements as requested to consolidate all agency activities and accounts during fiscal year 1997 for us to perform necessary interim audit tests.

These deficiencies further impaired the scope of our work when the Office of Financial Management was unable to produce timely year-end financial statements. According to government-wide milestones, agencies should have submitted draft financial statements to the auditors between December 15 and December 3 1, 1997. However, the Office of Financial Management did not provide us a first draft of the year-end financial statements until February 2, 1998, which was 34 days late.

The Office of Financial Management's inability to meet these milestones impaired our ability to plan and perform sufficient audit testing. Therefore, we lack sufficient evidence to express an opinion on whether the financial statements are presented fairly.

Plan to Compile Financial Statements

The Office of Financial Management did not prepare and provide a comprehensive plan for compiling the consolidated financial statements to ensure that the statements would be complete, reliable, timely, and consistent. According to a senior official in that Office, the plan was not developed because of other priorities involving the failure of the new core accounting system to work as intended. The Office had not developed a contingency plan for the difficulties experienced in implementing the new system.

Since the Office of Financial Management did not prepare and provide a plan, we could not assess the methodology intended for compiling the financial statements for fiscal year 1997. The commencement of the new core accounting system for fiscal year 1997 significantly changed the accounting processes used during fiscal year 1996. Therefore, a formal financial statement plan was imperative for us to adequately plan the nature, timing, and extent of audit testing. However, when questioned, Office of Financial Management officials repeatedly said that they did not know how the financial statements would be prepared and could not provide assurance that all financial transactions would be captured.

Delays in Providing Timely
Access to Documents

USAID's Office of Financial Management did not timely provide its methodology for making accruals, which impaired the performance and timing of our audit testing. In the fiscal year 1997 financial statements, the line items for accounts payable for Intragovernmental and Governmental accounts amounted to over $192 million and $1.7 billion, respectively. We considered these to be material line items in the financial statements. For fiscal year 1997, despite repeated requests, Office of Financial Management officials did not provide the methodology to be used to estimate accruals. Further, even after that Office had used the accrual methodology in preparing the financial statements, the methodology was not provided to us until February 2, 1998, 18 days after the government-wide date for providing audit adjustments.

Given the materiality of the line items for accounts payable, the late submission of the accrual methodology constitutes a serious scope impairment.

* * * * *

As described in the preceding paragraphs, the scope of our work was impaired to such an extent that we disclaim (are unable to express and do not express) an opinion on the accompanying financial statements and their related footnotes.

Finally, with respect to the "USAID Financial Report Overview" section of the accompanying financial statements, our objective was not to provide an opinion on this information, but to determine whether (1) the information is materially consistent with the information in the principal financial statements, and (2) assess the adequacy of the system for measuring and reporting performance.

We did not accomplish this objective because USAID officials did not provide us with a complete overview and supplemental financial management information until February 2, 1998. Therefore, we were unable to determine whether (1) the information and manner of presentation was materially inconsistent with the information in the principal financial statements, and (2) this section contains reliable and complete results on program performance.

Everett B. Orr

Office of Inspector General
March 2, 1998

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USAID INSPECTOR GENERAL'S REPORT ON INTERNAL CONTROLS

We attempted to audit the accompanying financial statements of USAID as of September 30, 1997. However, our report on these statements disclaims an opinion on whether they are presented fairly because the scope of our work was impaired.

In planning and performing our work to report on these financial statements, we obtained an understanding of the internal control structure. In this regard, we:

- obtained an understanding of the design of relevant policies and procedures,
- determined whether they have been placed in operation, and
- assessed control risk.

We obtained this understanding of the internal control structure to determine our auditing procedures for reporting on the financial statements, not to express an opinion on the internal control structure. Accordingly, we do not express an opinion on this structure.

Nevertheless, we noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions.[5] This report identifies these conditions and provides recommendations for correcting them.

Background on Internal Controls

Under the Accounting and Auditing Act of 1950, the Federal Managers' Financial Integrity Act of 1982 and implementing policies established by the Office of Management and Budget, USAID's management is responsible for establishing and maintaining effective systems of internal control. To fulfill this responsibility, management must make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The General Accounting Office has issued Standards for Internal Controls in the

[5]We noted other matters involving the internal control structure and its operation that we will report to the management of USAID in a separate letter.

Federal Government that executive agencies must follow in establishing and maintaining an effective internal control structure as required by the laws and executive branch policies.

The objectives of an internal control structure. according to the Office of Management and Budget's Bulletin No. 93-06, are to provide management with reasonable-but not absolute-assurance that:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets:

- funds, property and other assets are safeguarded against waste, loss, unauthorized use, or disposition;

- transactions, including those related to obligations and costs, are executed in compliance with (1) laws and regulations that could have a direct and material effect on the financial statements, and (2) any other significant laws and regulations for which compliance can be objectively measured and evaluated; and

- data that support reported performance measures are properly recorded and accounted for to permit the preparation of reliable and complete performance information.

Because of inherent limitations in any internal control structure, errors or irregularities may still occur and not be detected. Also, predicting whether the internal controls will be effective in the future is risky because changes in conditions may require additional controls or because the effectiveness of the design and operation of policies and procedures may deteriorate.

Scope of Our Consideration of USAID's Internal Controls

We obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation to meet the objectives of an internal control structure noted above. We also assessed control risk.

For the purpose of this report, we have classified USAID's significant internal control policies and procedures into the following categories:

Department of Treasury Reporting - This category consists of the policies and procedures associated with the receipt of annual apportionments, the distribution of funds to allowance holders, the commitment and obligation during spending actions, and the issuance of budgetary reports to the Office of Management and Budget and the Department of the Treasury.

Accounts Receivable - This category consists of the policies and procedures associated with establishing, recording, collecting. and maintaining records of miscellaneous receipts.

Credit Programs Receivable - This category consists of the policies and procedures associated with establishing, recording, collecting, and maintaining records of loans disbursed and the repayment of those loans.

Fixed Assets - This category consists of the polices and procedures associated with the receipt, storage, record keeping, and inventories of nonexpendable assets.

Grants Disbursements/Accounts Payable - This category consists of the policies and procedures associated with identifying, assembling, classifying, and recording transactions to report the grant operating/program expenditures, unliquidated obligations, and accrued expenditures. The amount of accrued expenditures establishes the accounts payable balance at year end.

Payroll - This category consists of the policies and procedures associated with the accounting of payroll costs as they are processed through payroll systems.

Financial Reporting - This category consists of the policies and procedures associated with the culmination of the previous internal control cycles after financial transactions have been summarized and posted to the general ledger.

Compliance with Laws and Regulations - This category consists of the policies and procedures associated with ensuring compliance with laws and regulations for transactions and events that may have a material effect on the financial statements, including the requirements of the Federal Financial Management Improvement Act of 1996.

Performance Measuring - This category consists of the policies and procedures associated with ensuring that data which support reported measures of program performance are properly recorded and accounted for to permit the preparation of reliable and complete information on program performance.

Performance Reporting - This category consists of the policies and procedures associated with ensuring that the information on program performance and manner of its presentation in the overview section are materially consistent with the information in the principal financial statements.

We do not express an opinion on the internal control structure because the purpose of our work was to determine our auditing procedures for reporting on the financial statements, not to express an opinion on this structure. We assessed control risk and performed limited tests of the internal control structure. In assessing risks, we considered reports that USAID management had issued under the Federal Managers' Financial lntegrity Act of 1982, a 1994 Auditability Self-Assessment made by USAID, as well as our prior and current audit efforts on financial and internal control matters.

We also do not express an opinion on the performance measures identified in the "USAID Financial Report Overview" section of the accompanying financial statements. The expression of such ah opinion was also not the purpose of our work. Although the Office of Management and Budget requires certain limited work on this performance information, scope impairments prevented us from determining whether USAID staff recorded proper support for the performance measures to account for and to permit the preparation of reliable and complete reports on program performance.

Even though our work was limited as discussed above, we noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and the Office of Management and Budget's Bulletin No. 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect USAID management's ability to have reasonable assurance that the control. objectives noted above are met.

Some of the reportable conditions are also material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties. Our work would not necessarily disclose all material weaknesses in the internal control structure.

The following section presents our findings and recommendations for those matters that we consider to be reportable conditions and material weaknesses.

USAID's Accounting and Financial Management Systems Contain Material Weaknesses

Material weaknesses in USAID's accounting and financial management systems have significantly impaired USAID management's ability to have reasonable assurance over the completeness, reliability, timeliness, and consistency of financial information. The lack of reasonable assurance over the quality of information impairs USAID management from: (1) implementing more effective financial management practices; (2) promoting high-level decision-making; and (3) deterring fraud, waste and abuse.

The Office of Management and Budget's Circular No. A-127 (Revised July 23,1993), requires that a single, integrated financial management system be designed to provide effective and efficient interrelationships between software, hardware, personnel, procedures, controls. and data contained within the systems. According to the Circular, a financial system supports the financial functions required to track financial events, and provides financial information significant to the financial management of the agency and required for the preparation of financial statements. A financial system is an information system, comprised of one or more applications, that is used for any of the following: (1) collecting, processing, maintaining, transmitting, and reporting data about financial events; (2) supporting financial planning and budgeting activities: (3) accumulating and reporting cost information; or (4) supporting the preparation of financial statements.

Prior audits and USAID management assessments identified material weaknesses in USAID's controls, including weaknesses pertaining to the primary accounting system, data reconciliations, accounts receivable, financial management procedures, and the Direct Loan Program (Appendix III and Appendix IV discuss the previously identified and reported weaknesses in detail). Because USAID management, responding to previous audit reports, is improving its process for managing information resources, is analyzing alternative accounting systems, and is preparing a realistic plan to implement a compliant integrated accounting and financial management system, we do not make further recommendations to implement effective systems. However, we do make recommendations to implement interim measures to mitigate the material weaknesses.

USAID management expected these material weaknesses to be corrected by the deployment of a 'new integrated accounting and financial management system-the New Management System-which was designed to replace aging and ineffective computer systems that USAID staff used to perform accounting, budgeting, procurement, and operational functions.

USAID management deployed the New Management System worldwide at the beginning of fiscal year 1997. At that time, the core accounting system called the AID Worldwide Accounting and Control System became USAID's primary accounting system. However, the new system did not work as intended. Consequently, the previously identified weaknesses have not yet been corrected, and USAID management identified additional weaknesses in its fiscal year 1997 report under the Federal Managers' Financial Integrity Act of 1982 (Integrity Act).

USAID management properly reported these material and other weaknesses with plans for corrective action in its most recent report under the Integrity Act. Appendix III summarizes the material weaknesses and planned corrective actions identified in the most recent report.

In addition to the material weaknesses reported by USAID's management, we have identified additional weaknesses. These weaknesses are (1) reviews of obligated and unobligated balances, (2) Letter of Credit disbursements, (3) Letter of Credit financial status reports, (4) accrued expenditures for advances and prepayments, (5) reports to regulatory agencies, (6) preparation of program performance measures, (7) integrated management system for reporting program results and related funding, and (8) annual reports on program results. The following sections discuss these weaknesses.

Reviews of Obligated and Unobligated Balances

USAID/Washington did not review obligated and unobligated balances as part of certifying the account balances of appropriations in fiscal year 1997. The Office of Financial Management did not establish procedures for conducting this review in Washington to ensure the validity of recorded obligations in the new core accounting system. As a result. USAID potentially over-obligated its appropriations (See "USAID Inspector General's Report on Compliance"). Further, the Office of Financial Management did not have a reasonable basis to certify that the obligations were proper and that the amount of unobligated balances or expenditures incurred were proper.

The Supplemental Appropriations Act of 1955 (Title 31 of the United States Code, Section 1501) provides that no amount shall be recorded as an obligation unless it meets specified criteria. Further, statements of obligations furnished to the Congress or to any of its committees shall include only amounts representing valid obligations. Title 31 of the United States Code, Section 1108(c) requires that agency heads support their appropriations request with a certification of the obligated balances. According to Treasury Financial Manual, Section 2- 1000, "Regulations Governing Reporting of Information Relating to Year-End Status and Closing of Appropriation and Fund Accounts:"

> The primary responsibility for reviewing the status of its accounts rests with the agency managing the appropriation or fund. Each agency, in order to properly certify obligated and unobligated balances...must verify its own accounts at least once a year...Accordingly, agency management should be aware that they are certifying that obligations are proper and that the amount of obligations or expenditures incurred is proper.

USAID/Washington did not review the obligated and unobligated balances as part of certifying the account balances of appropriations for fiscal year 1997. Prior to fiscal year 1997, the Office of Financial Management was responsible for recording all obligations and deobligations into the accounting system. However, the deployment of the New Management System required USAID management to re-engineer its processes for recording obligations and deobligations. Consequently, the Office of Procurement and other USAID/Washington offices were assigned the responsibility of recording obligations and deobligations in the new accounting system. Because of this change, the Office of Financial Management did not have the required documentation to conduct the reviews of fiscal year 1997 obligations and deobligations to ensure that the appropriations balances were valid. Therefore, the Office of

Financial Management needed to perform the role collaboratively with other USAID/Washington offices that recorded obligations and deobligations.

Office of Financial Management officials informed us that the lack of this review would cause problems during the preparation of the Year-End Closing Statement. Further, they said that this material weakness should be addressed by USAID's Management Control Review Committee.

In November 1997, the Office of Financial Management certified that the obligation balances for fiscal year ending September 30, 1997:

> . ..in each appropriation account of the agency reflect proper existing obligations and that the expenditures from the account since the preceding review were supported by a proper obligation of funds and otherwise meet the criteria of 31 U.S.C. 1501(A).

Since USAID/Washington did not review the obligated and unobligated balances for fiscal year 1997, the Office of Financial Management did not have a reasonable basis on which to certify that the obligations were proper and that the amount of unobligated balances or expenditures incurred were proper. Also, as a result of not making the review, USAID potentially over-obligated its appropriations (See "USAID Inspector General's Report on Compliance").

<u>Recommendation No. 1</u>: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer ensure that the account balances for appropriations are reviewed for validity at least annually to properly certify obligated and unobligated balances pursuant to Title 31 of the United States Code, Section 1108(c).

<u>Management Comments and Our Evaluation</u>

USAID's management agreed with this recommendation, but did not fully concur with the finding. Corrective action will be to reinstitute the necessary reviews and certifications in fiscal year 1998. Regarding USAID management's exceptions to the finding, USAID management said that the Office of the General Counsel has determined that USAID has not violated the legal requirements of the statute.

USAID management's action plan is responsive to this recommendation. We concur with the Management Decision reached. With respect to potential noncompliance, we will reassess our position upon receipt of the determination of General Counsel.

Letter of Credit
Disbursements

USAID's financial management staff do not properly match disbursements with the obligating documents at the time of the transactions. USAID's procedures for making disbursements also do not require recipient organizations to identify the appropriate obligation. As a result. USAID management did not have sufficient assurance that all disbursements made-about $1.69 billion in fiscal year 1997—were authorized, proper and correct, and that all disbursements were accurately recorded and reported.

Title 7, Appendix III, Chapter 6 (Disbursements), of the General Accounting Office's Policy and Procedures Manual for Guidance of Federal Agencies, dated May 1993, states:

> The disbursements shall be supported by basic payment documents, in the form of hard copy or machine readable source records, including purchase orders, contracts, receiving reports, invoices, bills, statements of accounts, etc., showing sufficient information to adequately account for the disbursements. The documentation should link all supporting records and enable audit of the transactions and settlement with the certifying or disbursing officers as required by law. ·

Further, General Accounting Office, Standards for Internal Controls In the Federal Government, dated 1983, requires that transactions be promptly recorded and classified.

USAID staff made disbursements to recipients at the organization level based on funds availability, and may have made disbursements for obligations that had not been recorded. We identified 13 Letter of Credit Financial Status Reports totaling $3.4 million that were not registered in the accounting system because the obligation had not been recorded. Because the accounting system does not facilitate tracing disbursements through liquidation, it is unclear whether the obligations had been exceeded.

Office of Financial Management officials said that the Letter of Credit Support System does not allow drawdown requests to be approved for more than the available balance in the Letter of Credit. They further said that the requirement to link the disbursement to the obligating document "was all new information".

Without linking the document, however, nothing prevents a drawdown from exceeding the obligation at the grant level. According to a representative of the General Accounting Office, this problem with Letters of Credit is a government-wide problem that the CFO Council is working on.

As a result, USAID management did not have reasonable assurance that all disbursements were authorized, proper, and correct, and that all disbursements were accurately recorded and reported.

Since this problem is a government-wide issue, we are not making a recommendation at this time.

Management Comments and Our Evaluation

USAID management agrees that Federal requirements require the proper matching of disbursements to valid obligations and associated obligating documents. However, management does not believe that disbursements need to be matched to a specific obligation at the time of drawdown.

Management responded that the findings inappropriately apply federal requirements for properly matching disbursements to obligations against USAID's practice of advancing fund against a higher level, a letter of credit. To explain this position, USAID cited other agencies that are using the pooling method to make Letter of Credit disbursements.

A representative from the General Accounting Office confirmed that some other agencies are using the pooling method to make disbursements and informed us that this is a problem government-wide and that the CFO Council is addressing this issue. We, therefore, are not recommending any additional management action at this time.

Letter of Credit Financial Status Reports

USAID's account balances for governmental advances and prepayments may be materially overstated, and the balances for operating expenses may be materially understated. These unreliable balances occurred because the Office of Financial Management did not track all Letter of Credit Financial Status Reports to ensure that they are recorded. As a result, USAID management does not have reasonable assurance that the financial statements are complete, reliable, and consistent.

The Cash Management and Payments Division identified a universe of 86 Letter of Credit Financial Status Reports totaling over $26 million that had not been recorded! However, we determined that at least 530 reports, totaling over $264 million,' also had not been fully recorded. All of these reports required an adjustment to prevent the line items for

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[6]The recording of these reports by financial management staff is done in three stages. The first stage is report registration, which has **no accounting impact. The second and third stages are report approval and certification,** respectively. **Both of these stages have an accounting impact.**

'The 530 **consists** of 13 reports totaling over $3.4 million that had not been registered, approved or certified; 465 reports totaling over $232 million had been registered, but not approved and certified; and 52 reports totaling over $29 million had been registered and approved, but not certified.

governmental advances and prepayments from being overstated and operating expenses from being understated. According to officials in the Office of Financial Management, the adjustments were made subsequent to our review. However, because of the uncertainties about the completeness of the universe made available to us, we are not sure of the absolute impact on the financial statements.

The Cash Management and Payments Division could not readily identify the unrecorded reports because it needed to implement a formal tracking system. Office of Financial Management officials said that the recording of the reports was delayed because USAID management decided in March 1997 to use the New Management System for Letter of Credit Agreements. However, the data processed for the first half of the year could not be recorded in the new system. As a result, the Letter of Credit team spent the second half of the year manually posting the data processed during the first half of the fiscal year and current transactions.

USAID management is looking into the possibility of a cross-servicing arrangements for the servicing of grants financed under the Letter of Credit method.

Recommendation No. 2: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer implement a tracking system for Letter of Credit Financial Status Reports and ensure that all transactions are promptly recorded.

Management Comments and Our Evaluation

USAID's management agreed with this recommendation. According to USAID's management, corrective action has been taken to implement an informal tracking system as a temporary solution until the Letter of Credit Support System can be replaced with a system that provides for the recommended tracking capability.

USAID management's action plan is responsive to this recommendation. We concur with the Management Decision reached.

Accrued Expenditures for Advances and Prepayments

USAID's account balances for advances and prepayments may be materially overstated and the related expenditures may be materially understated by at least $68 million because the Office of Financial Management did not properly accrue expenditures in accordance with applicable Federal accounting principles.

The Statement of Federal Financial Accounting Standard **No.** 1, which became effective in Fiscal Year 1994. states:

> Advances and Prepayments are reduced when goods or services are received...Advances should be initially recorded as an asset and should be subsequently reduced when expenses are actually incurred.

Office of Financial Management officials said that the Cash Management and Payments Division had not been tasked or aware of the responsibility to adjust these accounts. We are currently assisting the Cash Management and Payments Division with identifying and establishing a methodology for accruing expenditures and adjusting advances and prepayments processed through the Letter of Credit Support System until a compliant integrated accounting and financial management system is established.

As a result of not adjusting the accounts, the financial statements may not be complete, reliable, and consistent. The Office of Financial Management needs to develop and implement a methodology to appropriately estimate the amount of expenditures against outstanding advances and prepayments.

> **Recommendation No. 3: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer develop and implement a methodology to accrue expenditures and adjust outstanding advances and prepayments to ensure that the financial statements are not materially overstated.**

Management Comments and Our Evaluation

USAID's management did not agree with this recommendation. In explaining its disagreement with this finding and recommendation, USAID management's response appeared to indicate some confusion between Letter of Credit disbursements (previously discussed) and this finding—accruing expenditures based on goods and services received. We plan to seek clarification of USAID management's position during our audit follow-up process.

Reports To Regulatory Agencies

The Office of Financial Management inconsistently reported unobligated balances to Federal regulatory agencies and did not file quarterly reports on its budget execution. The staff attributed these problems to human error. Further, the Office did not conduct second party reviews or perform management oversight prior to submitting the reports. As a result, USAID's reports to the regulatory agencies contained errors totalling an absolute difference of over $143 million.

Federal regulations and executive branch policy require Federal agencies to prepare consistent and reliable reports as follows:

- General Accounting Office, Title 2, Chapter 3 - Financial Reporting, requires that "both internal and external reports should be prepared from the same source data (the underlying accounting records or data base) and should be in agreement."

- Department of Treasury regulations-Vol. 1 - Part 2 - Chapter 4200 (TL557)—requires coordination to ensure consistency between reports to Department of Treasury, Office of Management and Budget, and reports published by the agency.

- Office of Management and Budget Circular No. A-34 requires that "data submitted for each independent agency, departmental bureau, or similar subdivision will be approved by an officer duly authorized by the head of the agency to be responsible for the integrity of the submission." This Circular also calls for agencies to prepare reliable financial reports.

The Office of Financial Management reported unobligated balances to the Department of Treasury which were inconsistent with the unobligated balances reported to the Office of Management and Budget for the same balances. This inconsistent reporting occurred on the Report on Budget Execution* and the Year-End Closing Statement.[9]

Office of Financial Management personnel stated that the figures for the Report on Budget Execution were taken from the Year-End Closing Statement. However, when we compared the unobligated balance shown in the respective reports, we identified an absolute difference totalling over $143 million. Furthermore, comparability between critical internal financial reports and records and filings with regulatory agencies is nearly non-existent.

The Department of Treasury furnishes the Office of Management and Budget data prepared from agency reports for comparison to agency budget reports. Personnel from the Office of Management and Budget told us that they were concerned about the materiality of the differences between USAID's filings with Department of Treasury and the Office of Management and Budget.

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[8]The Office of Management and Budget's Standard Form 133," Report on Budget Execution," reports budgetary resources, status of budgetary resources, and relation of obligations to outlays.

[9]The Financial Management Service's 2108,"Year-End Closing Statement" is a reconciliation tool used by an agency and the Department of Treasury to track amounts available under the various agency appropriations at the end of the fiscal year.

Personnel from the Office of Financial Management attributed the inconsistencies in reporting to human error. The Office had not implemented the necessary internal controls to detect these errors. Specifically, the Office of Financial Management did not conduct second party reviews or perform management oversight prior to submitting the reports.

<u>Recommendation No. 4</u>: We recommend that the Chief Financial Officer require that figures be adequately supported by the general ledger before transmission to the regulatory agencies.

Management Comments and Our Evaluation

USAID management agreed with the finding and recommendation. Management stated that the Office of Financial Management is currently reviewing the differences in the unobligated balances reported to the Department of Treasury and those reported to the Office of Management and Budget. Management further added that the Office of Financial Management is pursuing additional human resources for greater attention to presentation of the financial statements of the Agency. The Office of Financial Management expects that by strengthening the general ledger team, it will be empowered to perform effectively and with sufficient ability to inject peer review of all work leaving the office. Management further stated that general guidance will be issued with the Office of Financial Management requiring peer review of all work intended for distribution outside of USAID.

USAID management's action plan is responsive to this recommendation. We concur with the Management Decision reached.

Preparation of Program Performance Measures

USAID and its operating units did not follow USAID policies and procedures for establishing performance measures and performance monitoring systems because (1) the operating units did not fully understand the policies and procedures, (2) operating units had not yet instituted procedures to validate data reported by their partners (e.g,. private voluntary organizations or host governments), and (3) USAID was still developing common indicators. To facilitate the use of better indicators by operating units and to facilitate USAID's ability to aggregate program results, USAID needs to complete its efforts to establish a common set of indicators.

USAID's internal control guidance (TIPS No. 6) states:

> Performance indicators are at the heart of a performance monitoring system-they define the data to be collected to measure progress and enable actual results achieved over time to be compared with planned results. Thus,

they are an indispensable management tool for making performance-based decisions about program strategies and activities.

USAID's policies and procedures (Automated Directive System Section E203.5.5) require USAID and its operating units to establish systems for monitoring performance which meet USAID standards for developing performance indicators and baseline data, managing and documenting the process for data collection, and ensuring the quality of performance data. USAID and its operating units shall define performance indicators for which quality data are available at intervals consistent with management needs and that are direct, objective, practical and unidimensional. Quantitative performance indicators are preferred and shall be used in most cases. If qualitative indicators are used, they must be defined to permit regular. systematic and relatively objective judgement regarding change in the value or status of the indicator.

USAID's policies and procedures require that data quality be assessed as part of the process of establishing performance indicators and choosing sources and methods for collecting data. Also, to the extent possible, comparable data for all strategic objectives that encompass more than one country shall be collected and reviewed regularly. The operating units' Strategic Plans are to include the performance indicators, targets and, to the extent possible, baseline data. The "Results Review and Resources Request Reports" (Results Reports) are to report annually the progress toward achieving the anticipated program results. The policies and procedures further state that USAID needs to ensure that information on performance and results are used in decision-making for USAID's resource allocation.

During the past year, we audited 11[10] of the approximately 95 USAID operating units and found that they generally did not prepare their Strategic Plans and Results Reports in accordance with established policies and procedures. For example:

> Nine operating units had indicators that were frequently not direct, objective, practical, and unidimensional.[11] For example, the audit of USAID/Ecuador disclosed that six indicators were not precisely defined and explicit enough to measure performance and success in an objectively verifiable manner. For the qualitative indicator, "Biodiversity research utilized", the unit of measure consists of design, dissemination, and utilization. However, the indicator lacks clarity in the meaning of dissemination and utilization, and how the change in the value of these units is to be measured.

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[10] Audits were conducted in Ecuador, Egypt, Kazakstan, Morocco, Namibia, Romania, Russia, Senegal, South Africa, Uganda, and the Ukraine. These 11 missions were selected based on their relatively large development programs in the selected activities (*i.e.* civil society, natural resources management, and biodiversity).

"Means to measure the results of one activity at a time.

Ten operating units had not developed or had not finalized a formal, ongoing system of collecting and verifying data to report accurate and reliable performance data. For example. the audit of USAID/Uganda showed that it did not have a formal, ongoing system of data collection, aggregation and verification to ensure the quality and accuracy of the information. In most cases, data was collected on an "as needed" basis rather than through a formal and well-defined reporting system. Moreover, a system of quality control that includes verification of the appropriateness and accuracy of the data was not in place. In testing 4 of the 12 performance indicators, differences existed between the reported and audited data in all 4 cases.

The above problems occurred for several reasons. Staffs at several operating units mentioned that they did not fully understand the established policies and procedures for developing performance indicators along with the related baseline data and targets. Regarding the problems with data collection and verification, two reasons were that (1) the operating units did not fully understand the established policies and procedures and (2) the operating units had not yet instituted procedures to validate data reported by their partners (e.g,. private voluntary organizations or host governments).

Problems have also been noted by the Office of Management and Budget. In our September 1997 status report on USAID's progress in implementing the Government Performance and Results Act of 1993 (Results Act),[12] we noted that the Office of Management and Budget had identified two principal areas needing attention-attribution and aggregation. Attribution is the extent to which USAID's programs caused specific outcomes. Aggregation involves the consolidation of individual operating unit results into agency-wide results. This requires standardization of performance measures and indicators at some level. The report also noted that USAID was still developing common indicators and expected to finalize these indicators by November 1997. However, these indicators had still not been finalized and standardized for use by operating units as of the end of December 1997.

The September 1997 status report included a recommendation that the Acting Assistant Administrator of the Bureau for Policy and Program Coordination develop a detailed work plan, including tasks, responsible offices/individuals and time lines, on how the Bureau will oversee the implementation of the Results Act. The Acting Assistant Administrator took no exception to the findings and stated that the recommendation was reasonable. However, the plan had still not been developed as of the end of December 1997 and the recommendation remains open.

[12] Audit Report No. 9-000-97-003-P, dated September 30, 1997, Audit of USAID's Status in Implementing the Government Performance Act of 1993.

We identified problems with USAID's development of common indicators in a June 1995 audit report.[13] The recommendation in that report to develop plans and time frames for establishing and monitoring a set of common indicators for USAID strategic goals (and objectives) was closed by the Bureau of Management based on USAID's assertion that the common indicators would be developed by November 1997. However, as discussed above, the common indicators and monitoring system have not yet been established or implemented as of the end of December 1997.

The recommendations in the two status reports, when fully implemented, will help resolve some of the problems impairing USAID's ability to measure and report on program performance. However, to facilitate the use of better indicators by operating units and USAID's ability to aggregate program results, USAID needs to complete its efforts to establish a common set of indicators.

Recommendation No. 5: We recommend that the Assistant Administrator/Bureau for Policy and Program Coordination establish a common set of indicators for use by operating units to measure progress in achieving USAID's strategic goals and objectives and that allow for the aggregation of program results reported by operating units.

Management Comments and Our Evaluation

USAID's management strongly disagreed with this finding and recommendation. Management stated that they have implemented consistent procedures and "standard" indicators for assessing the performance of every one of USAID's operational objectives in terms of whether it is exceeding, meeting, or falling short of its performance targets. Management agreed that the quality of performance data and documentation needs improvement, although management believed that very substantial progress has already been made.

Regarding the issue of common indicators, USAID's management disagreed that USAID's performance measurement requirements can be met by developing and imposing a new set of "common" indicators on USAID's operational programs. Management stated that the Office of Management and Budget and the U.S. General Accounting Office have both expressed support for USAID's approach to attribution of development results to USAID interventions by demonstrating plausible association through analysis, rather than by directly aggregating (rolling up) lower level indicators into higher level results. Management also believed that imposing common annual performance measures at the operational level would result either in

[13] Audit Report No. 1-000-95-006, dated June 30, 1995, Audit on USAID's Systems for Measuring Program Results.

inappropriate program designs or would require the development of a whole new system of indicators (likely costing tens of millions of dollars, if feasible at all) to uniformly track very specific program outputs. Management further believed that our recommendation for common indicators is both unrealistic and inappropriate.

USAID management stated that while "common" indicators may be useful and are already being used for some USAID activities (particularly in areas such as population, health. and education), in most program areas USAID's development assistance programs encompass a diverse range of approaches for achieving relatively high-level results. In programs concerned with democracy and governance, for example, there are a wide variety of approaches to strengthening civil society (for which USAID management contends it has a standard measure) and a wide range of shorter term results that reflect these different approaches (for which USAID management contends it has a variety of measures).

We do not agree with management's position. As discussed in this audit report, our audits over the past year identified that 9 of the 11 operating units audited during the past year had indicators that were frequently not direct, objective, practical, and unidimensional (as prescribed by USAID's policies and procedures).

Regarding "common" indicators, we do not understand USAID's strong disagreement with the recommendation. A draft USAID General Notice (dated January 21, 1998) states that some USAID working groups have reached consensus and have transmitted a core set of recommended "common indicators" to field missions and other groups are engaged in vigorous field testing programs for their indicators. The draft also states that USAID intends to produce a manual with a menu of "common indicators" to assist democracy officers in monitoring and tracking the performance of democracy and governance activities around the world. Also, USAID's draft Annual Performance Plan (as of November 6, 1997) states:

> "A comprehensive system of scoring of SOs [Strategic Objectives] was put into effect in 1997. In 1998 it is planned to refine the system by associating all operating unit strategic objectives with agency common indicators to enhance cross-bureau comparability."

In addition, we do not agree that, as implied by management's comments, that both U.S. General Accounting Office and the Office of Management and Budget have expressed support that common indicators are not required. As discussed in this audit report, a September 1997 audit report by our office identified that the Office of Management and Budget identified that two areas needing attention-attribution and aggregation. Aggregation involves the consolidation of individual operating units results into agency-wide results. As noted in that audit report, USAID was still developing common indicators and expected to finalize these indicators by November 1997. Furthermore, a U.S. General Accounting Report (GAO/NSIAD-97-194; dated September 12, 1997) stated:

"USAID is developing common indicators that missions will use to consistently measure progress in key areas worldwide. These measures are intended to help the agency aggregate the results of its various missions' programs to show progress in achieving overall agency goals. However, the use of common indicators will not resolve USAID's difficulty in attributing gains to its programs at the country level."

We agree with the General Accounting Office that the use of common indicators will not resolve the problem of attribution. However, that does not mean that common indicators are not needed for aggregation. As identified in this audit report the September 1997 audit report identified that attribution is the extent to which USAID's program caused specific outcomes. Aggregation involves the consolidation of individual operating unit results into agency-wide results. Thus, these are two different things.

USAID's comments were not responsive to the findings presented in this audit report or its reported status in developing common indicators (as identified in its draft Annual Performance Plan and draft General Notice referred to above).

Integrated Management System for Reporting Program Results and Related Funding

USAID has not yet developed and maintained an integrated system for reporting program results and related funding. The lack of a compliant integrated accounting and financial management system inhibits USAID's ability to relate (1) obligations and expenditures to USAID's overall strategic goals and objectives, and in support of each operating unit's strategic objective and intermediate results; and (2) program results to budget components included in its financial statements. This in turn impairs USAID's ability to manage for results and to report results in relation to funding.

Federal laws and executive branch policies require agencies to develop and maintain integrated systems for reporting program results and related funding. Examples of these laws and regulations include:

- Office of Management and Budget Circular No. A-127 (Revised), Financial Management Systems, states that ". ..each agency shall establish and maintain a single, integrated financial management system...[and] the agency financial management system shall be able to provide financial information in a timely and useful fashion."

- The Chief Financial Officers Act of 1990 (section 902.[a][3][D][iv]) states: "An agency CFO shall develop and maintain an integrated agency accounting management system which provides for systematic measurement of performance."

- Office of Management and Budget Bulletin No. 93-02 states: "Whenever possible financial data should be related to other measures of performance on a program-by-program basis. The inclusion of performance measures will facilitate using the financial statement to assess both financial and program performance."

USAID has not yet met the above requirements. USAID in its Federal Managers' Financial Integrity Act (Integrity Act) report for fiscal year 1997 identified the lack of an effective, integrated financial management system as a material weakness. The report stated that the system does not meet some important financial management system requirements, such as being capable of producing all required financial reports and other management information at an acceptable level of timeliness and accuracy. However, the report did not specifically identify issues related to performance measures as material weaknesses.

Although the Integrity Act report mentioned that the program operations component of the New Management System is currently operational, USAID officials said that performance data had not yet been recorded in the system. Furthermore, USAID's Center for Development Information and Evaluation maintains its own database of performance indicators, but it is not an official performance measurement database and is not complete. USAID officials said the official records for performance measures are the hard copies of the Results Reports.

We identified similar problems with USAID's ability to identify funding in support of its strategic objectives in a June 1995 audit report (previously mentioned). That report recommended that the Deputy Administrator develop plans and time frames for USAID's financial accounting systems to permit tracking of obligations and expenditures according to USAID's overall strategic goals and in support of each mission's and other operating unit's strategic objective and program outcomes.

This recommendation was closed by the Bureau for Management in April 1997 on the assertion that, "One of the features of USAID's New Management System is the linkage between Agency goals/obligations and primary purpose coding. This relationship exists at both the obligation and expenditure stages. This system is already designed and programmed to accomplish this [recommended] tracking."

However, as discussed above, USAID has not yet implemented an integrated system to meet the above requirements. Therefore, action needs to be taken to complete development and implementation of the required system.

<u>Recommendation No. 6:</u> We recommend that the Chief Financial Officer develop plans and time frames for USAID's accounting and financial management system to permit tracking of obligations and expenditures according to USAID's overall strategic goals and objectives and in support of each operating unit's strategic objective and intermediate results.

Management Comments and Our Evaluation

USAID's management agreed with this recommendation and stated that every effort will be

- provide other explanatory information that would help readers understand the significance of the measures and results.

Bulletin No. 94-01 also states that (1) the performance measures presented in the overview should be limited to the most significant financial and program performance measures for the reporting entity and (2) agencies should take care to prepare adequate supporting documentation for the information presented in the overview section and retain such documentation on file in a manner suitable for review and audit.

USAID has not designed and implemented effective policies and procedures to enable it to comply with the Office of Management and Budget's current and future requirements for reporting program results under the Government Management and Reform Act of 1994. We reported in March 1997[14] serious problems with the program results identified in the overview section of USAID's consolidated financial statements and the Annual Performance Report for fiscal year 1996. Neither of these reports provided a clear and concise description of USAID's 1996 accomplishments compared to what was anticipated; but, instead the reports contained mostly information from earlier years. Both reports also reported high-level results that were difficult, if not impossible, to attribute to USAID's activities.

The overview section of USAID's financial statements also did not make a correlation between the program performance measures in the overview and the principal financial statements. For example, the Statement of Operations and Changes in Net Position showed that for USAID appropriations, $2.1 billion were expended under the Economic Support Fund, $1.8 billion were expended under Direct and Guaranteed Loans, and $823.5 million were expended under Assistance for the New Independent States of the Former Soviet Union. However, the overview section did not clearly identify significant performance results achieved with these funds?

In addition to the problems with the integrated management system previously discussed, several other factors caused the above problems. Although the USAID guidance (Department of State Cable 002636; dated January 7, 1997) for the preparation of the Results Reports stated that the Results Reports should include actual performance results for fiscal year 1996, USAID has not emphasized the importance of the reporting and has not ensured that the results reported occurred during that period. Our second survey report[16] recommended that USAID consider changing the submission date of the Results Reports to an earlier date to

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[14] Audit Report No. 9-000-97-002-S, dated March 31, 1997, Second Survey Report on USAID's Implementation of the Government Performance Act of 1993.

[15] Office of Management and Budget Bulletin No. 9346 requires auditors to disclose material inconsistencies among the overview section and the principal statements.

[16] Report No. 9400-97-002-S, dated March 31, 1997, Second Survey Report on USAID's Implementation of the Government Performance Act of 1993.

allow sufficient time to prepare the Annual Performance Report and the Overview of the Reporting Entity section of the consolidated financial statements.

Another reason is that the Chief Financial Officer is not fulfilling all his requirements under the Chief Financial Officers Act of 1990. As mentioned previously, the Chief Financial Officers Act of 1990 requires the Chief Financial Officer to develop and maintain an integrated agency accounting and financial management system which includes financial reporting and internal controls which comply with internal control standards and Office of Management and Budget policies and procedures. The system should also provide for:

- complete, reliable, timely, and consistent information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management; and

- the systematic measurement of performance.

Nevertheless, officials from USAID's Office of Financial Management said that the Chief Financial Officer is only responsible for the financial information included in the financial statements report, not the performance information included in the overview section. Instead, USAID's Office of Financial Management officials believed USAID's Bureau for Policy and Program Coordination (Bureau) was responsible because they relied on the Bureau to collect reliable performance data. Bureau officials, however, said that while the Bureau provides USAID's Office of Financial Management with a draft of USAID Performance Reports, which contains performance information, USAID's Office of Financial Management was responsible for the preparation of the overview section. Furthermore, a Bureau official said that there was nothing in writing stating that the Bureau was responsible for the preparation of the overview section.

The overview section of USAID's financial statements for fiscal years 1996 and 1997 were not provided by the due dates for us to determine whether USAID recorded proper support for the program performance measures to account for and to permit the preparation of reliable and complete reports on program performance. However, subsequent to our report for fiscal year 1996, we reviewed the quantifiable results reported in the program performance section of the overview section as well as seven results classified as re-engineering and found that 29-76 percent-of the 38 results reported were incorrect, vaguely set forth, or unsupported. For example:

> The following program performance result appeared in the fiscal year 1996 overview section: *"In El Salvador, four out of five ex-combatants are fully reinserted into productive civilian life." The* statement was not correct for several reasons. First, the result represented cumulative program results from 1992 to January 1997 and not for fiscal year 1996. Second, the data provided supports a figure of 63 percent, not four out of five (or 80 percent). Finally,

the data provided did not support or define the words "fully," "reinserted," and "productive."

The Mission could not find in its files the documentation which was used to support the numbers included in the following statement: *"A 1995 law in Russia supported by USAID has increased the development of nongovernmental organizations (NGOs), a vital channel for conveying the interests of the public to the government. NGOs now number 40,000, compared to only a handful in 1991."* According to Mission sources, no published reports existed on the number of Nongovernmental organizations in Russia until 1997 and the information was prepared based upon undocumented interviews, e-mails and phone calls at that time. The Mission did provide a report issued in 1997 from an outside source which shows 4,613 nongovernmental organizations registered in 1991 and 40,481 nongovernmental organizations registered through 1995. The 4,613 are not a "handful" and the 40,481 does not relate to the number registered in or active during fiscal year 1996. Furthermore, the reliability of the data in the report is unknown.

USAID officials were unable to provide support for the following results statement: "In less than six months during 1996, the malnutrition rate dropped from 40 percent to below 5 percent in one of the areas surveyed [in Angola]."

USAID stated that it *"Combined administrative costs with other government agencies to achieve $7 million in cost savings over 5 years."* This statement is incorrect since the amount is based on estimated cost savings from fiscal years 1996 through 2000—not what was actually achieved.

USAID stated that it "Reduced project design time by 75 percent." USAID officials could not provide documentation to support this statement. The officials said that the statement may have been based on one Mission's experience as an "experimental lab".

USAID officials acknowledged the need to better support the performance information. For example, one Africa Bureau official stated that it approached the effort more in keeping with a "routine briefer" to leadership than an official performance reporting document of USAID. The information was drafted to inform decision-makers in the Africa Bureau of the status at a particular period in time which would be updated as additional information became available. Therefore, sufficient attention was not given to obtain and retain the required documentation that would have been given if the analysts had known the information would be used for more formal reporting purposes outside the Africa Bureau.

To ensure that complete and reliable data is obtained and reported in the program performance portion of the overview section of the USAID's financial statements and the Annual Performance Report, we recommend the following:

Recommendation No. 7: We recommend that USAID:

7.1 Establish procedures to ensure (1) operating units report results for the year ended September 30 and (2) results reported in the overview section of USAID's financial statements and Annual Performance Report be clearly shown as achievements for that year; and

7.2 Require the Chief Financial Officer to fulfill his responsibility under the Chief Financial Officers' Act for obtaining and reporting complete, and consistent program performance information for the overview section of USAID's financial statements (fiscal year) report.

Management Comments and Our Evaluation (Rec. No. 7.1)

USAID's management strongly disagreed that they need a new policy to impose new results reporting requirements on operating units. They stated that these operating units already report annually on their program results and USAID systematically and consistently assesses the progress of every operating unit objective.

Furthermore, USAID's management stated that they continue to make major improvements in collecting results data for preparation and submission of the Annual Performance Report required under the Government Performance and Results Act and the performance information is also used for the overview section for the financial statements. They acknowledged the need to further improve results gathering and to accumulate that information into the Annual Performance Report and financial statement overview that more effectively presents performance information for the most recent year. They also point out that matching performance and results directly to financial information is not an easy task given that resources expended by USAID in one year produce results that can only be measured over several subsequent financial periods.

Finally, regarding the finding that 29 of the 38 results reported in the overview to the fiscal year 1996 financial statements were not correct, vaguely set forth, or were not supported, USAID's management stated that part of the analysis of performance reporting in the audit appears misleading (e.g., labeling data from 1995 instead of 1996 as "incorrect").

We agree that USAID does not need a new policy on annual results reporting for its operating units. As stated in the finding, USAID guidance for the preparation of operating unit results reporting does require reporting on the immediate past fiscal year. In addition, we noted that USAID policy (ADS 203.5.9a) requires such specificity. However, as we also stated in the finding, USAID has not ensured that the operating unit results reporting occurred during that period. Therefore, we are revising Recommendation No. 7.1 to require USAID to establish procedures to ensure compliance.

Moreover, the report identifies that USAID will need to require operating units to change the submission date of the results report to an earlier date (the previous Fall each year) SO that the Agency can report the immediate past fiscal year results in its overview section to the financial statements and Annual Performance Reports.

Regarding matching performance results to financial information, we recognize the difficulty in doing this. However, as stated in the finding, under the Office of Management and Budget's Bulletin No. 93-06, we are required to disclose material inconsistencies among the overview section and the principal financial statements for fiscal year 1997. Furthermore, beginning for fiscal year 1998 under the Office of Management and Budget's Bulletin No. 97-01, USAID will be required to link performance measures in the overview to the programs presented in the Statement of Net Cost. The Agency will most likely be able to more directly link output-type performance measures to financial data (i.e., expenditures) than outcome-type performance measures.

Finally, in testing results from the overview in the 1996 financial statements, we selected all the quantitative results reported in the overview which were identified as 1996 results or no specific year was identified. We found 29 results were either not correct, vaguely set forth, or were not supported by documentation. The ones that were vaguely set forth included results that covered multiple years or were not for fiscal year 1996. Since the report is suppose to present the significant results achieved by the reporting entity during the past year, the results cited in the report were misleading in that they would lead a reader to believe that the results occurred in fiscal year 1996 rather than earlier periods.

Management Comments and Our Evaluation (Rec. No. 7.2)

Generally, USAID's management comments were responsive to the findings and recommendation in that the comments clearly designate the Chief Financial Officer responsible for the preparation and presentation of the performance information in the overview section of the annual financial statements. Furthermore, they acknowledged the need to work colloboratively with the Bureau for Program and Policy Coordination to obtain reliable, timely, accurate and consistent program performance information which, as stated in the finding, was lacking. Therefore, we conclude that a management decision has been reached.

Timothy B. Ow

Office of Inspector General
March 2, 1998

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USAID INSPECTOR GENERAL'S REPORT ON COMPLIANCE

We attempted to audit USAID's principal financial statements for the year ended September 30, 1997, but our report on these statements (including the information in the overview section on program performance) disclaims an opinion on whether they are presented fairly because the scope of our work was impaired. USAID's management is responsible for compliance with applicable laws and regulations related to these financial statements.

Although we are unable to fully report on USAID's compliance with laws and regulations because of scope impairments, instances of material noncompliance came to our attention with regards to the requirements of the following:

- Federal Financial Management Improvement Act of 1996.
- Computer Security Act of 1987.
- Budget and Accounting Procedures Act of 1950.
- Antideficiency Act.
- Chief Financial Officers Act of 1990.
- Supplemental Appropriations Act of 1955.
- Prompt Payment Act of 1982.
- Debt Collection Act of 1982.
- Debt Collection Improvement Act of 1996.
- Foreign Assistance Act, As Amended in 1968.
- Federal Managers' Financial Integrity Act of 1982.

USAID recognizes that it does not have reasonable assurance of complying with laws and regulations. The following sections discuss the instances of potential noncompliance with the above laws and related regulations.

Federal Financial Management Improvement Act **of 1996**

USAID has not met the requirements of the Federal Financial Management Improvement Act of 1996[17] to implement and maintain a financial management system that complies substantially with (1) Federal requirements for financial management systems. (2) applicable Federal accounting standards and **(3) the** United States Standard General Ledger at the transaction level. As a result. USAID managers do not always receive the complete. reliable. timely and consistent information they need to report useful financial or performance results or efficiently manage agency operations. USAID has not established a compliant integrated system because it lacks effective processes for managing information resources. Both USAID's Chief Financial Officer and Chief Information Officer share organizational responsibility for the ineffectiveness of the processes.

Federal Requirements for
Financial Management Systems

The Federal Financial Management Improvement Act (FFMIA), Public Law 104-208, was included in the 1997 Omnibus Consolidated Appropriations Act. The Congress found that Federal financial management and fiscal practices do not (1) identify costs fully, (2) reflect total liabilities of congressional actions, or (3) accurately report the financial condition of the Federal government. The Act calls on agencies to improve their financial management systems so that all assets, liabilities, revenues, expenditures, and the full cost of programs and activities can be consistently and accurately recorded, monitored, and uniformly reported. Congress concluded that the development of financial management systems that can meet Federal system requirements will improve Federal financial management.

These requirements are designed to enable agencies to provide complete, reliable, timely, and consistent information for decision-makers and the public. Both individual agencies and regulatory agencies need this information to: (1) carry out their fiduciary responsibilities: (2) deter fraud, waste and abuse; (3) ensure that reliable financial data are obtained, maintained and reported; and (4) facilitate the efficient and effective delivery of programs.

Section 803(a) of the FFMIA requires agencies to implement financial management systems that meet three requirements--complying with Federal requirements for financial management systems, following applicable accounting standards, and using the United States Standard General Ledger at the transaction level. These requirements are detailed in the Office of Management and Budget's Circular No. A-127, Financial Management Systems. Section 7 of this Circular identifies the requirements for a financial management system. The following

[17] In this section, we report on USAID's compliance with Federal requirements for financial management systems rather than **compliance with the Act itself.**

presents the 12 characteristics that Federal financial management systems should possess according to Section 7:

- Agency-wide Financial Information Classification Structure.
- Integrated Financial Management System.
- United States Standard General Ledger at the Transaction Level.
- Federal Accounting Standards.
- Financial Reporting.
- Budget Reporting.
- Functional Requirements.
- Computer Security Act Requirements.
- Documentation.
- Internal Controls.
- Training and User Support.
- Maintenance.

Other policy documents further detail these requirements, including the Office of Management and Budget's Circulars No. A-130, Management of Federal Information Resources, No. A-134, Financial Accounting Principles and Standards, No. A-l 1, Preparation and Submission of Budget Estimates, and No. A-34, Instructions on Budget Execution; Treasury Department's Treasury Financial Manual. In particular, the Joint Financial Management Improvement Program has published several documents describing detailed functional requirements that systems should possess to perform effectively.

The FFMIA requires, beginning with the fiscal year 1997 audit of agency financial statements, that auditors report whether the agency's financial management system complies with the requirements identified in Section 803(a) of the FFMIA. If the system is found not to be compliant, the report is to address the nature and extent of noncompliance, the cause of noncompliance, the organization responsible for noncompliance, comments from responsible officials, and recommendations to correct the deficiencies. The FFMIA also requires the agency head to make a determination whether the agency's financial management system complies with the requirements. If the agency head determines that the system does not comply. a remediation plan is required. Generally, the plan should bring the system into compliance within three years.

Nature and Extent of Noncompliance

For fiscal year 1997, USAID's financial management system did not substantially comply with Federal requirements for a financial management system, applicable Federal accounting standards, or the United States Standard General Ledger at the transaction level.

Deficiencies in financial management systems have hindered USAID for a number of years. A series of reports by the Office of the Inspector General and the General Accounting Office, as well as USAID management assessments, have disclosed numerous financial and management problems that were caused by ineffective financial management systems. Since 1988, USAID has identified the lack of an effective, integrated financial management system as a material weakness under the Federal Managers' Financial Integrity Act (Integrity Act).

Although USAID has made several attempts to correct these deficiencies, it has not yet succeeded. Most recently, USAID developed the New Management System, which was deployed worldwide at the beginning of fiscal year 1997. This system was designed to replace aging and ineffective computer systems that USAID used to perform accounting, budgeting, procurement, and operational functions. This new system was expected to comply with all Federal requirements for financial management systems.

During fiscal year 1997, however, we issued several reports identifying technical and operational problems that prevented the New Management System from operating effectively? In large part, because the core accounting component of the New Management System has not operated effectively, USAID has had to rely on a combination of legacy systems, informal and unofficial records maintained by individual managers or organizational units, and the new system. Our reports, as well as studies and analyses conducted by USAID, show that, throughout fiscal year 1997, USAID's financial management system did not substantially comply with the 12 characteristics listed in Section 7 of the Office of Management and Budget's Circular No. A-127.

In its fiscal year 1997 report under the Integrity Act, USAID reported that neither the new system nor the legacy systems comply substantially with Federal requirements for a financial management system, applicable Federal accounting standards, or the United States Standard

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'*Audit Report No. **A-000-97-004-P,** March 31, 1997, Audit of the Worldwide Deployment of the New Management System (NMS); Audit Report No. **A-000-97-005-P,** July 11, 1997, Audit of USAID's Efforts to Resolve the Year 2000 Problem; Audit Report No. A-000-97-008-P, September 30, 1997, Audit of USAID's Compliance with Federal Computer Security Requirements; Audit Report No. **A-000-97-009-P,** September 30, 1997, Audit of the Internal Controls for the Operational New Management System; and , Audit Report No. A-000-97-010-P, September 30, 1997, Audit of the Status of USAID's New Management System (NMS).

General Ledger at the transaction level. USAID also recognizes that, because its financial management system does not incorporate the FFMIA's requirements, USAID managers do not always receive the information they need to reliably report financial or performance results or efficiently manage agency operations. In this regard, USAID's report to the President identified additional material weaknesses that cause various adverse financial and operational problems.

The following page summarizes indicators of noncompliance reported by Office of Inspector General audits and USAID management assessments.

Compliance With Federal System Requirements	
System Requirement	**Indicators of the Status of Compliance: Fiscal Year 1997**
Information Classification Structure	USAID relied on a combination of legacy systems, informal records, and the New Management System. Because the-se systems do not contain standard data definitions or formats, USAID lacked an agency-wide classification structure.
Integrated System	Because USAID relied on multiple incompatible systems that are not able to exchange data, it does not have an integrated system.
United States Standard General Ledger at the Transaction Level	Appendix IV of this report, cites an example of transactions that are not supported by the United States Standard General Ledger at the transaction level.
Applicable Federal Accounting Standards	This report (1) disclaimed an opinion on USAID's financial statements because, in part, the accounting system did not provide complete, reliable, timely, and consistent financial information and (2) identified several significant internal control weaknesses.
Financial Reporting	USAID identified New Management System reporting and resource management as a material internal control weakness in its report for fiscal year 1997 under the Integrity Act.
Budget Reporting	USAID's Office of Financial Management reported that obligations exceeded the appropriated amount in two cases in fiscal year 1997. That Office believes that the reports of over-obligations are the result of double recording of obligations rather than an actual over-obligation.
Functional Requirements	The New Management System has not been tested to determine its compliance with functional requirements, but USAID reports identify numerous important requirements that have not been met.
Computer Security Act	We reported in September 1997, that USAID had not implemented an effective computer security program. USAID identified its computer security program and the New Management System computer security as material weaknesses in its fiscal year 1997 report under the Integrity Act.
Documentation	USAID has reported incomplete-New Management System source code—and identified the lack of financial management policies as a material weakness in its fiscal year 1997 report under the Integrity Act.
Internal Controls	We reported in September 1997, that the New Management System did not have a system of internal controls that met Federal government standards.
Training and User Support	In March 1997, we reported that many users of the New Management System did not receive adequate training.
Maintenance	NMS is difficult to maintain because programmers developing the NMS software used ad hoc coding standards and these standards were inconsistently enforced resulting in numerous deficiencies in the code.

Cause of Noncompliance

The previously cited Office of Inspector General audits demonstrated that ineffective processes for managing information resources are the primary cause of USAID's difficulties in deploying effective information systems. USAID reported its deficiencies in management information processes as a material weakness in its fiscal year 1997 report under the Integrity Act.

In March 1997, we reported serious deficiencies in the processes for managing information resources that contributed to the premature deployment of the New Management System, a system that had not been tested and has not operated effectively. USAID had adopted a high risk approach, did not follow accepted system development practices, and deployed the system worldwide in spite of severe problems that had been reported previously. Specifically, in September 1996, we reported that USAID's plans to deploy the New Management System worldwide involved significant risks because tests were not adequate to demonstrate that the system would meet Federal accounting or internal control standards or operate effectively under full workloads.

Organization Responsible for Noncompliance

The Chief Financial Officer and the Chief Information Officer share primary responsibility for USAID's financial management system deficiencies. Both positions are located within the Management Bureau. The Chief Financial Officer and the Chief Information Officer share responsibility to implement and maintain effective and efficient financial management systems that meet Federal requirements for financial management systems.

The Chief Financial Officers Act of 1990 (Public Law 101-576) created the position of Chief Financial Officer in 23 Federal agencies, including USAID. This Act called for the Chief Financial Officer to report directly to the head of the agency and to be responsible for, among other things;

- overseeing all financial management activities relating to the programs and operations of the agency;

- developing and maintaining an integrated agency accounting and financial management system that complies with all Federal requirements for financial management systems; and

- directing, managing, and providing policy guidance and oversight of agency financial management personnel, activities, and operations; including the approval and management of design and enhancement projects for an agency's financial management system.

Although USAID's Chief Financial Officer is responsible for ensuring that financial management systems meet Federal requirements. this responsibility was not carried out. On September 27, 1994, the Chief Financial Officer requested a waiver from a mandatory requirement of the Office of Management and Budget that agencies use a General Services Administration-approved off-the-shelf system to replace legacy core accounting systems. In the request, the Chief Financial Officer committed that the system would comply with all Federal requirements for financial management systems. In granting the waiver, the General Services Administration stipulated that USAID comply with the terms of its waiver request, including subjecting the system to a benchmark test before deployment. In September 1996,[19] and again in September 1997,[20] we reported that USAID had not complied with the terms of the waiver and had not subjected the system to the benchmark test. Further, in another September 1997 report, we reported that the New Management System lacked a system of internal controls that met Federal requirements.[21] That report pointed out that responsible financial management officials did not show a supportive attitude toward the development of effective internal controls.

The Chief Information Officer shares responsibility for ensuring that disciplined processes are followed, but did not carry out that responsibility. The Clinger-Cohen Act of 1996 mandates that Executive agencies implement a process to maximize the value' and assess and manage risks involved in information technology investments. The Act establishes the position of Chief Information Officer and, among other things, assigns this officer responsibility to ensure that information technology investments, including financial management systems, are managed effectively. The Chief Information Officer is specifically responsible for

- providing advice and assistance to the agency head and senior managers to ensure that information technology is acquired and information resources are managed effectively;
- developing, maintaining, and facilitating implementation of an integrated agency-wide information technology architecture; and
- promoting the effective and efficient design and operation of all major processes of the agency for managing information resources.

The Clinger-Cohen Act also makes the head of each agency, in consultation with the Chief Financial Officer and Chief Information Officer accountable for establishing policies and

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“Audit Report No. A-000-96-001-S, September 27, 1996, Interim Report on the Status of USAID's New Management System.

[20] Audit Report No. A-000-97-010-P, September 30, 1997, Audit of the Status of USAID's New Management System (NMS).

[21] Audit Report No. A-000-97-009-P, September 30, 1997, Audit of the Internal Controls for the Operational New Management System.

procedures that ensure that (1) agency information systems provide financial and program performance data for agency financial statements; (2) financial and performance data are provided to financial management systems in a reliable, consistent, and timely manner: and (3) financial statements support assessments and revisions of mission and administrative processes, as well as measurements of the performance of information technology investments.

Our March 1997 report,[22] however, disclosed a continuing lack of disciplined practices in the management of information resources, including (1) USAID's decision to deploy the New Management System worldwide before it was tested or ready for implementation, and (2) deficiencies in enforcing USAID-wide data or system development standards. USAID's organizational structure for the Chief Information Officer had not been effective. The Clinger-Cohen Act calls for the Chief Information Officer to have, as a primary duty, the effective management of agency information resources. Within USAID, however, the Chief Information Officer during most of fiscal year 1997 was the Acting Assistant Administrator of the Management Bureau, who was responsible for several other major management organizations including procurement, personnel, and financial management.[23]

USAID Actions to Correct Deficiencies

USAID recognizes that it needs to strengthen its capabilities for managing information resources and take action to implement a financial management system that complies with Federal requirements. Our September 1997 report concluded that USAID had committed to implement disciplined processes for managing information resources to comply with the requirements of the Clinger-Cohen Act, and had also taken initial steps to strengthen its organizational control over investments in information technology. For example, USAID hired a new Director of its Office of Information Resources Management and established a Capital Investment Review Board.

USAID has also begun taking action to correct the deficiencies of the financial management system. USAID is analyzing alternative ways to implement a system that will comply with Federal requirements for financial management systems. USAID currently estimates that these deficiencies will not be corrected until fiscal year 2000. However, a reliable estimate of the time and cost required to bring USAID's financial management system into compliance with the FFMIA will not be available until USAID selects an alternative and develops detailed implementation plans that include tasks, time frames, and resources.

'"Audit Report No. A-000-97-004-P, March 31, 1997, Audit of the Worldwide Deployment of the New Management System (NMS)

[23]Subsequently, USAID designated the Acting Assistant Administrator for Management as the Acting Chief Information Officer.

Recommended Remedial Actions

Because USAID, in response to several previous Office of Inspector General recommendations, is improving its processes for managing information resources, is analyzing alternative financial management systems, and is developing a schedule to bring its systems into compliance, we have not included recommendations in this report.

Management Comments and Our Evaluation

USAID management said that we were substantially correct in our description of the above conditions (based on Agency comments, we have made certain corrections between the draft and final report), and voiced appreciation for our recognition of USAID's significant changes in direction to identify deficiencies and chart corrective courses.

USAID management emphasized the difficulty it encountered in trying to find an off-the-shelf system that met both USAID's requirements and Federal requirements. USAID took a risk that was not fully successful. USAID management is now taking steps to consider replacing the core accounting system. USAID plans to retain three modules of the New *Management System that are critical to the full integration with the core financial systems.

To assist USAID management with its plan, we are issuing a companion report on financial management systems which will serve as a baseline for gauging USAID's progress.

Computer Security Act of 1987

USAID has not implemented an effective computer security program as required by the Computer Security Act.

The Computer Security Act of 1987 (Public Law No. 100-235) requires Federal agencies to protect information by: (1) identifying sensitive systems, (2) developing and implementing security plans for sensitive systems, and (3) establishing a training program to increase security awareness and knowledge of accepted security practices. The Office of Management and Budget's Circular No. A-130 contains executive branch policy for implementing this law.

In September 1997, we reported" that management deficiencies had prevented USAID from implementing an effective computer security program as required by the Computer Security

[24] Audit Report No. A-000-97-008-P, dated September 30, 1997, Audit of USAID's Compliance with Federal Computer Security Requirements.

Act and the Office of Management and Budget. These deficiencies exposed USAID to high risks that resources will not be adequately protected from fraud or misuse. The deficiencies occurred because USAID did not implement an adequate system of management controls to suppon an effective computer security program In this regard. USAID had not (1) developed an organizational structure that clearly delegated responsibility and provided appropriate authority, (2) established planning policies needed to provide a foundation for an effective security program, and (3) implemented key management processes to ensure that security requirements were met.

USAID accurately reported this deficiency in its fiscal year 1997 report on the Integrity Act and has begun taking steps to correct the problems, including appointing a computer security program manager. Therefore, we are making no additional recommendations.

Management Comments and Our Evaluation

USAID management did not comment on the above issue which repeats what we previously reported.

Budget and Accounting Procedures Act of 1950

As shown in our report on internal controls, **USAID** (1) has not maintained an adequate system of internal and accounting control to comply with the Budget and Accounting Procedures Act of 1950, and (2) has not always provided the Department of Treasury all requested information on **USAID's** financial operations.

The Budget and Accounting Procedures Act of 1950 (Chapter 946, 64 Stat. 832) requires each Federal agency to maintain a system of accounting and internal control that provides:

- full disclosure of the financial results of agency activities;
- adequate financial information needed for agency management purposes;
- effective control over and accountability for all funds, property and other assets for which the agency is responsible;
- reliable accounting results to serve as the basis for preparation and support of agency budget request, for controlling the execution of its budget, and for providing financial information required by Office of Management and Budget; and

- suitable integration of the accounting of the agency with the accounting of the Department of Treasury in connection with the central accounting and reporting responsibilities imposed on the Secretary of the Treasury.

This law (Title 3 1 of the United States Code. Section 351 l(a)) further requires that this system must conform to the accounting principles. standards. and related requirements and internal control standards prescribed by the Comptroller General.

The law also requires the entity to provide information requested by the Secretary of the Treasury on the entity's financial operations (Title 31 of the United States Code. Section 35 13(a)).

Management Comments and Our Evaluation

USAID management concurred that additional work is required to improve financial systems to meet the requirements above.

Antideficiency Act

USAID potentially violated the **requirements of the Antideficiency** Act governing the obligations of funds.

The Antideficiency Act represents a series of related laws (Title 31 of the United States Code. Sections 1341(a), 1342, 1349-1351, and 1511-1519) whose objective is to prevent the government from making payments or committing itself to make payments without having sufficient funds available. In addition to prohibiting overspending at the total appropriation level, the law also prohibits overspending official administrative subdivisions of appropriations, known as "apportionments".

The Antideficiency Act stipulates that an entity shall not make expenditures or obligations that exceed the amount available for expenditure or obligation in an appropriation or fund. This Act further **stipulates that the entity** shall not make or authorize expenditures or obligations that exceed:

- the amount of an apportionment: or

- a lesser amount, if any, established by agency regulations[25] (such as the allotment level).

Criminal penalties are prescribed for knowingly and willfully violating the Antideficiency Act, while those responsible for unintentional violations are subject to administrative discipline. Some of the most common causes of violating the Antideficiency Act are:[26]

- Using the wrong appropriation or apportionment when not enough funds were available in the correct appropriation or apportionment;

- Using a current year appropriation for something that represents a "bona fide need" of a future year;

- Exceeding funds available (such as from contracts with contingent liabilities or from other legal liabilities that have not been recorded);

- Not imposing fiscal discipline on contractors (e.g. not requiring contractors to account for costs in a manner which ensures compliance with the Antideficiency Act.);

- Delegating authority for financial control to too high or too low of a level;

- Not reviewing financial data for accuracy, particularly when the accounting, paying and other systems are not integrated and lack consistency;

- Exceeding a statutory limitation on amounts for which funds can be used, such as limitations on the amount of assistance to a country or activity; and

- Not recording or improperly recording obligating documents. Documents which are either not recorded or not recorded against the proper accounting line create unmatched disbursements that can "mask" the actual status of an appropriation, allowing activities to continue rather than to cease.

Executive branch policy, as stipulated in the General Accounting Office's Policy and Procedures Manual for Guidance of Federal Agencies, Title 7-Fiscal Guidance, states that "agencies are precluded by the Antideficiency Act from (1) incurring obligations or expenditures in excess of the amounts available in appropriations, fund accounts, or apportionments. In addition, the Antideficiency Act requires agency heads to establish fund control systems that can be used to identify agency staff responsible for causing obligations or expenditures to exceed limitations."

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[25]Entities are required to establish regulations that provide for a system of administrative controls over their execution of budget authority (Title 31 of the United States Code, Section 1514(a)).

[26]Source: Publications of the Naval Sea Systems Command

Indicative of potential violations of the above provisions, USAID's Office of Financial Management reported cumulative obligations in excess of appropriations to the Department of Treasury on its FMS-2108, Year-end Closing Statement, report for fiscal year 1997. The report showed the excess obligations in two appropriations: Development Assistance FY 96/97 in the amount of $378,492[27] and Special Initiatives FY 96/97 in the amount of $4,733.[28]

USAID personnel attributed the causes of the possible over-obligations to: (1) possible double recording of obligations from the overseas offices and USAID/Washington; (2) problems reconciling the accounting systems used in Washington and the overseas offices (the New Management System and the Mission Accounting and Control System); (3) problems using the AID Worldwide Accounting and Control System as an accounting system; (4) problems using non-integrated systems; and (5) inconsistencies in using or understanding the hierarchy of management organization tables in the New Management System.

In addition, we identified a potential over-obligation in appropriation 72x1014: Sub-Saharan Africa Development Assistance. This possible over-obligation is due to an amendment to an existing contract that could not be electronically recorded in the AID Worldwide Accounting and Control System module of the New Management System. This amendment was tracked, outside the Office of Financial Management, by the Office of Procurement on a manual spreadsheet. The Office of Procurement acknowledged that an amendment in the amount of $2,099,856 did not get recorded in the New Management System against the appropriation for fiscal year 1997. Our review of the appropriation balance reflected on the Year-end Closing Statement revealed that this amendment will cause an apparent over-obligation of $4,870.

USAID is analyzing the appropriations to determine whether or not actual violations of the Antideficiency Act occurred. We are monitoring this situation and plan to follow-up when USAID completes the analysis.

<u>Management Comments and Our Evaluation</u>

The Office of Financial Management has been actively reviewing this matter and has found that obligations were recorded twice in the case of one appropriation and in the second there

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[27]On February 13, 1998, USAID notified the OIG that the cause of the possible over-obligation in the Development Assistance appropriation was four obligations, totaling $439,667, that had been recorded between the New Management System and the Mission Accounting and Control System.

[28]On January 28, 1998, USAID notified us that the cause of the possible over-obligation in the Special Initiatives appropriation in the amount of $4,733 had been identified and resolved. According to USAID personnel, an accounting error occurred when funds were deobligated and transferred between appropriations. This transfer took place twice, thereby decreasing the amount available for obligation in the current appropriation. To rectify this error, on January 28, 1998, USAID sent a fourth SF, 1151, Nonexpenditure Transfer Authorization to the Department of Treasury, moving the funds to the current appropriation.

was a financial error in the recording of appropriation transfers to the Department of Treasury. Management is continuing to review one more appropriation to confirm its expectation that USAID is not antideficient.

Chief Financial Officers Act of 1990

USAID has not established the integrated accounting and financial management system required by the Chief Financial Officers Act of 1990 and executive branch policy.

The Chief Financial Officers Act of 1990 (Public Law No. 101-576) requires each Federal agency's Chief Financial Officer to, among other things, develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls which:

- complies with applicable accounting principles, standards, and requirements, and internal control standards;
- complies with such policies and requirements as may be prescribed by the Director of the Office of Management and Budget;
- complies with any other requirements applicable to such systems; and
- provides for (1) complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management; (2) the development and reporting of cost information; (3) the integration of accounting and budgeting information; and (4) the systemic measurement of performance.

Executive branch policy, contained in the Office of Management and Budget's Bulletin No. 94-01, Form and Content of Agency Financial Statements, was issued under the authority of the Chief Financial Officers Act, as well as, the Budget and Accounting Act of 1921, as amended, and the Budget and Accounting Procedures Act of 1950, as amended. The Bulletin defines the form and content of financial statements that are required to be submitted to the Director of the Office of Management and Budget pursuant to the requirements of the Chief Financial Officers Act.

The Bulletin states that the "financial statements shall be the culmination of a systematic accounting process. The statements are to result from an accounting system that is an integral part of a total financial management system containing suffkient discipline, effective internal controls. and reliable data."

As disclosed in our report on internal controls, USAID's financial statements are not a result of a systematic accounting process as required by the Chief Financial Officers Act of 1990 and executive branch policy. The statements resulted from non-integrated accounting systems that do not have sufficient discipline. effective internal controls, and reliable information.

Management Comments and Our Evaluation

USAID management said it was acutely aware of the deficiencies in the core accounting system. USAID is proceeding with corrective action.

Supplemental Appropriations Act of 1955

The Supplemental Appropriations Act of 1955 (Title 31 of the United States Code 1501) prescribes specific criteria governing the recording and reporting of financial transactions as obligations. This law provides that no amount shall be recorded as-an obligation unless it meets specified criteria and that statements of obligations furnished to the Congress or to any of its committees shall include only amounts representing valid obligations. Title 31 of the United States Code, Section 1108(c) requires that agency heads support their appropriations request with a certification of the obligated balances.

USAID did not meet the requirements of this law because, as discussed in our report on internal controls, it did not follow Federal implementing policy, contained in Section 24000 of the Treasury Financial Manual, to verify its accounts at least once per year.

Management Comments and Our Evaluation

As described in USAID management's response to Recommendation No. 1, USAID management concurred with the Recommendation but did not believe a legal basis exists for the depth of the review of unliquidated obligations suggested by us. We plan to reassess our position upon receipt of the determination made by USAID's legal counsel.

Prompt Payment Act of 1982

USAID did not meet the statutory and regulatory deadlines for reporting on its payment practices.

The Prompt Payment Act of 1982 (Public Law No. 100-496) requires Federal entities to. among other things, make payments for property or services by the payment due date specified in the related contract o'r, if a payment due date is not specified in the related contract, generally 30 days after the invoice for the amount due is received. If payments are not made within the appropriate time period, the entity shall pay an interest penalty. The entity shall submit to the Office of Management and Budget a report on the agency's payment practices during the year by November 30 for the prior fiscal year. The Act requires the Office of Management and Budget to issue implementing regulations.

Executive branch policy for implementing the Prompt Payment Act, contained in the Office of Management and Budget's Circular No. A-125, Prompt Payment, requires each Federal agency to report specific prompt payment information to the Director, Office of Management and Budget, by November 30 following the close of the fiscal year.

USAID, however, did not submit its report for fiscal year 1997 until January 14, 1998—about six weeks late. USAID did not meet the reporting requirements due to difficulties in retrieving complete reports from the New Management Systems in a timely manner.

Management Comments and Our Evaluation

Management acknowledged that obtaining information from the AID Worldwide Accounting and Controls System (the system) to meet prompt pay reporting requirements was not successful. The system does not fully address all requirements of the Prompt Pay Act. Several attempts were made to extract the necessary data from the system.

We will work to support management efforts to correct this deficiency.

Debt Collection Act of 1982

USAID did not fully comply with Federal law governing (1) the assessment of interest on delinquent debt and (2) reports of amounts owed to the Federal government.

The Debt Collection Act of 1982 (Public Law 97-365) amended the Federal Claims Collection Act (Public Law 97-258) and addresses the collection of debts owed to the Federal government. This law (Title 31 of the United States Code, Section 3717(a)(1)) prescribes that the head of any executive or legislative agency shall assess a minimum amount of interest on delinquent debt using rates published by the Secretary of the Treasury. This law (Title 31 of the United States Code, Section 3719(a)) further requires that the entity shall submit a report at least annually to the Secretary of the Treasury summarizing the status of loans and accounts receivable managed by the agency.

The executive branch's implementing policy-Treasury Financial Manual, Part 2, Chapter 4100—requires each Federal agency to report[29] annually or quarterly (if combined receivables exceed $100 million) to the Secretary of the Treasury all outstanding receivables due from the public, as well as all outstanding receivables involving direct and guaranteed loans.

USAID, however. did not assess interest on delinquent receivables because it had not established policies and procedures for doing so. Furthermore, although USAID reported the amount of outstanding loans receivable as of September 30, 1997, this report was not complete, accurate and reliable because it did include amounts collected but not yet applied to specific loans. Finally, USAID did not report outstanding public receivables.

Recommendation No. 8: We recommend that the Chief Financial Officer:

8.1 Implement a comprehensive policy that will incorporate an automatic assessment of interest charges against all delinquent receivables, and that these assessments be actively monitored for managerial and statutory reporting purposes; and

8.2 Ensure that the required filing for all'receivable categories is accomplished.

Management Comments and Our Evaluation

USAID management agreed with the recommendation. Management stated that it intends to incorporate interest assessment and collection into the core financial system of USAID. Management further stated that AID Worldwide Accounting and Control System is building that capability for headquarters operations and will be used more extensively throughout fiscal year 1998. Management further stated that it recognizes the reported deficiency related to reporting outstanding public receivables and will work to address this issue in the near future.

USAID management's action plan is responsive to this recommendation. We concur with the Management Decision reached. We plan to review the effectiveness of the proposed policy during the next audit cycle.

[29] This reporting is to be accomplished by each agency on a Schedule 9 Report. This report requires that each government agency provide sufficient detail into the aging, composition, and collection tools employed for all outstanding receivables.

Debt Collection Improvement Act of 1996

Contrary to law, USAID did not (1) inform debtors of their due process rights, (2) refer delinquent debts in excess of 180 days to the United States Treasury, and (3) provide information regarding the issuance or guarantee of credit to consumer credit reporting agencies.

With respect to USAID not informing debtors of their due process rights, the Debt Collection Improvement Act of 1996 (Public Law 104-34)[30] requires each agency to provide a debtor with "due process rights" when demanding payment on outstanding debts. Due process rights include the ability to verify, challenge and compromise claims, and have access to administrative appeals which are both reasonable and protect the interests of the United States. USAID needs to issue guidance to billing offices incorporating debtor rights into all demands for payment issued by USAID.

In regards to USAID not referring delinquent debts to the United States Treasury, the Debt Collection Improvement Act of 1996 requires that each agency automatically refer delinquent debts in excess of 180 days to the United States Treasury for the recovery of agency debts. USAID has no process to identify the population of receivables due to USAID at any time, and no formal training or instruction has been issued to billing offices. As a result, we identified $10.8 million of accounts receivable that were delinquent in excess of 180 days. Of this amount, only $22,733—less than one percent—had been referred to the United States Treasury as required. USAID needs to issue guidance to billing offices to ensure that debts delinquent in excess of 180 days are appropriately referred to the United States Treasury as required.

Concerning USAID not providing information to consumer credit reporting agencies, the Debt Collection Improvement Act of 1996 amended Title 31 of the United States Code (Public Law 97-258), Section 371 l(f) to require that agency heads provide information regarding the issuance or guarantee of credit to consumer credit reporting agencies[31] as appropriate. USAID

[30] The basic premises upon which the Debt Collection Act of 1982 and the Debt Collection Improvement Act of 1996 are based are that all agencies of the federal government should develop adequate management and operational controls which respect to the identification of, claiming and recovery of outstanding indebtedness. The Debt Collection Improvement **Act of** 1996 **extended the coverage of its predecessor legislation by** broadening the requirement for reporting and administering debts within an individual agency and by providing a starting point in which all debts owed to the United States government could be identified, quantified and centralized.

[31] This required reporting is to occur not less than 60 days in order for the debtor to be afforded all reasonable due process rights and formal notification of the intent to refer the claim to a consumer credit reporting agency.

did not implement this requirement. USAID needs to incorporate this aspect of debt collection into a comprehensive policy and procedures for accounts receivable.

Recommendation No. 9: We recommend that the Chief Financial Officer develop and implement policies and procedures to ensure adherence to the requirements of the Debt Collection Act of 1982 and the Debt Collection Improvement Act of 1996. These policies and procedures should at a minimum ensure that:

9.1 All billing offices incorporate due process rights into demands for payment;

9.2 All delinquencies in excess of 180 days are identified in a timely manner, and referred to the United States Treasury; and

9.3 The issuance or guarantee of consumer credit is reported to consumer credit reporting agencies.

Management Comments and Our Evaluation

USAID management agreed with the recommendation. The Office of Financial Management stated that it recognizes the lack of compliance with the Act as a serious condition and one which requires significant attention to policy building and engagement to the collection tools available through the Department of Treasury. Management also stated that a policy team has been detailed to the Office of Financial Management/Central Accounting and Reporting division and tasked with solving this issue as one of its highest priorities.

USAID management's action plan is responsive to this recommendation. We concur with the Management Decision reached. We plan to review the effectiveness of the proposed policy and procedures during the next audit cycle.

Foreign Assistance Act, As Amended in 1968

As discussed in our report on internal controls, USAID has not yet implemented an effective system to meet the requirements of Section 621A of the Foreign Assistance Act, as amended in 1968 (Public Law No. 90-554).

This Section states that foreign assistance funds could be utilized more effectively by the application of a management system that will include the following: the definition of objectives for United States foreign assistance, the development of quantitative indicators of progress toward those objectives, the adoption of methods for comparing actual results of programs and projects with those anticipated when they were undertaken, and provides information to USAID and Congress that relates funding to the objectives and results in order to assist in the evaluation of program performance.

Management Comments and Our Evaluation

Management believed that with the submission of a Strategic Plan (9/97) and Annual Performance Plan (2/98), and preparation of the Annual Performance report, USAID "is designing and implementing" a system that is compliant with the Government Performance and Results Act. Management also believed that this system is also in compliance with the intent of the Foreign Assistance Act (as amended).

We agree that, when fully implemented, the system should be in compliance with the Foreign Assistance Act (as amended).

Federal Managers' Financial Integrity Act of 1982

Contrary to Federal law and the executive branch's implementing policies, USAID has not (1) promptly resolved all audit recommendations, (2) established adequate internal accounting and administrative controls, and (3) provided adequate ongoing evaluations and reports on the internal controls. As a result, USAID has not taken corrective action on material weaknesses that impair USAID from providing complete, reliable, timely and consistent information on the activities of USAID.

The Federal Manager's Financial Integrity Act of 1982, Public Law No. 97-255 (Integrity Act), amended Section 113 of the Accounting and Auditing Act of 1950 (Title 31 of the United States Code, Section 66a) to require that each executive agency establish internal accounting and administrative controls, in accordance with standards prescribed by the Comptroller General, which provide reasonable assurance that:

- obligations and costs are in compliance with applicable law;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- 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 the assets.

The Integrity Act further mandated that: (1) the Comptroller General's standards for internal control include standards to ensure the prompt resolution of all audit findings; (2) the Office of Management and Budget establish guidelines for the evaluation by agencies of their systems of internal accounting and administrative control to determine compliance with the above standards; (3) executive agencies provide ongoing evaluations and reports on the adequacy of the systems of internal accounting and administrative control; and (4) the head of each executive agency report annually on whether the agency's accounting system conforms to the principles. standards and related requirements prescribed by the Comptroller General.

Part of the executive branch's implementing policies are contained in the Office of Management and Budget's Circular No. A-123. This Circular requires agencies to develop and implement management controls to ensure that (1) programs achieve their intended results; (2) resources are used consistent with agency mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and (5) reliable and timely information is obtained, maintained, reported and used for decision making. The Circular also states that managers should ensure that appropriate authority, responsibility and accountability are defined and delegated to accomplish the mission of the organization. Furthermore, the Circular requires that the head of each agency submit annually to the President and the Congress a statement on whether the agency's controls provide reasonable assurance that they are achieving their intended objectives; and a report on material weaknesses in the agency's controls.

The Office of Management and Budget's Circular No. A-50 contains another implementing policy of the executive branch. This policy requires prompt resolution and corrective actions on audit recommendations. The Circular says that resolution shall be made within a maximum of six months after issuance of a final report and corrective action should proceed as rapidly as possible.

Pursuant to the Integrity Act and the implementing policies of the executive branch, USAID identified nine material control weaknesses in its fiscal year 1997 report under the Integrity Act (See Appendix III for a description of each material control weakness identified by USAID). However, we identified the following seven material control weaknesses that were not reported (See "USAID Inspector General's Report on Internal Controls"):

- USAID did not review the validity of unliquidated obligations as of September 30, 1997, as required by the Treasury Financial Manual.

- USAID's advances processed through the Letter of Credit Support System were not linked to supporting records at the time of the transaction.

- USAID did not report consistent unobligated balances to Federal regulatory agencies.

- USAID's processes for establishing and reporting performance measures were inadequate.

- USAID's management has not delegated appropriate authority and responsibility to the Chief Financial Officer to carry out his responsibility under the Chief Financial Officers' Act.

- Material weaknesses exist in USAID's internal controls for monitoring program performance.[32]

- USAID has not promptly resolved audit recommendations and corrected identified weaknesses (See Appendix V).

USAID needs to establish and implement a process for periodic evaluations to ensure that all material weaknesses are identified, reported, and corrective action is taken.

> **<u>Recommendation No. 10</u>: We recommend that the Assistant Administrator/Bureau for Program and Policy Coordination, in preparing the next Bureau submission to the Administrator under the Federal Manager's Financial Integrity Act, perform an assessment of the internal control weaknesses on performance measures identified in this report and report the material weaknesses.**

Management Comments and Our Evaluation

USAID's management generally agreed with the recommendation. Management agreed to perform an internal control assessment to report any material weaknesses identified to the Administrator. However, management did not accept that all the weaknesses identified in this audit report are material and, hence, they stated weaknesses identified next year may or may not include those identified in this audit report. Unfortunately, management did not provide additional comments to identify which weaknesses are not considered to be material.

We believe that USAID's management response is generally responsive to this finding and recommendation. Management decision has been reached. However, this recommendation should remain open until the recommended internal control assessment is performed and material weaknesses are appropriately identified in the next Bureau for Program and Policy Coordination's submission under the Federal Managers' Financial Integrity Act.

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[32] The Office of Management and Budget's Bulletin No. 93-06 requires that auditors include in the report on compliance any material weaknesses not reported under the Financial Managers' Financial Integrity Act (Integrity Act) if these matters continue to exist. Our report on the internal controls identifies that these weaknesses had been reported in USAID's report to the President under the Integrity Act for fiscal year 1994 but were deleted in the report for fiscal year 1995."

Our objective was not to provide an opinion on USAID's overall compliance with the provisions of applicable laws and regulations. Accordingly, we do not express such an opinion.

Office of Inspector General
March 2, 1998

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Message from the Acting Director of the Office of Financial Management

The United States Agency for International Development (USAID) was created in 1961 to advance U.S. foreign policy interests by promoting broad-based, sustainable development and providing humanitarian assistance for natural and man-made disasters. Over the past three decades, USAID has provided assistance to the international community by helping to address, ameliorate, and even eliminate the problems of rapid population growth, environmental degradation, endemic poverty, debilitating hunger, mass migration, and anarchy. USAID operates in an increasingly complex environment and thus targets its resources to only those countries and activities that achieve significant results.

A results-driven strategic planning process is the centerpiece of USAID's management reforms. USAID's strategic planning now focuses on continuous evaluation and learning at every stage of a program, strategic objective, and activity and its operating, budget, accounting, and personnel evaluation systems have been re-engineered to focus the Agency on achieving results at every level.

The Office of Management and Budget and the CFO Council continue to lead the Federal Government in an aggressive direction toward better financial control over operations. As the Acting Director of the Office of Financial Management, I have welcomed and strongly supported the many initiatives toward revolutionizing the way we do business. Within USAID we are in the middle of a multi-year program to develop an entirely new program delivery system. As an essential part of the Agency's overall decision management systems, I have developed and started implementation of a series of operational improvements to our financial management systems. While this has proven to be no easy task, the progress made, and the additional improvements to soon come, are designed to make this Agency the leader, with the most effective and efficient financial management operations in the Federal Government.

We plan to achieve all goals for government-wide financial management legislated by the Chief Financial Officer's Act and as outlined by OMB and the CFO Council. This will be attained by the Agency's ever continuing re-engineering program. Our vision, mission and strategy, presented below, continues to tie directly to and support those guiding principles promoted by OMB and the CFO Council's in carrying out the Government Performance and Results Act (GPRA) and Government Management Reform Act (GMRA).

- Our **mission** is to provide professional financial management services and timely, accurate, and understandable financial management information to promote accountability, encourage efficiency, and safeguard USAID resources.

- Our **strategy** is that USAID will be the best by using the best systems, the best technology and the best people in implementing our financial management initiatives.

The Administrator and I are fully committed to improving performance in all areas of accountability, effectiveness and efficiency during these times of shrinking government resources. We also are continuing our strong support of OMB's and the CFO Council's aggressive push to improve financial management throughout the Federal government. USAID has made and will continue to make substantial progress in addressing long standing resource management and accountability problems. My goals for greatly improved accountability and operational performance are detailed in our strategic plan. Through the flexible and continued implementation of the plan, my commitment to attaining my stated vision and mission is well underway.

This marks the second year that USAID has prepared agency-wide financial statements in accordance with the Government Management Reform Act. These consolidated financial statements are the product of the untiring efforts of our dedicated staff. They are our best effort to date towards the presentation of fair and accurate financial statements.

As the United States Agency for International Development's Acting Director of the Office of Financial Management, I am proud to submit our Fiscal Years 1997 and 1996 Financial Statements.

Tony Cully
Acting Director of the Office of Financial Management

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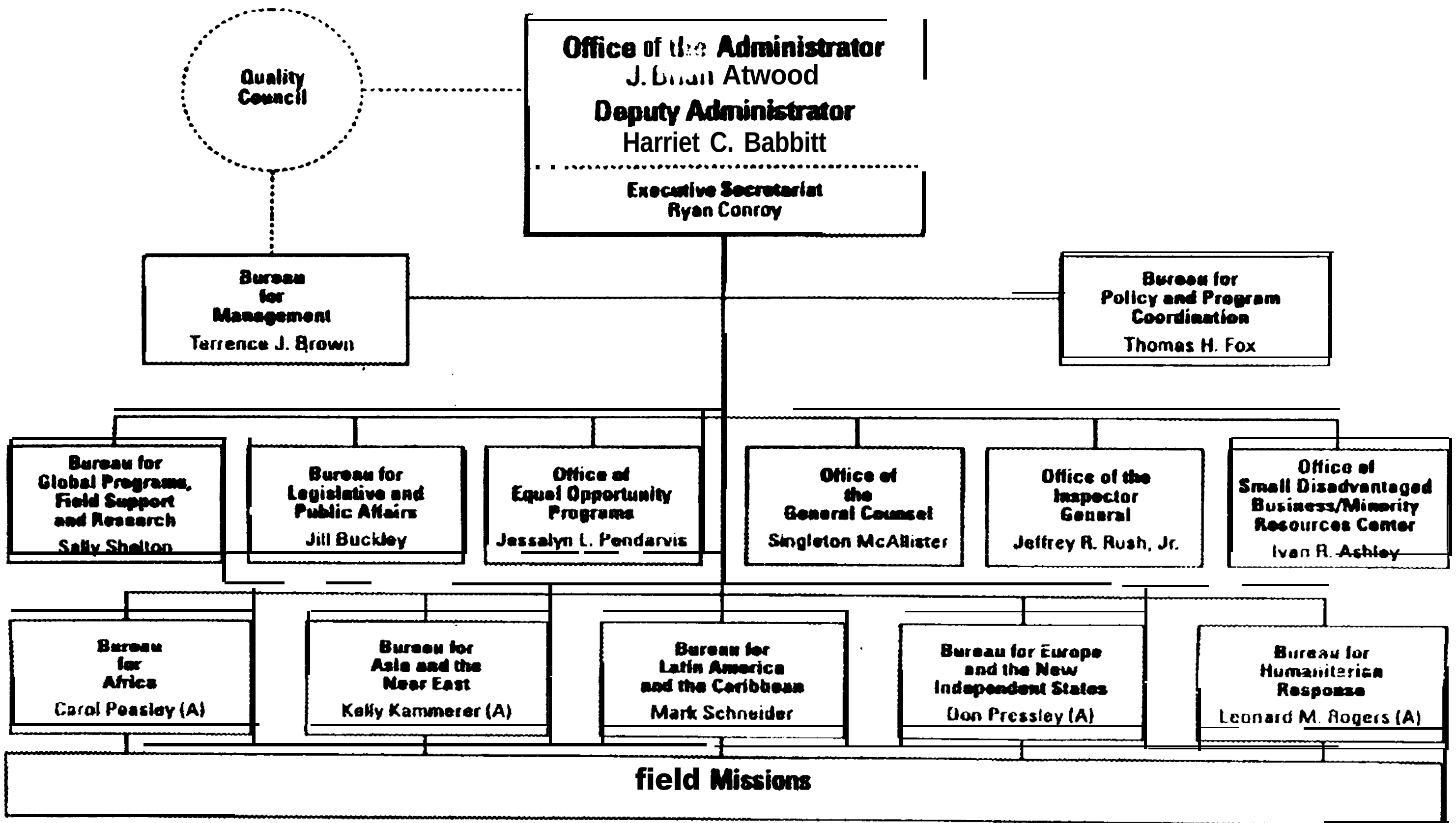
Agency for International Development



December 1997

MANAGEMENT IMPROVEMENTS

MANAGEMENT IMPROVEMENTS

Since May 1993, when USAID became one of two "reinvention laboratories" as part of the Vice President's National Performance Review, USAID has sought to remake itself by:

- improving its strategic focus on fewer but more attainable objectives.
- linking resource allocation more directly to program performance.
- reducing redundancy in management and empowering employees.
- instilling critical values of customer service, teamwork, results orientation, empowerment and diversity into the organization's corporate culture.
- supporting the new values with reformed operating systems that simplify and streamline our work, and
- bolstering new operating systems with modem technology that will improve accountability, and better track USAID's program and financial performance.

The goal of these management reforms is to make USAID a more responsive, effective and efficient organization in delivering assistance resources in the 74 countries in which USAID worked at the end of Fiscal Year 1997.

Promoting the new management vision and introducing new ways of doing business have been affected by resource shortages that drove both the pace and content of the reform effort. These include a significant reduction in the Operating Expenses budget, cuts in the program dollar budget, and a 29.1% reduction in US Direct Hire staffing. At the start of FY 1997, USAID was spending only about 8% of its total budget on operating expenses, down from just over 10% in FY 1993-95.

These cuts have focused our efforts on restructuring overseas operations. Although USAID's comparative strength lay in its overseas presence, deep funding cuts in FY 1996, especially in operating expenses, mean that such an advantage can no longer be sustained as in the past. Following major staff reductions over the past two years (including a Reduction in Force), USAID has begun to take stock of its remaining human and physical resources to achieve a new equilibrium between its mission and its management capacity.

In the midst of downsizing, USAID is embarking on a new phase of management reform. Having gone beyond the "experimental lab" phase, we are reviewing what we have learned from the past three years, and are beginning to act on that learning. We are starting to tackle some "tough" management areas---human resources and workforce, information management, and procurement---to support our smaller, more focused field missions in managing for results.

The past two years have marked an important watershed in USAID's corporate culture, as we began to see evidence of how the new core values were being implemented.

TEAM WORK AND PARTICIPATION

Assessments of experience with Country Experimental Labs as well as other studies indicate strong support for working in and managing by teams. More than half USAID's field operating units have modified their organizational structures by establishing teams keyed to approved strategic objectives.

Surveys conducted within USAID and by the GAO suggest effective teamwork shortens the activity development cycle, improves the speed and quality of decision-making, allows USAID to empower its Foreign Service Nationals (FSN) more, and facilitates adjustment to a lower US Direct Hire (USDH) presence overseas. While the evidence so far is limited, there is a growing body of it that suggests "teams" support customer service and improve activity management and performance reporting.

A major initiative growing out of reengineering reforms is the New Partnerships Initiative (NPI). NPI is an integrated approach to development assistance that increases the capacity of local actors--from civil society, the business community, and institutions of democratic local governance-to work together to solve problems at the community level. It builds upon one of the precepts of reengineering, increased stakeholder involvement in the design and implementation of USAID programs, to emphasize the formation of local and international coalitions of public and private sector actors (both between societies and across diverse sectors within a given society). In late 1997, USAID agreed to work with our non-government organization partners to develop "strategic partnerships" in countries where USAID Missions have formally closed.

CUSTOMER SERVICE

Customer service planning by the start of FY 1997 had become an integral element in every USAID operating unit's strategic plan. It is incorporated as a formal part of USAID's Automated Directives System (ADS), USAID's fully computerized internal manual of policies, essential procedures and reference materials. Customer service plans are in place, or being developed for every field operating unit and headquarters' office. USAID also developed new training modules in 1996 on delivery of customer service and initiated actual training of staff.

EMPOWERMENT AND ACCOUNTABILITY

The principle of empowerment in USAID involves locating authority (and responsibility) at the point where resources are managed.

Reforms in USAID's operating systems have succeeded in promoting empowerment and accountability by unifying headquarters' approval of field mission strategic plans and objectives with authorization to deliver assistance. This is accomplished through management contracts between field Mission Directors and regional bureau Assistant Administrators. Almost all field operating units have such contracts in place. Also, field mission authorities to issue implementation documents, waive competition and advertising requirements and negotiate and implement agreements with other USG agencies are being fully used.

RESULTS ORIENTATION

USAID's results orientation means operating units are to manage towards the achievement of results. This entails a process of setting clear objectives and targets, collecting adequate information to judge progress, and adjusting strategies and tactics as required.

By the end of 1996, nearly all USAID operating units expending development assistance had strategic plans in place with identified objectives. Operating unit strategic objectives typically have five to eight year timeframes for their achievement, reflecting the long-term effort required to realize sustainable economic and social development impacts. Strategic plans are developed in concert with host-country governments, with Agency development partners (such as Private Voluntary Organizations), and with customer input, acknowledging the importance of involving those most affected by the interventions in the solutions.

The Office of Inspector General's first interim report on USAID's implementation of the Government Performance and Results Act (GPRA) of 1993 concluded that USAID substantially accomplished what it proposed as a "pilot" agency, made progress in developing an Agency strategic plan, and made significant progress in establishing operating unit performance monitoring systems to report results. Since that report, USAID has issued its strategic plan, prepared in close coordination with the State Department.

DIVERSITY

USAID addresses diversity as **a core** value in several ways. First, it includes USAID's carrying out the mandates of the equal opportunity law, investigating allegations of discrimination and responding affirmatively to indications of unfair practices, all of which impact the effectiveness and quality of the work environment. In a team environment, USAID must be proactive to resolving employment disputes and ensure equal opportunity.

Second, USAID must "value" diversity because of its unique mission as a foreign affairs agency that works directly with customers and partners in different cultures. Effective teamwork and participation reinforce valuing diversity by providing an environment in which all employee contributions are elicited irrespective of background, appearance or interaction style. Means by which USAID has promoted diversity in its work environment include greater use of multi-disciplinary teams, encouraging use of expanded teams to include partners and customers, and empowerment of Foreign Service Nationals to head or make key contributions to the work of teams.

Third, USAID approaches diversity as a value requiring constant reinforcement through training in Equal Opportunity Program principles.

ACHIEVEMENTS IN AGENCY BUSINESS AREAS

USAID is making major progress in most of its core business areas and administrative support systems.

OPERATIONS

Changes to how USAID plans, delivers and monitors its assistance have been the most dramatic. Almost all Agency operating units have strategic plans in place supported by management contracts. Most field missions have formed and operate within strategic objective teams with increased authorities. About 80% of all Agency operating units have performance monitoring systems in place with baseline data for strategic objectives, established baseline data for at least one of their strategic objectives.

The Automated Directives System (ADS) Series 200, which governs operations has replaced four handbooks and has resulted in dramatic improvements in efficiency. Surveys at selected field missions made by both USAID and the GAO by the start of FY 1997 indicate that the time from conceptualization to funding of an activity can be reduced by one-half. Where previously eight separate documents where required for project approval, only four are required under the reengineered system. While the evidence is still anecdotal, similar reports are being provided by other field missions.

PROCUREMENT

Procurement and assistance are two of the major ways through which USAID translates its development objectives into performance. They are also among the most important areas of interaction between contractors, and grantees and USAID. USAID has been part of the overall federal effort to make procurement more user friendly, while administering resources responsibly.

We concentrated on two key areas: communication/training and use of innovative contracting techniques.

Improving communications with the contractor/grantee community is an important part of USAID's reform effort. In 1996, USAID used its website to post contract information on approximately 75 solicitation documents, representing about half of all competitive contracts. Most of the queries on USAID's website received that year involved procurement topics and issues.

Within USAID, however, there was acknowledgment that the processes involved in assistance and acquisition needed serious reform and streamlining. A Task Force was formed in late 1997 to recommend ways to do this. Their recommendations focused on more training for non- contract personnel, improved "teamwork" between contract and non-contract personnel, and increased delegations of warrant authorities. Implementation of these recommendations has already started.

ORGANIZATIONAL MANAGEMENT AND **HUMAN RESOURCES** DEVELOPMENT

USAID has been going through a critical period of staffing and organizational restructuring. Driven by severe budget cuts, USAID revamped its overseas presence, reducing USDH stafiing in field Missions by 34.4% compared to FY 92. In addition, 28 Missions have been closed since FY 92, with another 12 Missions beginning the process of closeout.

In projecting staffing capabilities, USAID, in consultation with the State Department, determined that USAID would retain full Missions in about 25-30 countries, about 40% of our current full Mission presence. Programs in smaller posts would remain in about 15 to 20 countries, leaving USAID in only about 50 countries compared with over 100 countries in 1992.

In late 1997, another Task Force formed to look at workforce planning issues and make recommendations about the size and composition of USAID's direct hire staffing. Their recommendations favored preserving current overseas staffing, trimming Washington staff, increase finding for staff training, and discussed alternative ways for managing USAID overseas missions.

Improvements in other areas of personnel management were in employee evaluation and the assignments process. A revamped employee evaluation program was put into use in 1996 and will be further streamlined in 1998. That program ties employee work objectives to strategic objectives of USAID's operating units and, more broadly, the Agency's goals. It focuses employees and raters on "results" and achievements rather than process, and heavily valued teamwork. Also, a new assignments process has been put in place that reduces the time it takes to assign foreign service officers by an average of 50 percent.

Finally, toward the end of 1997, USAID launched Reengineering Effort for Organization and

Management (REFORM). Among other things, this Initiative will implement changes that will:

- delegate to field Missions increased authority to change their organizational structures to support team-based organizations.
- allow field Missions greater latitude to delegate authorities to FSNs.
- revise Foreign Service National position classifications to reflect the new way of doing business.
- allow field Missions greater latitude to install incentive systems to recognize results achievement and effective teamwork.

BUDGET

Over the past two years, USAID operating units have struggled with the problem of how to simplify the internal process of allocating resources. USAID's budget process has been encumbered by numerous hard and. soft earmarks, to-which have been added special Administration and Agency initiatives. These have significantly reduced the discretion USAID has to match program and operating expense resources with program performance.

By the end of CY 1996, USAID issued guidance to its operating bureaus to put in place a common factors system for allocating resources. Standard weights are to be applied across all bureaus to factors like performance, country need, development partnership with the host country and foreign policy priorities to identify explicitly priorities and tradeoffs between as well as within regions. These factors were slightly adjusted in early 1998 as part of a streamlined, more performance-focused R4 review.

INFORMATION RESOURCES MANAGEMENT

A critical element to making Agency core values succeed is effective information and communication systems. An integrated information system (as envisioned by the New Management System or NMS), will empower employees by providing ready access to shared information, and improving accountability through better record keeping systems. On another level, communication promotes management effectiveness and teamwork by sharing experiences and best practices within and outside the Agency.

USAID has been successful in improving its ability to communicate internally and externally with both employees and customers. The last two years witnessed development of a variety of channels for reaching employees and customers alike: USAID intemet and intranet with links to Agency documents, policies and announcements in Washington and 40 of our largest missions;

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publication of On Track, a monthly reengineering digest; disseminating USAID Automated Directives System and supplementary references on CD-ROM as well as its access on internet; PPC/CDIE Reengineering Best Practices Series and Performance Monitoring and Evaluation TIPS available through "CDIE On-Line;" a Reengineering and Reform Reference Guide issued periodically by the Agency's Quality Council; establishment of a special USAID Electronic Bulletin Board on Reinventing USAID; and a network called RF Net that serves as an interactive forum for an employee colloquy on issues involving reengineering and Agency policy. All these media are supported by electronic help desks, such that by the start of FY 1997 all employees had access to at least one channel of management support for management and policy queries.

USAID has also enhanced its use of information technology to improve its outreach to customers and stakeholders. By the start of FY 97, USAID corporate web pages on the Internet were reaching an estimated 65 million people worldwide. For example, organizations and individuals are now able to access procurement policies and business opportunities from nearly anywhere in the world.

The most serious challenge that USAID faced in the information management area in 1996 was in introducing a fully functioning NMS worldwide. Enthusiasm for this integrated financial and information management system was high. Both hardware and software were standardized, and a standard international transmission system was established as the platform for data transmission. And, substantial effort and funding were directed toward training. The system itself was rolled out on October 1, 1996 in 43 Missions, and in Washington. Its success promised resolution to the Agency's long-standing material weakness of lacking an integrated financial accounting system, greater efficiencies in budgeting, reporting results, and managing financial resources. Initially, the system processed $288 million in contracts and grants, as well as the $1.2 billion Israel cash transfer. In addition, 14,500 records from financial accounting and contract information management systems were "migrated" to the new system's data base.

Soon after its introduction, problems not anticipated or seen in prior testing emerged. These problems included interactivity between the different modules, telecommunications linkage problems, and data reconciliation. Following a report issued by USAID's IG office in late 1996, the Agency took several management actions. First, an NMS Task Force of senior personnel was formed with the mission of diagnosing and prioritizing the measures needed to address the system's problems. Second, a new director of Information Resources Management was appointed, an experienced foreign service officer was brought in to head the NMS Task Force, and a full outside consultant's assessment of the NMS was commissioned. The consultant's report identifies coding and software flaws and carefully assesses the options for moving forward.

The next steps are to complete the assessment of the consultant's report and to define a comprehensive plan to: get the agency year 2000 compliant, put in place a financial management system that complies with federal standards and can produce auditable financial statements, and complete the basic functionality for all modules of NMS and for data integration among them.

PROGRAM PERFORMANCE

PROGRAM PERFORMANCE

The Agency for International Development promotes sustainable development in five goal areas: achieving broad-based economic growth. building democracy and governance. stabilizing world population and protecting human health, protecting the environment, and providing humanitarian assistance.

Many Agency activities relate to two or more goals. Because of this, synergistic effects abound. For example. promoting community management of natural resources often enhances democracy by allowing citizens to exercise more control over their livelihood and destiny. Increasing economic opportunity for the poor typically enhances their sense of participatory democracy and the potential for good, local government. Likewise, USAID has found that as people become better educated, birth rates and child mortality drop, and nutrition improves. When girls are able to get a basic education, they raise healthier children. Improving education also encourages rule of law and helps develop an active and open civil society. USAID is increasingly planning activities to benefit from such natural synergies. Other examples abound. Reduction in population pressures through voluntary family planning programs facilitates economic growth. Good governance, especially a reduction in over-regulation and illicit enrichment, promotes microenterprise development. These efforts will likely become more widespread.

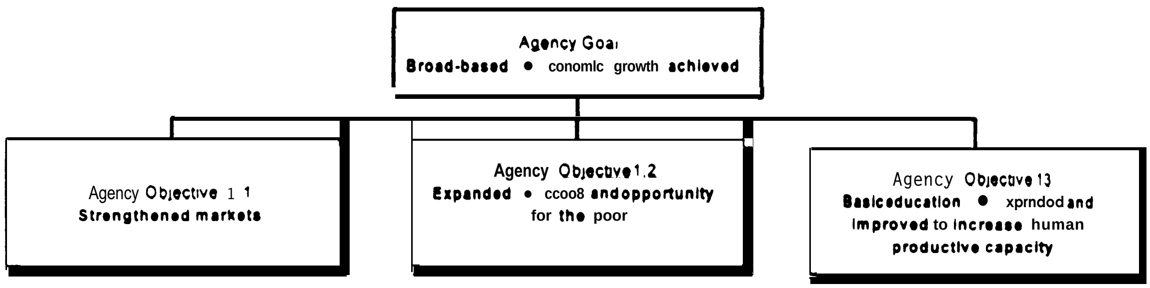
In all its activities the Agency collaborates closely with host country partners, nongovernmental organizations, international financial institutions, and other donors. These partnerships are essential to USAID's work; they both increase program effectiveness and promote sustainability.

1. ACHIEVING BROAD-BASED ECONOMIC GROWTH

Economic Growth Strategy

USAID helps developing and transitional economies achieve broad-based, rapid, and sustainable growth by promoting 1) strengthened markets, 2) expanded access and opportunity for the poor, and 3) expanded and improved basic education to increase productivity.

Economic Growth **Strategic Framework**



Strong markets for inputs (such as capital, labor, and equipment) and for goods and services sustain broad-based economic growth. Vigorous competition and widespread participation help markets become more efficient and reflect human wants and productive capacities. They also provide higher quality goods and services at lower prices

Strengthened markets contribute to economic growth. That, in turn leads to increased employment and higher incomes. But the benefits of economic growth may not be widely shared, at least at the outset. Progress in reducing poverty and food insecurity may be slow because of market imperfections and unequal opportunities. These inequalities are a problem especially for women and ethnic minorities, who predominate among the poor. Economic growth is required for a sustainable reduction in poverty. Policies and institutions that increase access and opportunity for the poor accelerate the reduction of poverty.

Economic growth that is driven by both markets and opportunity will be sustainable when most of the people have the skills and education to participate in the economy. Experience shows that with a basic education—basic literacy, numeracy, and problem-solving skills-people have a much better chance of escaping poverty and leading productive lives. Basic education also provides the foundation for further education and training, enabling people to acquire new skills required for a changing economy.

Results

More than half of USAID-recipient developing countries. with 1.8 billion people. achieved at least moderate economic growth during 1 W-96.

> Ten countries-with almost 1.5 billion people-achieved verv rapid average annual growth in per capita income (3.4 percent to more than7 percent). USAID supported economic growth programs in most countries in this group. They include Bangladesh, the Dominican Republic, El Salvador, Ethiopia, India, Indonesia. Mozambique. Peru, Sri Lanka. and Uganda.
>
> Seven countries, accounting for 100 million people, grew 2 to 3 percent. This is faster growth than most countries in the Organization for Economic Cooperation and Development achieve. In this group, USAID had economic growth programs in Cambodia, Jordan. and Nepal.
>
> Fourteen countries, with more than 300 million people, achieved growth of 1 to 2 percent. That put them about on par with most OECD countries. Growth in this range contributes to meaningful reductions in poverty. Countries with USAID economic growth programs in this category include Benin, Bolivia, Ghana, Guatemala, Guinea, Malawi, the Philippines, and Tanzania.
>
> In 11 other countries (240 million people) growth was weak or negligible (0 to 1 percent). In this group, USAID had economic growth programs in Ecuador, Egypt, Honduras, Mexico, Morocco, Senegal, and Zambia.
>
> In 15 countries (300 million people) per capita income clearly declined. Many USAID-assisted countries in this group experienced considerable political turmoil, including Burundi, Haiti, Liberia, Rwanda, and South Africa.

Countries making the transition from planned to free-market economies in central and Eastern Europe and Central Asia must be considered separately. Their transition inevitably began with an economic decline as central planning ended. Of the 24 countries USAID assisted during 1992–96, only Poland achieved economic growth in 1992. By 1994 growth was rapid in four countries (Albania, Armenia, Poland, and the Slovak Republic). It was low to moderate in seven others, among them the Czech Republic, Hungary, Latvia, and Romania). By 1996 growth was rapid in nine countries, and low to moderate in nine others.

UNAUDITED

Future economic growth will benetit from recent progress in promoting basic education. Basic education improves people's prospects for escaping poverty and leading productive lives. The Agency has promoted universal primary education in all regions where it supports this objective.

Sub-Saharan Africa has made enormous progress. In Benin. Ghana. Guinea. Malawi. Mali. Namibia. and Uganda enrollment has increased 34-71 percent in six trears. Even so. half the primarv school-age children are still not in school. Less than half of those entering first grade will complete their primary education. Many will drop out before thev acquire minimal levels of literacv and numeracy. In most countries, far fewer girls enroll' and stay in primary school than boys. Few sub-Saharan countries have higher than 60 percent enrollment. In Ethiopia and Mali enrollment is below 30 percent.

In Asia and the Near East, many countries. including Indonesia, the Philippines. and Sri Lanka, have made strides in increasing enrollment and completion rates. But Bangladesh. India, and Nepal have major problems, with enrollment below 70 percent. Yet worse off are Morocco (56 percent) and Pakistan (30 percent). In South Asia and the Middle East, girls are far less likely to attend school and complete a primary education.

The picture is much better in Latin America. In many countries 90 percent of school-age children attend school, and with the exception of a few countries, girls are going to school and completing their education at close to the rate of boys. However, these statistics mask poor quality and unequal access. Although enrollment is high, about 45 percent (based on a weighted average by population) complete primary school, and repetition rates are very high. There are large pockets of underserved children-schools are very poor and not serving students' needs--especially in Guatemala and Haiti.

Conclusion

Helping countries achieve broad-based economic growth presents a challenge for USAID and other donors alike. The performance of USAID programs promoting each of its three objectives shows the extent to which the Agency is well positioned to respond to that challenge. Programs that strengthen markets, expand access and opportunity for the poor, and expand and improve basic education yielded significant results across all regions.

The performance of a number of programs fell short of expectations, in part owing to overambitious goals. Often, though, the shortfalls were due to factors outside the Agency's control. Country-specific factors, such as weather, political will, and institutional capacity, can often affect the success of assistance programs. Nonetheless, USAID demonstrated its ability to learn from unsatisfactory performance and revise programs and program expectations where needed. Overall. USAID's performance continues to demonstrate that its strategy for achieving broad-based economic growth is sound and appropriate.

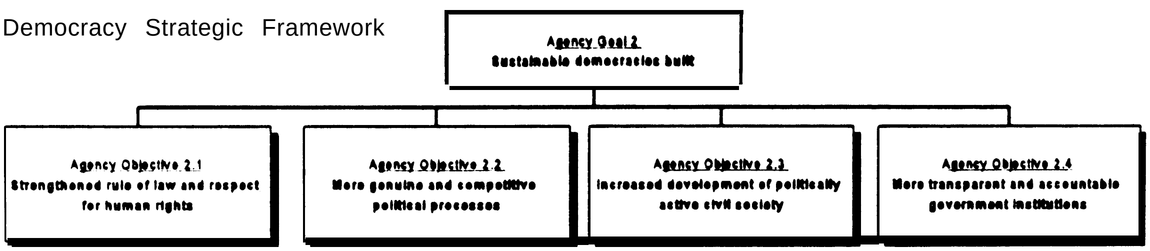
2. BUILDING DEMOCRACY AND GOVERNANCE

Democracy and Governance Strategy

USAID has refined its promotion of democracy over the last several years, building on lessons learned to support indigenous democratic transitions more effectively. In every instance, USAID assistance reflects the dynamic situation in each country.

To guide democracy programming, the Agency pursues four objectives: 1) strengthened rule of law and respect for human rights, 2) more genuine and competitive political processes, 3) increased development of a politically active civil society, and 4) more transparent and accountable government institutions.

Democracy Strategic Framework



USAID provides assistance to countries seeking to create the legal foundation for democracy. Establishing the rule of law protects citizens against the arbitrary use of state authority and against lawless acts of other citizens. The Agency also helps enhance the ability of the judiciary to ensure fair application of existing laws. To ensure that, once established, the rule of law applies equally to all, USAID stresses the importance of guaranteeing equal rights for women and the disadvantaged.

Free and fair elections strengthen the foundation for democracy. USAID and its partners help countries develop the necessary institutional capacity to support, organize, and conduct elections. Assistance includes improving the ability of political parties to function in a competitive election. It also involves ensuring that citizens. especially women and the rural poor. understand the electoral process.

In a democracv. a politically active civil societv creates a vital link between the public and decision-makers. Organizations and associations of citizens form a counterweight to state power. If there is no tradition of independent. politically active groups. citizens in fragile democracies often rely on the state and do not understand the potential of civil societv. USAID and its partners promote participation bv *all* citizens in the political process. That contributes to the development of a politic&y active civil society.

USAID and other donors recognize the importance of developing good governance practices. Corruption. mismanagement. and inefficiency hinder development. Accordingly, the Agency works with countries seeking to establish transparency, accountability, and participation in their government.

Results

The process a country undergoes on the path to democracy is slow and complex. During the last decade, communications have improved, citizens move around more freely, and democratic values and institutions have been promoted. All this has contributed to democratization around the world. Despite a few notable setbacks, the level of democracy in USAID-assisted countries continued to improve. The Agency uses the Freedom House country ratings to assess the state of democracy in countries that receive assistance. Among those countries, 14 advanced on the Freedom House scale during 1993–96. but seven regressed.

Seven of the 11 advances occurred in Africa (Eritrea, Ethiopia, Malawi, Mozambique, South Africa, Tanzania, and Uganda). In Eastern Europe, Bosnia, Latvia, and Romania received improved ratings. In Asia, the Philippines and Mongolia improved their ratings. In Latin America and the Caribbean, the level of democracy in Haiti and Panama increased.

Freedom House reported some setbacks among USAID-assisted countries. In the new independent states, the ratings of Belarus, Kazakstan, and Slovakia fell. In Africa, Asia and the Near East, and Latin America and the Caribbean, democracy declined in Niger, Cambodia, Lebanon, and Ecuador.

> The number of countries rated Free increased from 76 to 79, the highest number since the survey was launched in 1972. Two of the newly free countries, Romania and the Philippines, have USAID-supported democracy programs. Democracy-

building is tenuous. Setbacks included Ecuador and Slovakia. which went from Free to Partly Free. Belarus and Niger now rank Not Free.

Freedom House raised the rating of Sierra Leone from Not Free to Partlv Free. A coup in the spring of 1997, though. confirms the volatility of democratic transitions. The rating for Bosnia also rose from Not Free to Partly Free. There. too, the transition to democracy remains tenuous.

The pattern of democratic evolution demonstrates the need for increased efforts. rather than complacency, in promoting democracy. Although many countries are becoming more democratic, only 19 of 67 countries with USAID-assisted democracy programs rated Free. Continued assistance helps extend and reinforce the momentum gained.

Conclusion

With assistance from the U.S. Agency for International Development, many countries made important progress toward establishing or strengthening democracy. Nevertheless, recent events in Albania, Armenia, Belarus, Cambodia, Sierra Leone, and Peru remind us of the volatile nature of democratic transitions. Despite setbacks in some countries, the foundation for democracy and the ideals encouraged by USAID and its partners often remain. In authoritarian regimes, the Agency supports civil society organizations that create a demand for change. Once liberalization and democratization begin, USAID helps to ensure the consolidation of democracy. The results demonstrate the Agency's growing experience in building sustainable democracies.

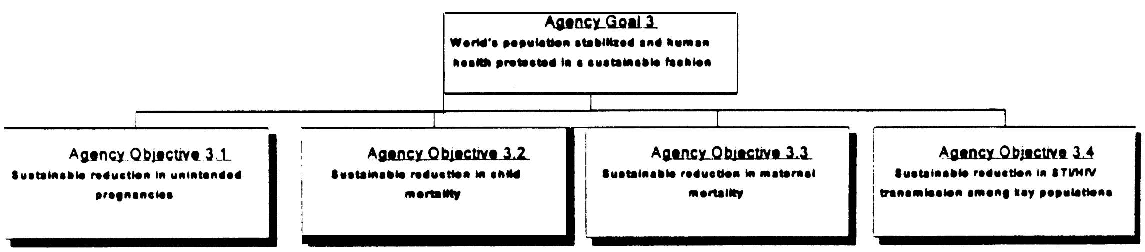
USAID and its partners faced many challenges as they worked with countries to establish the rule of law, conduct free and fair elections, expand the level of citizen participation, and promote transparent and accountable governance. The Agency has continued to identify indicators to monitor the progress of democracy programs. As appropriate, USAID has adapted democracy programming to the specific needs and requirements of different countries. The prevalence of improvements in individual Freedom House ratings confirms the continued advance of democracy worldwide. The U.S. government, USAID, its partners, and governments around the world recognize the importance of ensuring the continuation of that trend.

3. STABILIZING WORLD POPULATION AND PROTECTING HUMAN HEALTH

Population, Health, and Nutrition Strategy

USAID-funded population. health, and nutrition programs have saved millions of lives and made it possible for millions of couples to plan their families. A world leader in population and health assistance, USAID contributed to significant results. The Agencv’s strategy to stabilize world population and protect human health in developing countries rests on four closely related objectives. These are 1) sustainable reduction in unintended pregnancies, 2) sustainable reduction in child mortality, 3) sustainable reduction in maternal mortality. and 4) sustainable reduction in sexually transmitted infections.

Population, Health and Nutrition Strategic Framework



These objectives are synergistic. Gains toward one objective. such as child survival, encourage couples to practice family planning, which reduces unintended pregnancies. This in turn improves the health of a mother and her children and contributes to reductions in maternal and child mortality. Most USAID programs are integrated with activities directed at more than one objective in population, health, and nutrition. These objectives are also closely linked to objectives in other sectors. Women’s status, education, and economic dependency are often crucial factors determining their health and that of their families. Integrated approaches have also helped expand services to hard-to-reach populations in Cambodia, Egypt, Ghana, Kenya, Malawi, Nepal, Peru, the Philippines, Tanzania, and Zambia, among others.

To achieve the objectives, USAID uses four program approaches that are essentially the same for each. They are 1) improving health and family-planning approaches and technologies. 2) building local capacity. 3) improving host country policies and program support. and 4) expanding the availability. quality. and use of health and family-planning services.

Results

During the last two decades, tremendous progress has been made in reducing high rates of population growth and improving health in USAID-assisted countries. Dramatic increases in the use of modern contraceptive methods (such as condoms, implants. and birth-control pills) have reduced fertility rates and contributed to improved child and maternal health. Better information about. and increased use of, child health services aimed at the primary causes of childhood deaths have led to remarkable decreases in infant and child mortality. Over the last 10 years, death rates for children under 5 have declined by 25 percent in Africa. They fell by more than 70 percent in Asia and the Near East and Latin America. Although high rates of death related to pregnancy and childbirth continue to be a devastating problem in many countries, increased attention to maternal mortalitv has begun to identify effective interventions. Recent data indicate that aggressive HIV and AIDS prevention programs may in some areas have slowed the spread of this affliction.

USAID is one of the leaders in the effort to improve child survival. Nonetheless, the examples noted below are the result of close collaboration with a variety of other-bilateral and multilateral donors, and the developing countries themselves, have made enormous investments in this area. But USAID has been a major contributor to a global partnership that is paying off big dividends.

> Twenty years ago, fewer than 5 percent of the world's children in developing countries were immunized against measles, diphtheria, pertussis, polio, and tuberculosis. Now, more than 80 percent are. Polio has been eradicated from the Western Hemisphere and may be eradicated globally by the year 2000.
>
> During 1980-85, infant mortality in developing countries (excluding China) fell from 107 in 1,000 live births to 74 in 1,000. In the same period, under-5 mortality rates fell from 165 in 1,000 to 116 in 1,000.
>
> From 1986 through 1993, oral rehydration therapy of diarrhea-an intervention that USAID was heavily involved in developing-saved 8.3 million lives.

> In the developing world nearly 400 million couples use contraception to avoid unwanted births. Family planning alone can prevent 25 percent of all maternal and infant deaths.

Despite these accomplishments. much work remains. USAID must continue its efforts to increase the use and quality of. and the demand for. family-planning and reproductive health services. It must do the same with maternal and child health services. Efforts to prevent HIV transmission and improve the management of sexually transmitted diseases must also continue. New approaches for mitigating the impact of the pandemic AIDS must be identified. USAID must expand its efforts to combat other infectious diseases as well. In this respect. it needs to address antimicrobial resistance, strengthen disease surveillance systems. and combat increased incidence of tuberculosis and malaria. To achieve sustained. long-term gains in all these areas. the Agency must continue its efforts to encourage our partners to provide additional financial resources. It must also work to increase the involvement of the private sector.

Conclusion

USAID continued to progress toward its goal of stabilizing population and protecting human health. The Agency's population, health, and nutrition programs concentrated on sustainability and promoted activities that preserve and build on progress while decreasing host country dependence on donor-provided resources and technical assistance. USAID assistance helped develop and strengthen host country political commitment, promoted participation of local organizations, and encouraged increased allocation of local resources to the population, health, and nutrition sector.

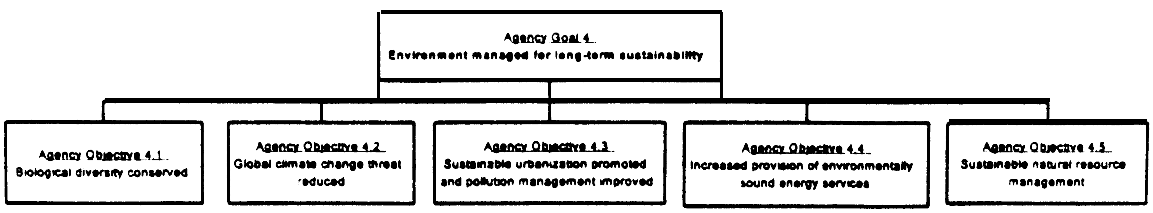
USAID's programs continue to address urgent and life-threatening health needs in developing countries. The Agency and its partners have made remarkable progress toward reducing unintended pregnancies and child and maternal mortality. Despite impressive increases in the use of contraception over the past 25 years, the actual numbers of reproductive-age men and women in poorer countries has also greatly increased. While the efficacy of prevention interventions is now being proved, controlling the spread of sexually transmitted infections, including HIV/AIDS, remains problematic. This will continue until adequate resources can be devoted to increase access to services by vulnerable populations. As the work continues, more and more countries are developing sustainable capacity to address their own population, health, and nutrition needs.

4. PROTECTING THE ENVIRONMENT

Environment Strategy

Environmental management for long-term sustainability is one of USAID's primary goals. Working with its partners, USAID helps targeted populations become better stewards of their own natural resources. To realize this goal the Agency pursues five objectives: 1) conserving biological diversity, 2) reducing threats of global climate change. 3) promoting improved urbanization and pollution management, 4) increasing the provision of environmentally sound energy services. and 5) promoting sustainable natural resource management.

Environment Strategic Framework



A significant proportion of the world's biodiversity is found in countries assisted by USAID. Conserving biological diversity worldwide is crucial for the maintenance of ecosystems. Within many threatened ecosystems, known and still undiscovered plant and animal species offer potential solutions to hunger and health problems of this and future generations.

Actions to reduce the threat of global climate change help counter a worldwide problem that could have enormous economic, environmental, social, and health consequences. Human-induced emissions of greenhouse gases, which trap heat in the earth's atmosphere, may have caused a measurable rise in average global surface temperatures since the turn of the century. Additional incremental changes in temperature over time will, among other effects, damage agriculture- and forestry-based livelihoods, especially in low-lying coastal areas affected by rising sea levels.

In selected cities. the Agency works to improve urban management and ameliorate poor living conditions by financing needed housing. helping municipalities cope with sanitation problems, making clean water available to the urban needy. and reducing pollution. In the developing world. rapid urbanization will increasingly concentrate populations in cities. intensifying urban pollution and environmental health problems.

The Agency encourages use of efficient. renewable, and clean energy technologies. Energy consumption in developing countries is expected to rise significantly in the coming decades. Without environmentally sound alternatives to fossil fuel use. most of the additional energy production in these countries will come from the indiscriminate burning of traditional fuels (wood, coal. and oil). That will increase global carbon dioxide emissions. The effect on both the industrial and developing worlds will be negative.

Working closely with host country counterparts and local people, USAID concentrates on the long-term productive management of farmlands. forests. water, and coasts. These resources provide the foundation for sustained, equitable economic growth for much of the developing world. Rapid degradation of natural resources occurs because of conflicts over their use, market distortions, extreme poverty, population pressures, and inappropriate technologies and practices. USAID responds to natural resource degradation by strengthening national policies and institutions, fostering community empowerment and stewardship, and encouraging the adoption and use of appropriate technologies and practices.

Results

The global environment continues to be threatened with biodiversity loss, global climate change, urban pollution and sanitation problems, unclean energy production, and natural resource degradation. Sound environmental management is key to fostering long-lasting development. Productive lands and waters provide the underpinnings for equitable economic growth. Moreover, degradation of the global environment ultimately threatens the economic and national security of the United States. A country's commitment to addressing environmental degradation is often reflected in its laws and policies. Without such a commitment, efforts to improve the environment may be snort lived. **As** USAID works in a variety of country contexts, the challenges it faces in promoting protection of the world's environment differ greatly.

To assess government commitment to national and global environmental concerns, USAID examined several indicators that measure existence of national environmental strategies and participation in international environmental treaties, such as the Convention on Biological Diversity, signed in Rio de Janeiro in 1992. These indicators show that developing countries still need assistance to establish the enabling conditions for them to become good stewards of the environment.

About one fifth of USAID-assisted countries had high levels of government commitment to the environment. Many of these are in Africa and Asia.

Close to half of USAID-assisted countries had medium levels of government commitment. The majority of countries in Latin America and the Caribbean fall into this category.

Nearly one third of USAID-assisted countries had low levels of government commitment. Most of these countries are in Europe and the new independent states. including Central Asia. Few of these countries have any form of national environmental strategy, but many were beginning to develop such plans.

From 199 1 through 1995. the world lost an average of 11.3 million hectares (about 44,000 square miles) of forest area annually. Most deforestation came as tropical forest loss. One of the largest overall positive trends for USAID-assisted countries is the transfer of forest management responsibilities from governments to local communities. This has led to improved forest management as local communities have the greatest interest in protecting their natural resources for long-term use. USAID has supported community management of forest resources in countries such as Guinea, Malawi, Namibia. Nepal, Niger, the Philippines, and Tanzania.

More than half of all people in the developing world will live in urban areas by the year 2000 and 60 percent by the year 2020. One of the greatest threats to human health and the environment is lack of access to sanitation services. In the nine countries in Asia and the Near East where USAID has urban programs, access of city populations to sanitation services increased from an average of 63 to 80 percent during 1985-93, the latest period for which data are available. The trend was less favorable in Latin **America** and the Caribbean. There the percentage of the urban population with access to sanitation services declined slightly (74 to 71 percent) in the seven countries with USAID urban programs. Country statistics are mostly lacking or incomplete for the countries where USAID operates in Africa, Europe, and the new independent states,

Conclusion

USAID continued to progress toward its goal of managing the environment for long-term sustainability. Although environmental degradation is increasing worldwide, the Agency has been able to initiate and promote many activities in environmental management.

Programs undertook to conserve biodiversity, reduce threats to global climate change. promote improved management of pollution and of urban areas, promote environmentally sound energy services. and fostering sustainable natural resource management. In more than 50 countries. USAID helped strengthen environmental policies and institutional capacity, increase community stewardship of natural resources. and facilitate adoption of improved technologies and practices to protect the earth.

USAID environmental interventions differed by region because of the varving character of environmental problems around the globe. Many programs had outstanding results. but in some cases programs did not meet expectations. In such instances, operating units sought to learn from these situations and change their strategy or approach. The Agency works closely with other donors and the private sector to maximize its environmental impact. This collaboration and USAID's work with beneficiaries help ensure the sustainability of natural resource activities that protect the environment worldwide.

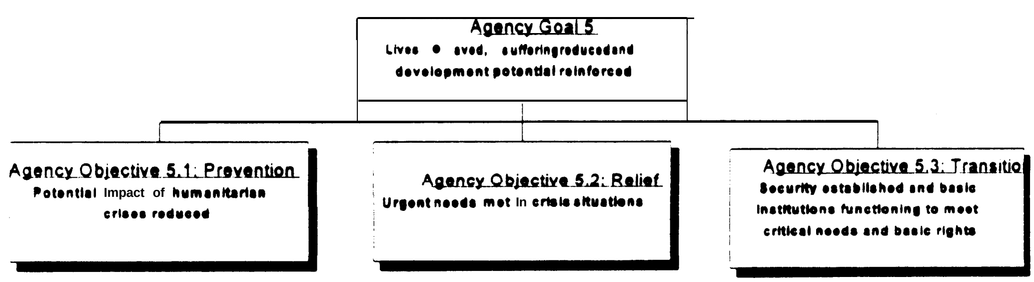
5. PROVIDING HUMANITARIAN ASSISTANCE

The Agencv's fifth goal is to save lives. reduce suffering associated with natural or man-made disasters. and reestablish conditions necessary for political or economic development. This humanitarian assistance cuts across the Agencv's other four goals: promoting economic growth. improving health. fostering democracy and governance. and protecting the environment. It lays the groundwork for long-term development in countries coming out of crisis.

Humanitarian Assistance Strategy

USAID provides humanitarian assistance to meet several objectives: 1) disaster prevention, preparedness. and mitigation; 2) timely delivery of disaster relief and short-term rehabilitation supplies and services; and 3) preservation of basic institutions of civil governance during disaster and crisis and support for new democratic institutions during periods of national transition.

Humanitarian **Assistance** Strategic Framework



Building and reinforcing local capacity to anticipate and cope with disasters and their aftermath cross-cut these objectives.

U.S. private voluntary organizations and international and indigenous nongovernmental organizations carry out much of USAID's humanitarian assistance. These partners are a valued resource because they have an intimate knowledge of field conditions and provide continuity. A recent assessment by the Advisory Committee on Voluntary Foreign Aid found that the USAID–PVO partnership is significantly stronger than it was only four years ago.

In 1995, USAID developed a new strategic framework for humanitarian assistance. The three primary objectives are prevention. relief, and transition. Measuring results in humanitarian assistance is a challenge. In traditional disasters. the number of people receiving assistance or the tons of food provided can be recorded. It is difficult. however. to measure the impact of preventive activities, of buildings that didn't collapse in an earthquake or famines that didn't happen during a drought. It is equally difficult to measure progress when countries are in disequilibrium. Gains may be ephemeral. as conditions teeter between chaos and stability. Final resolution often takes years to accomplish.

USAID helps with three types of disaster: natural disasters, such as famine, floods, and earthquakes; man-made disasters, such as the collapse of buildings or industrial accidents; and complex emergencies. such as civil war or failed states. Complex emergencies are usually political, more violent, longer lasting, and more difficult to resolve than the natural or man-made disasters. Through 1989, USAID primarily responded to the more traditional emergencies—80 percent of the Agency's Office of Foreign Disaster Assistance budget went to natural disasters. By 1996, however, the figures were reversed. That year 90 percent of funds went to complex emergencies

Results

Humanitarian assistance serves the U.S. national interest as an investment. in people and their future development. USAID responded to 18 complex emergencies in 16 countries and 47 natural and 4 man-made disasters in 35 countries. The Title II Food for Peace program operated 30 programs, delivering emergency food aid in 18 countries, primarily in Africa. With 842,550 metric tons of emergency food costing almost $450 million Overall, the program fed 25 million people.

> The Office of Foreign Disaster Assistance obligated approximately $154 million on relief for 69 declared disasters. More than 28 million victims received assistance. There were 47 natural disasters, including 17 floods, 2 droughts, 3 epidemics, 2 tornados, 11 tropical cyclones (typhoons and hurricanes), 1 cold wave, 7 earthquakes, 2 mud slides, and 2 avalanches. Of 11 man-made disasters, 3 involved civil strife, 3 were accidents, 2 were fires, 2 involved displaced persons, and 1 involved refugees. In addition, 11 countries had complex emergencies.

In 10 complex emergencies. USAID delivered basic necessities to people in Angola. Bosnia-Herzegovina. Burundi. Croatia. Northern Iraq. Serbia. Sierra Leone. Somalia. Sudan. and Rwanda. USAID contributed to the transition from war to peace in many of these situations by working to restore law and order. demobilize the military. eliminate land mines. better inform citizens, and promote local governance.

Preparedness planning and early warning had big pavoffs. 5 of 13 at-risk countries in Latin America countries are better prepared to respond to crisis situations. and are less likely to require outside emergency assistance. Famine early warning helped avert serious food shortfalls in Chad, Ethiopia, Kenya, Mauritania, Niger. Rwanda, and Somalia.

Food for Peace Title II food aid went to 25 an estimated 45 million people worldwide. The goal was to enhance food security by improving household nutrition, generating income, and encouraging agricultural production.

Conclusion

Every year, USAID provides humanitarian assistance to meet the needs of millions who fall prey to natural, man-made, and complex disasters. It helps fill the void in societies where people have fallen through the safety net or are in need because of poverty. Humanitarian assistance continues to call for a significant level of funding to meet the ongoing and growing needs of people at risk.

Meeting peoples' urgent needs through relief, rehabilitation, transition. and recovery is a hallmark of USAID's humanitarian strategy. Because of increasing demands on scarce resources, the approach to relief must be continually refined. More and more there is a requirement to prioritize resource allocations, narrow the focus of relief distributions, and more accurately measure how disasters affect vulnerable populations.

The Agency has achieved success in helping several societies move from breakdown to stability. Because varying conditions underlie turmoil, USAID has adapted its approaches. In Angola, for example, the thrust is to diffuse conflict and reintegrate ex-military personnel into society. In helping Rwanda make the transition to stability, the Agency is emphasizing a grass-roots approach to returning displaced persons and refugees to their communities.

Given the increasing call for humanitarian resources, there is a pressing need to protect investments by paying more attention to preparedness, prevention, and mitigation of natural and complex disasters. USAID is increasingly successful in implementing famine early warning systems and in responding to non-food-related natural disasters. In complex disasters affected bv military. political. ecological. and social forces, neither the indicators of impending disaster nor the most appropriate response is well understood. The international community needs to continue to increase its support for early warning on disasters. USAID has played a preeminent role in addressing globally the need for more research and application of early warning systems. There is a need for greater use of preventive diplomacy, and USAID is in the forefront of those trying to develop appropriate preventive interventions.

Approaches to humanitarian assistance are evolving. Changes are sometimes incremental. sometimes very rapid. Assistance programs require a series of planned, prioritized actions to respond appropriately to unending complex human conditions. USAID's work in this area has shown the need to link relief with development, to prioritize when it can respond. and to support others around the world in building capacity to prepare for, prevent, mitigate and respond to disasters. USAID has made great strides in delivering its humanitarian assistance and continues to address the challenges it faces.

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FINANCIAL PERFORMANCE

FINANCIAL MANAGEMENT GOALS:

We have established the following financial management goals for the five-year period covering FYs 1997-2001. Implementation is underway and substantive accomplishments have been made in each area.

1. ACCOUNTABILITY

OMB/CFO Council ***Priority***: Design management structures that help **ensure** accountability for achieving **results.**

Status:

USAID has had a mixed history of compliance with applicable government accounting principles and standards over the years. Overall accountability was sufficient, but much more needed to be done. Limited technical and monetary resources have slowed our progress in raising the Standards of various financial systems to comply with applicable accounting and internal control principles, standards and requirements. Some records were inaccurate and the utility and quality of many reports for management questionable. Our plan to improve accountability is focused on our effort to develop and implement an integrated accounting system.

Recent Accomplishments:

- Overseas cash reconciliations with Treasury have been streamlined by relying on **SF-224** submissions instead of reconciliations to SF-1221 reports from U.S. Disbursing Officers. Increasing use of electronic payment methods continues to reduce the risks of lost payments and improve cash management.

- Reporting requirements are being rationalized in the new systems. Reports are being reviewed as to their management utility and a series of more appropriate reports have been created. Unnecessary and/or unproductive reporting is being eliminated.

- Funding reservation responsibilities have been distributed closer to the users. This saves time and cuts unnecessary steps and paper flow.

- Performance objectives and results will be incorporated as key elements in budget guidance and budget and program management reviews.

Plans:

Within our current resource constraints, we have made significant progress, and plan to continue our efforts to improve accountability at USAID in several areas. Major system improvements will continue in 1998 including:

- Streamlined and re-designed programming and budgeting procedures on both the project and administrative side of our business.

- JFMIP government accounting principles/standards are being incorporated into our new financial systems and procedures.

2. FINANCIAL ORGANIZATION AND PERSONNEL

OMB/CFO Council Priority: Develop a quality Federal financial management workforce and appropriate CFO organization structure to achieve financial management priorities.

Status:

USAID's program budget for FY 1997 was approximately $6.6 billion, supported by about $500 million in operating expenses. We have U.S. direct hire financial officers in 42 of the approximately 60 countries in which USAID has an overseas presence. We employ about 2,500 U. S. direct hire personnel worldwide. Financial management has approximately 100 U. S. employees in Washington and 80 U.S. employees overseas. About 1,300 additional foreign national employees work at USAID missions abroad as voucher examiners, accountants, and financial analysts. The financial management operation has been restructured to meet the intent of the CFO Act.

Recent Accomplishments:

- General Schedule financial management employees continue to be sent overseas for short-term assignments. This provides a "low cost" service to missions while giving these Washington-based personnel an overseas perspective of our world-wide operations.
- Authority to "write-off' debt and make financially-eriented decisions has been increased and delegated outward to missions. This empowers missions to more actively manage their own portfolios and make their own decisions associated with their programs.
- Ninety-eight percent of all USAID personnel receive salary through direct deposit electronic funds transfers. This is the one of the highest rates in the US Government.

Plans:

In the area of financial organization and personnel we are actively working to:

- improve the effective delegation, communication and accountability of financial management personnel worldwide in supporting the needs of their respective operational teams;
- re-design and upgrade the jobs of financial management personnel to fit the new management systems under development and implementation; and

- reorganize Washington operations to reduce redundancies, streamline operations and incorporate non-financial personnel in positions of accountability.

- continue to upgrade U.S. and foreign national professionals' job skills through training.

The focus on change in this area will be to restructure and streamline operations as we downsize the overall organization and change our business operations. Our financial managers of the future must be able to integrate more fully the strategic planning, budgeting, financial management, and performance measurement functions in a much more automated operating environment. We are investing in our financial management personnel and are re-engineering our organization now to assure this future goal can be met.

3. ASSET MANAGEMENT

OMB/CFO Council Goal: Redesign the way that Federal agencies plan, budget, manage, evaluate, and account for Federal programs.

Status:

The lack of integrated financial systems has hindered our ability to manage assets effectively. Until we finish implementing an integrated financial management system that meets the requirements of the Joint Financial Management Improvement Program (JFMIP), many asset management problems will persist. However, across the board, we are making every effort to protect assets and improve resource management.

Recent Accomplishments:

- Application of off-the-shelf travel management software worldwide. Work has also begun on the electronic, "paper-less" system where all travel documents are signed and routed through this electronic system. The former USAID CFO co-chaired a 47-member inter-agency task force supporting application throughout the U.S. Government.

- USAID financial personnel had a leadership role in the JFMIP Travel Re-invention Task Force. Task Force recommendations are likely to lead to over $800 million in travel savings in the U. S. Government.

- Travel advances are much more tightly managed overall. Outstanding travel advances dropped from $4.2 million in 1990 to about $400,000 in 1997. Travel cards are being utilized now by employees which improves cash management and control.

- Official travelers are using the corporate American Express card. Our follow-up system assures that traveler's vouchers are processed quickly (usually within a week) and employees' AMEX liabilities quickly paid (the lowest outstanding AMEX debt in the U.S. Government).

- Implementation of the Electronic Certifying System (ECS) is nearly complete worldwide. Approximately 44 locations are in operation or about to come on-line. Payments are made faster and more accurately, with reconciliations virtually automated away. Ninety-seven percent of USAID/Washington's vouchers are now paid electronically, one of the highest rates in the US Government.

- USAID missions are implementing the use of private local banks to make overseas local currency payments. This pilot effort will increase USAID personnel productivity and, if it proves fully successful, will likely be used more widely to provide more effective and efficient service in a down-sized overseas environment.

Plans:

We have alreadv begun to correct weaknesses in the following areas:

- Improving asset management, fully carrying out Prompt Pay Act requirements worldwide, and improving cash management.
- Improving property management.
- Developing credit management policies and procedures.
- Establishing a credit review board.
- Outsourcing the loan servicing function.
- Cross-serving for the letter of credit advance and liquidation processing.
- Decrease overseas imprest funds by privatizing banking services
- Improve accounts receivable by
  - incorporating them in the integrated financial management system
  - establish policy
- Improve ICASS

4. MANAGEMENT CONTROL

OMB/CFO Council Priority: Design management structures that help ensure accountability for achieving results.

Status:

USAID is well underway in rationalizing and upgrading its management controls, especially in the area of financial management.

Recent **Accomplishments:**

Recent internal control reviews have resulted in strengthened controls over cashier operations, reduced the time to pay vendors under the Prompt Pay Act and reduced the total amount of outstanding travel advances.

Plans:

We plan to continue to upgrade the management control program for financial operations to include the following goals:

- Streamlining the management control program to make it more effective and a true management tool for all managers, not just in financial management.
- Carrying out an agency-wide standardized portfolio review and reporting system. This will provide line managers tools to ensure that effective management processes are in place in each mission/office and that appropriate management actions and mid-course corrections are being made.
- Tracking performance indicators related to management control and tying them directly to the managers' own performance.
- Institutionalizing management control efforts. We will continue to better focus on achieving management integrity in our functional approach and assure the oversight process is effective and efficient.
- Undertaking an expanded review of financial management overseas, to include broad-gauged inspection of the adequacy of financial and administrative management controls in both the project and operational settings.

- Establishing a core staff of management control specialists to plan initiatives, set policies and coordinate compliance in all financial management operations worldwide.

5. FINANCIAL SYSTEMS

OMB/CFO Council Priority: Establish financial management systems, using standardized information and electronic data exchange, and commercially provided software and transaction processing services to the extent possible.

A. Vision of the Future

The Chief Financial Officers Council has proposed that the various CFOs should work in partnership with program managers to use modem management techniques, integrated financial management systems, and accurate and timely financial information to achieve desirable results in a cost effective manner. This was based on the Vice-President's National Performance Review (NPR).

USAID's Office of Financial Management subscribes to the recommendations of the NPR and the vision statement prepared by the CFO council and has created its own vision and strategic plan to move USAID to the forefront of a new era of responsive, effective, collaborative, customer-oriented financial management. To make this vision a reality, USAID embarked on an ambitious undertaking to replace thirteen disparate financial management systems and applications with a single integrated financial and information management system.

The objectives of USAID's single integrated financial management system are to:

- capture accounting transactions when and where they occur;
- reduce the creation and flow of paper; and
- generate information, not just data.

Our goal is an integrated financial management system linking the mixed financial systems for budgeting, procurement, program operations, human resources and property management. This will enable us to capture accounting transactions when and where they occur, eliminating redundant data entry and greatly simplifying the reconciliation processes..

B. Current Systems Problem Description

The problem with current USAID legacy financial systems is their lack of integration. The estimated level of redundancy among these systems is forty-five percent. Thus, lack of data integrity coupled with redundant system maintenance is a major problem which needs immediate corrective action. Like many other federal agencies, most of USAID's legacy accounting systems are outdated, expensive to maintain, non-integrated, and produce data that is inconsistent with data contained within other support systems. Problems with the legacy systems include the following:

- USAID uses numerous headquarters and overseas financial management systems, subsystems, and "cuff record" systems that require the input of redundant and inadequately controlled data.

- USAID's major financial systems are not integrated. Obligation and disbursement transactions which take place in the field are first recorded in the MACS, electronically transmitted to Washington, summarized, and then manually re-entered in summary form in Washington.

- The USAID accounting system has been included in the President's list of the top 100 "High Risk" programs for the past few years. The reasons include:

  - inadequate internal controls;
  - financial abnormalities;
  - inaccurate reporting; and
  - the lack of timely management information to support policy formulation and program planning.
  - unique requirements that inhibit the implementation of COTS software

C. Approach to Improved Financial Management

The Office of Management and Budget and the CFO Council continue to lead the Federal Government in an aggressive direction toward better financial control over operations. We plan to achieve all goals for government-wide financial management, legislated by the Chief Financial Officer's Act, and as outlined by OMB and the CFO Council. This will be attained by the Agency's continuing re-engineering program and made operational through the full implementation of an integrated financial management system. Our vision, mission and strategy continues to tie directly and support those promoted by OMB and the CFO Council's guiding principles in carrying out the Government Performance and Results Act (GPRA) and the Government Management Reform Act (GMRA).

As an essential part of the Agency's overall management systems we have developed and started implementation of a series of operational improvements to our financial management systems. While this has proven to be no easy task, the progress made, and the additional improvements to come, are designed to make the Agency a leader, with the most effective and efficient financial management operations in the Federal Government.

The lack of a single, integrated financial management system has been identified as a material weakness for USAID since 1988. In 199 1, a Business Area Analysis was conducted and a Strategic Information Systems Plan documented the Agency's financial system requirements and strategies.

The USAID Worldwide Accounting and Control System (AWACS) was developed and is a component of an integrated computer-based corporate information system, the New Management System (NMS). Three other components of NMS are currently operational -- program operations, acquisition and assistance (A&A), and budget. The NMS was deployed in Fiscal Year 1997 and provides worldwide budget and program operations capability, and increased procurement and accounting functionality for Washington operations.

The current AWACS version does not comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Agency management and the Inspector General have identified internal control deficiencies and other vulnerabilities associated with the development and deployment of NMS, particularly AWACS.

An agreement has been signed with the Federal Systems Integration and Management Center (FEDSIM) to conduct an independent verification and validation (IV&V) of NMS. FEDSIM will review the financial management systems to evaluate (1) compliance with the Federal Financial Management Improvement Act (FFMIA); (2) progress towards USAID's goal for a worldwide accounting system that captures transactions when and where they occur; and (3) the ability to provide accurate and timely management information. The Agency will make a management decision on the lowest management risk and cost alternative to meet its financial management system requirements in 1998 and the future, based on the work and recommendations of the FEDSIM contractor. A fully integrated financial management system that meets all applicable Federal accounting standards remains our goal.

6. AUDITED FINANCIAL REPORTING

> ***OMB/CFO Council Priority:*** Provide accountability by issuing a comprehensive set of standards for Federal agencies that will require their financial reports to demonstrate how Federal money is spent.

Status:

USAID is required under the Government Management and Reform Act (GMRA) of 1994, to prepare consolidated financial statements beginning with FY 1996; have them audited; and submit them to the Office of Management and Budget and the Department of Treasury. USAID is well on the way in meeting the requirements for audited financial statements. We produced agency-wide financial statements for the first time for FY 1996.

Plans:

Improved financial management through the implementation of the GMRA and Government Performance and Results Act (GPRA) of 1993 has been a priority and will continue to be. We have made significant progress implementing the requirements of the legislation. Weaknesses in internal controls and systems were identified and reported which enabled us to minimize risks and improve processes, including those inherent in the preparation of the FY 1996 financial statements. Coopers & Lybrand, a public accounting firm with extensive CFO Act experience, was engaged to assist in the improvement of overall quality of the financial 1996 reporting processes. KPMG Peat Marwick, another public accounting firm, has been engaged to assist in the preparation of the 1997 reports.

MILESTONES FOR IMPLEMENTATION

1. ACCOUNTABILITY	97	98	99	00	01
Develop/implement financial management performance standards	X	X	X		
Incorporate all appropriate government accounting principles/standards	X	X	X		
2. FINANCIAL MANAGEMENT ORGANIZATION					
Transition FM personnel and operations to the new management operational environment	X	X	X		
Strengthen CFO-field controller relationship	x	x	X		
Educate USAID on CFO/GMR Act requirements	X	X	X	X	X
Recruit/train personnel. especially interns	X	x	X	X	X
3. ASSET MANAGEMENT					
Undertake reconciliations in preparing for new system	X	X			
Implement Prompt Pay Act requirements	X	X			
Improve cash management	X	x	X		
Improve property management	X	X	X		
Develop/ implement credit management policies & procedures	X	X	X		
4. MANAGEMENT CONTROLS					
Conduct mission level Internal Control Reviews	X	X	x	X	X
5. FINANCIAL SYSTEMS					
Ensure all financial systems conform to A-127 and JFMIP "Core" requirements	X	x	x		
Develop an operational data warehouse/corporate database	x	x	x		
Develop/implement an integrated financial management system	X	X	X	X	X
Develop upgraded management information systems for budgeting and program management	X	X	X		
6. AUDITED FINANCIAL REPORTING					
Issue financial statements	X	X	X	X	X
Develop performance standards	x	X	X		

UNAUDITED

Section 6 of the USAID's Consolidated Financial Statements-Independent Auditor's Report-was not used in the Office of Inspector General's Audit Report.

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CONSOLIDATED
FINANCIAL STATEMENTS
and NOTES

Limitations of Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the U.S. Agency for International Development, pursuant to the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994.

While the statements have been prepared from the books and records of the entity in accordance with formats prescribed by the Office of Management and Budget, the statements are different from the financial reports used to monitor and control the budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30,
(In Millions)
(Unaudited)

		1997		Restated 1996
Assets				
Entity Assets:				
Intragovernmental Assets:				
Fund Balances With Treasury (Note 2)	$	9,707	$	9.692
Accounts Receivable, Net (Note 3)		516		327
Advances and Prepaynents (Note 4)		51		277
Governmental Assets:				
Accounts Receivable, Net (Note 3)		2		5
Credit Program Receivables. Net (Note 5)		7,797		7,830
Advances and Prepayments (Note 4)		1,143		1,417
Cash and Other Monetary Assets (Note 6)		2		16
Operating Materials and Supplies (Note 7)		19		9
Property, Plant and Equipment (Note 8)		55		38
Total Entity Assets		19,292		19,611
Non-Entity Assets:				
Intragovernmental Assets:				
Fund Balances With Treasury (Note 2)		6		6
Cash and Other Monetary Assets (Note 6)		248		235
Total Non-Entity Assets		254		241
Total Assets	$	19,546	$	19,852

The accompanying notes are an integral part of these financial statements.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30,
(In Millions)
(Unaudited)

	1997	Restated 1996
<u>Liabilities</u>		
Liabilities **Covered by Budgetary Resources:**		
Intragovernmental Liabilities:		
Accounts Payable (Note 9)	$ **189**	$ 109
Debt (Note 10)	322	340
Other Intragovernmental Liabilities (Note 11)	18	17
Governmental Liabilities		
Accounts Payable (Note 9)	1,713	1,606
Liabilities for Loan Guarantees (Note 5)	**487**	**392**
Other Governmental Liabilities (Note 11)	**273**	**262**
Total Liabilities Covered by Budgetary Resources	3,002	2,726
Liabilities not Covered by Budgetary Resources:		
Governmental Liabilities:		
Liabilities for Loan Guarantees (Note 5)	376	386
Accrued Unfunded Annual Leave and Separation Pay (Note 12)	25	**24**
Accrued Unfunded Workers Compensation Benefits (Note 13)	**45**	40
Total Liabilities **Not Covered by Budgetary Resources**	446	450
Total Liabilities	3,448	3,176
<u>Net Position [Note 14)</u>		
Unexpended Appropriations	9,016	9,775
Invested Capital	7,270	**7,488**
Cumulative Results of Operation	258	(137)
Future Funding Requirements	(446)	(450)
Total Net Position	16,098	16,676
Total Liabilities and Net Position	**$** 19,546	**$** 19,852

The accompanying notes are an integral part of these financial statements.

UNAUDITED

U.S. AGENCY FO'R INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
FOR THE YEAR ENDED SEPTEMBER 30,
(In Millions)
(Unaudited)

	1997	Restated 1996
Revenues and Financing Sources		
Appropnated Capital Used	$ 6,485	$ 6.365
Revenue from other Federal Agencies	7	30
Interest and Penalties. Non-Federal (Note 15)	102	419
Interest, Federal	15	0
Donations	51	0
Other Revenues and Financing Sources (Note 16)	842	101
Total Revenues and Financing Sources	7,502	6,915
Expenses [Note 17)		
Program **Expense:**		
For USAID Appropriations:		
Economic Support Fund	2,205	2,130
Direct and Guaranteed Loans	102	1,666
Development Assistance	1,249	1,090
Assistance for the New Independent States of the Former Soviet Union	770	824
Development Fund for Africa	565	678
Special Assistance Initiative	588	534
International Disaster Assistance	191	129
Child Survival and Disease Program	15	0
International Organizations and Programs	18	32
Americans Schools and Hospitals Abroad	5	8
Sahel Development Program	0	7
Demobilization and Transition Fund	1	6
Sub-Saharan African Disaster Assistance	(1)	1
Central American Reconciliation Assistance	0	1
Foreign Currency Trust Fund	40	63
Gifts and Donations	51	0
U. S Dollar Advances from Foreign Trust Funds	0	1
Total Program Expense for USAID Appropriations	$ 5,799	$ 7,170

The accompanying notes are an integral part of these financial statements.

UNAUDITED

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF OPERATIONS AND CHANCES IN NET POSITION
FOR THE YEAR ENDED SEPTEMBER 30,
(In Millions)
(Unaudited)

4

		1997		Restated 1996
Program Expense (continued):				
For Allocation Appropriations from Other Agencies:				
Commoditv Credit Corporation Fund	$	292	$	p m 329
Total Program Expense for Allocation Appropriations from Other Agencies		292		329
Total Program Expenses		6,091		7,499
General and Administrative Expense:				
Operating Expense, USAID		569		590
Pavment to Foreign Service Retirement and Disability Fund		44		44
Operating Expense, Inspector General		29		34
Foreign Service National Separation Pay Trust Fund		2		2
Total **General and Administrative Expenses**		644		670
Total **Expenses**		6,735		8,169
Excess (Shortage) of Revenues **and** Financing Sources Over Total Expenses	$	767	$	**(1,254)**
Wet Position (Note 14)				
Net Position, Beginning Balance, as Previously Stated	$	**16,676**	$	18,544
Adjustments (Note **18)**		9		0
Net **Position, Beginning Balance, as** Restated		16,685		18,544
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses		767		**(1,254)**
(Minus) Non-Operating Changes (Note 19)		((1,354)	1	4)
Net Position, Ending Balance	$	**16,098**	$	16,676

The accompanying notes are an ***integral part*** *of these financial statements.*

UNAUDITED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the United States Agency for International Development (USAID). Thev have been prepared from the books and records of USAID in accordance with USAID's accounting policies, of which the significant policies are summarized in this note. These statements are presented in accordance with the applicable form and content requirements of the Office of Management and Budget (OMB) Bulletins 94-01 and 97-01, *Form and Content of Agency Financial Statements,* and the Government Management Reform Act (GMRA) of 1994 . 'The GMRA does not require the Statement of Cash Flows and the Statement of Budgetary Resources and Actual Expenses and these statements are not presented. These statements are therefore different from the financial reports also prepared by USAID pursuant to OMB directives that are used to monitor and control USAID's use of budgetary resources.

USAID accounting policies follow an "other comprehensive basis of accounting" as agreed to and published by the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Comptroller General. This basis consists of the following hierarchy:

I. Accounting standards and principles recommended by the Federal Accounting Standards Advisory Board (FASAB) and approved and issued by the above named officials. These are known as Statements of Federal Financial Accounting Standards (SFFAS).

2. Form and content requirements in OMB Bulletin 94-01 and subsequent issuances.

3. Accounting standards contained in USAID's accounting policy manuals and handbooks.

4. Accounting principles published by authoritative standards setting bodies (e.g., Financial Accounting Standards Board (FASB)) and other authoritative sources (1) on the absence of other guidance in the first three parts of the hierarchy, and /or (2) if the use of such accounting standards improves the meaningfulness of these financial statements.

B. Reporting Entity

USAID, established in 1961 by President John F. Kennedy, is the independent U.S. Government agency that provides economic development and humanitarian assistance to advance United States economic and political interests overseas.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Programs

The financial statements reflect the various program activities. shown bv appropriation in the financial statements. which include such programs as the Economic Support Fund, Development Assistance. Assistance for the New Independent States of the Former Soviet Union. Development Fund for Africa. Special Assistance Initiatives, International Disaster Assistance. International Organizations and Programs. and Direct and Guaranteed Loan Programs. This classification is consistent with the Budget of the United States.

Economic Support Fund

Programs funded through this account provide economic assistance to select countries in support of efforts to promote stability and U.S. security interests in strategic regions of the world.

Development Assistance

This program provides economic resources to developing countries with the aim of bringing the benefits of development to the poor. The program promotes broad-based, self-sustaining economic growth and supports initiatives intended to stabilize population growth, protect the environment and foster increased democratic participation in developing countries. The program is concentrated in those areas in which the United States has special expertise and which promise the greatest opportunity for the poor to better their lives.

Assistance for the New Independent States of the Former Soviet Union

This account provides funds for a program of assistance to the independent states that emerged from the former Soviet Union. These funds support U.S. foreign policy goals of consolidating improved U.S. security; building a lasting partnership with the New Independent States; and providing access to each other's markets, resources, and expertise.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Development Fund for Africa

The Development Fund for Africa account provides development assistance to sub-Saharan African countries. This account is designed to enhance USAID's effectiveness in meeting Africa's development requirements. These resources finance both project and non-project assistance to address shared development programs and policy objectives in reform-oriented African countries. These funds also support initiatives intended to promote economic growth. stabilize population growth. protect the environment and foster increased democratic participation.

Special Assistance Initiatives

This program provides funds to support special assistance activities. The majority of funding for this program in fiscal year 1997 was for democratic and economic restructuring in Central and Eastern European countries consistent with the objectives of the Support for East European Democracy (SEED) Act. All SEED Act programs support one or more of the following strategic objectives: promoting broad-based economic growth with an emphasis on privatization, legal and regulatory reform and support for the emerging private sector; encouraging democratic reforms; and improving the quality of life including protecting the environment and providing humanitarian assistance.

International Disaster Assistance

Funds for the International Disaster Assistance Program provide relief, rehabilitation, and reconstruction assistance to foreign countries struck by disasters such as famines, floods, hurricanes and earthquakes; support assistance in disaster preparedness, prevention and mitigation. as well as the longer term recovery efforts managed by the Office of Transition Initiatives.

Child Survival and Disease

This new program provides economic resources to developing countries to support programs to improve infant and child nutrition with the aim of reducing infant and child mortality rates; to reduce HIV transmission and the impact of the HIV/AIDS pandemic in developing countries; to reduce the threat of infectious diseases of major public health importance such as polio, and malaria; and to expand access to quality basic education for girls and women.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

International Organizations and Programs

The United States makes assessed payments and contributes to voluntarv funds of over twentv-five international organizations and programs involved in a wide range of sustainable development. humanitarian, and scientific activities.

Direct and Guaranteed Loans:

Direct Loan

These loans are authorized under Foreign Assistance Acts, various predecessor agency programs, and other foreign assistance legislation. Direct Loans are issued in both U.S. dollars and the currency of the borrower. Foreign currency loans made "with maintenance of value" place the risk of currency devaluation on the borrower, and are recorded in equivalent U.S. dollars. Loans made "without maintenance of value" place the risk of devaluation on the U.S. Government, and are recorded in the foreign currency of the borrower.

Housing Guaranty

The Housing Guaranty Program (HGP) extends guaranties to U.S. private investors who make loans to developing countries to assist them in formulating and executing sound housing and community development policies that meet the needs of lower income groups.

Micro and Small Enterprise Development

The Micro and Small Enterprise Development (MSED) Program supports private sector activities in developing countries by providing direct loans and loan guarantees to support local micro and small enterprises.

NOTE 1. **SUMMARY** OF **SIGNIFICANT ACCOUNTING** POLICIES - Continued

Israeli Loan Guarantee

Congress enacted the Israeli Loan Guarantee Program in Section 226 of the Foreign Assistance Act to support the costs for immigrants resettling to Israel from the former Soviet Union, Ethiopia. and other countries. Under this program. the U.S. Government will guarantee the repayment of up to $10 billion in loans from commercial sources. to be borrowed in $2 billion annual increments. Guarantees are made by USAID on behalf of the U.S. Government, with funding responsibility and basic administrative functions resting with USAID.

Ukraine Loan Guarantee

The Ukraine Export Credit Insurance Program was established with the support of the Export-Import Bank of the U.S. to assist Ukrainian importers of American goods. The program commenced operations in Fiscal Year 1996 and is expected to expire in Fiscal Year 1998. Guarantees in the portfolio have maturities of six to eighteen months.

Fund Types

The accompanying consolidated financial statements for USAID include the accounts of all funds under USAID's control. The agency maintains 35 general funds, 1 special fund, 10 revolving funds, 4 trust funds, and 21 deposit funds.

General and Special funds are used to record financial transactions under Congressional appropriations or other authorization to spend general revenue.

Revolving funds are established by law to finance a continuing cycle of operations, with receipts derived from such operations usually available in their entirety for use by the fund without further action by Congress.

Trust funds are credited with receipts generated by the terms of the trust agreement or statute. At the point of collection, these receipts are available immediately or unavailable depending upon statutory requirements.

Deposit funds are established for (1) amounts received for which USAID is acting as a fiscal agent or custodian, (2) unidentified remittances, (3) monies withheld from payments for goods or services received, and (4) monies held waiting distribution on the basis of legal determination

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Trust Funds

The unexpended balance in trust funds at vear end is recorded in the financial statements. Further. to the extent that the income from the trust funds is used towards USAID expenses. the income is recorded as other income in the financial statements.

The Foreign Currency Trust Funds were established to maintain foreign currencies owned bv participating governments which USAID holds in trust. These funds are used to pay for program and operating expenses of USAID-related activities in a foreign country. Funds may be withdrawn onlv by mutual agreement between the participating government and the United States. If the bilateral agreement is terminated. all remaining funds revert to the participating government.

The U.S. Dollar Advances from Foreign Governments Trust Fund was established to maintain advances of U.S. dollars from foreign governments and/or international organizations to facilitate the purposes of the Foreign Assistance Act of 1961. USAID acts in a fiduciary capacity in carrying out specific activities and programs in accordance with bilateral agreements with foreign countries and draws from the Foreign Governments' Trust Fund balances to pay for related expenses.

The Gifts and Donations Trust Fund was established to maintain money, funds, property, and services of any kind made available by gift, device, bequest, and grant.

The Foreign Service National Separation Pay Trust Fund was established to fund and account for separation payments for eligible foreign service national employees who voluntarilv terminate employment. It is only applicable in those countries that, due to local compensation'plans, require a lump-sum voluntary separation payment based upon years of service and rate of pay.

Social Progress Trust and Enterprise Development Funds

Though not recorded in the financial statements, USAID has established several unique loan and enterprise funds to support economic growth in accordance with the authorizing legislation. The major funds include the Latin American Social Progress Trust Fund administered by the Inter-American Development Bank, Enterprise Funds in Central and Eastern Europe and the former Soviet Union authorized under the Support for East European Democracy and Freedom Support Acts, and the South African Enterprise Fund.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

USAID does not take an active role in the management of these funds beyond the authorization of the transfer for the U.S. Government. There has been no financial control over these institutions since they were established. However. if the funds are terminated or liquidated. these funds should be returned to the U.S. Government. Hence. the government has an equitv interest in these funds. however. they are not measurable and accordingly they are not recorded in the financial statements.

C. Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

D. Budgets and Budgetary Accounting

The components of USAID's budgetary resources include current budgetary authority (i.e., appropriations and borrowing authority) and unobligated balances remaining from multi-year and no-year budget authority received in prior years. Budget authority is the authorization provided by law to enter into financial obligations that result in immediate or future outlays of federal funds. Budgetary resources also include reimbursements and other income (i.e., spending authority from offsetting collections credited to an appropriation or fund account) and adjustments (i.e., recoveries of prior year obligations).

Pursuant to Public Law 101-S 10, unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but not new obligations, until that account is canceled. When accounts are canceled, five years after they expire, amounts are not available for obligation or expenditure for any purpose.

According to section 5 17 of the Fiscal Year 1993 Appropriations Act, funds appropriated for certain purposes under the Foreign Assistance Act of 196 1, as amended, shall remain available until expended if such funds are initially obligated within their period of availability.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

E. Revenues and Other Financing Sources

USAID receives the majority of its funding through congressional appropriations which are annual. multi-year. and no-year appropriations that may be used. within statutory limits. Appropriations are recognized as revenues at the time the related program or administrative expenses are incurred. Appropriations expended for capitalized property and equipment are not recognized as expenses.

Additional financing sources for USAID's various credit programs and trust funds include amounts obtained through: collection of guaranty fees, interest income on rescheduled loans, penalty interest on delinquent balances, permanent indefinite borrowing authority from US. Treasury. proceeds from the sale of overseas real property acquired by USAID, and advances from foreign governments and international organizations.

Revenues are recognized as financing sources to the extent these receipts were payable to USAID from other agencies, other governments and the public in exchange for goods and services rendered to others.

F. Fund Balances with the U.S. Treasury

Cash receipts and disbursements are processed by the U.S. Treasury. The balances with Treasury are comprised of primarily appropriated funds that are available to pay current liabilities and finance authorized purchase commitments, but also include revolving, deposit, and trust funds.

G. Foreign Currency

The Direct Loan Program has foreign currency funds which are used to disburse loans in certain countries. Those balances are reported **at the** U.S. dollar equivalents using the exchange rates prescribed by the U.S. Treasury. **A** gain or loss on translation is recognized for the change in valuation of foreign currencies at year-end.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

H. Accounts Receivable

Accounts receivable consist of amounts due mainlv from foreign governments but also includes amounts due from other Federal agencies and private organizations. USAID regards amounts due from other Federal agencies as 100 percent collectible. USAID establishes an allowance for uncollectible accounts receivable for non-loan or revenue generating sources that have not been collected for a period of over one year.

I. Credit Program Receivable

Loans are accounted for as receivables after funds have been disbursed. For loans obligated prior to October 1. 1991 (the pre-credit reform period), loan principal, interest, and penalties receivable are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on a method prescribed by OMB that takes into account country risk and projected cash flows.

For loans obligated on or after October 1, 199 1, the loans receivable are reduced by an allowance equal to the present value of the subsidy costs (due to the interest rate differential between the loans and Treasury borrowing, the estimated delinquencies and defaults net of recoveries, the offset from fees, and other estimated cash flows) associated with these loans. This allowance is re-estimated when necessary and changes reflected in the operating statement.

Loans are made in both U.S. dollars and foreign currencies. Loans extended in foreign currencies can be with or without “Maintenance of Value” (MOV). Those with MOV place the currency exchange risk upon the borrowing government, while those without MOV place the risk on USAID. Foreign currency exchange gain or loss is recognized on those loans extended without MOV, and reflected in the net Credit Programs Receivables balance.

Credit Program Receivables also represent origination and annual fees on outstanding guarantees, interest on rescheduled loans and late charges. Claims receivable (subrogated and rescheduled) are due from foreign governments as a result of defaults for guaranteed loans. Receivables are stated net of an allowance for uncollectible accounts determined using a specific identification methodology by country.

While estimates of uncollectible loans and interest are made using methods prescribed by OMB, the final determination as to the ability to collect the loan is affected by actions of other related agencies within the U.S. Government.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - **Continued**

J. Advances and Prepayments

Funds disbursed in advance of incurred expenditures are recorded as advances. The majoritv of advances consists of funds disbursed under letters of credit to contractors and grantees. The' advances are liquidated and recorded as expenses upon receipt of reports of expenditures from the recipients.

K. Operating Materials and Supplies

USAID has operating materials and supplies held for use which consist mainly of computer paper and other expendable office supplies not in the hands of the user. USAID also has materials and supplies in reserve for foreign disaster assistance stored at strategic sites around the world which consists of water purification units, vehicles, and tents. USAID additionally has birth control supplies stored at several sites.

USAID's office supplies are deemed items held for use because they consist of tangible personal property to be consumed in normal operations. USAID's supplies held in reserve for future use are not readily available in the market or there is more than a remote chance that the supplies will be needed, but not in the normal course of operations. USAID has no supplies that fit in the category of excess, obsolete, and unserviceable operating materials and supplies .Their valuation is based on cost and they are not considered "held for sale".

L. Property, Plant and Equipment

USAID capitalizes Washington and field missions' assets with original acquisition costs exceeding $25,000 and a useful life greater than two years. Acquisitions not meeting this criteria are recorded as operating expenses. Some of the land, buildings, and equipment in which USAID operates is provided by the General Services Administration, who charges USAID rent that is expensed on the income statement. Neither internally developed nor contractor developed software is capitalized because it is for internal USAID use. USAID's capitalized assets are valued at historical cost and are not depreciated.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

M. Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by USAID as the result of transactions or events that have already occurred. However, no liability can be paid by USAID absent an appropriation or borrowing authority. Liabilities for which an appropriation has not been enacted are therefore classified as liabilities not covered by budgetary resources (unfunded liabilities), and there is no certainty that the appropriations will be enacted. Also. USAID non-contract liabilities can be abrogated by the U.S. Government. acting in its sovereign capacity.

N. Liabilities **for Loan Guarantees**

The Credit Reform Act (CRA) of 1990, which became effective on October 1, 1991, has significantly changed the manner in which USAID's loan programs finance their activities. The main purpose of CRA was to more accurately measure the cost of Federal credit programs and to place the cost of such programs on a basis equivalent to other Federal spending. Consequently, commencing in 1992, the loan program's funding for activities changed so that activities are funded through direct appropriation provided for that year only, rather than through cumulative appropriations granted in prior years and accumulated under the Revolving Fund.

For USAID's loan guarantee programs, when guarantee commitments are made, the program records a guarantee reserve in the program account and this reserve is based on the present value of the estimated net cash outflows to be paid by the Program as a result of the loan guarantees, except for administrative cost, less the net present value of all revenues to be generated from those guarantees. When the loans are disbursed, the Program transfers from the program account to the financing account the amount of the subsidy cost related to those loans. The amount of the subsidy cost transferred, for a given loan, is proportionate to the amount of the total loan disbursed.

For loan guarantees made before the CRA, liabilities for loan guarantees for pre- 1992 loans represent unfunded liabilities. For financial statement purposes the unfunded amounts are shown separate from the post-1991 liabilities. The amount of unfunded liabilities also represent a future funding requirement to USAID. The liability is calculated using a reserve methodology that is similar to OMB prescribed method for post-1991 loan guarantees.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

O. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year. the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent that current or prior year appropriations are not available to fund annual leave earned but not taken. funding will be obtained from future financing sources. Sick leave and other types of leave are expensed as taken.

P. Retirement Plans

USAID employees are covered by one of four retirement plans. There are two Civil Service plans. Civil Service Retirement System (CSRS) and Federal Employees Retirement Svstem (FERS). and two foreign service plans, Foreign Service Retirement and Disability System (FSRDS) and the Foreign Services Pension System (FSPS). The Agency contributes approximately 7.5 percent of an employees gross salarv for CSRS and FSRDS, and approximately 24 percent of an employees gross salary for FERS and FSPS.

Employees may elect to participate in the Thrift Savings Plan (TSP). Under this plan, FERS and FSPS employees may elect to have up to 10 percent of gross earnings withheld from their salaries and receive matching contributions from a minimum of one percent to a maximum of 5 percent. CSRS and FSRDS employees may elect to have up to 5 percent of gross earnings withheld from their salaries, but do not receive matching contributions.

USAID funds a portion of employee post employment benefits (PEB) and makes necessary payroll withholdings. It has no liability for future payments, nor is it responsible for reporting the assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees for these programs. Reporting of such amounts is the responsibility of the Office of Personnel Management and the Federal Retirement Thrift Investment Board. Current year operating expenses are charged for the full amount of employer PEB costs with the unfunded portion being charged to Other Revenue Sources-Imputed Financing in accordance with SFFAS # 7.

Foreign Service Nationals and Third Country Nationals at overseas posts who were hired prior to January 1, 1984 may be covered under CSRS. Employees hired after that date are covered under a variety of local governmental plans in compliance with host country laws and regulations. In a limited number of cases where no plans are regulated by the host country or where such plans are inadequate. the employees are covered by a privately managed pension plan to conform with prevailing practices by employers.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The Foreign Service National Separation Pay Trust Fund (FSNSPTF) was established in **1991** by public law 102-138 to finance separation payments for eligible individuals. primarily Foreign Service Nationals employed bv USAID. The FSNSPTF finances separation liabilities to employees who resign. retire. or lose their jobs due to a reduction-in-force: and is applicable only in those countries that, due to local law, require a lump sum voluntary payment based on years of service.

Q. Net Position

Net position is the residual difference between assets and liabilities. It is composed of unexpended appropriations, invested capital, cumulative results of operations. and future funding requirements.

- Unexpended appropriations are appropriations not yet expended, including undelivered orders.

- Invested capital includes the acquisition cost of capitalized fixed assets financed by appropriations, as well as pre-credit reform direct loans financed by appropriations.

- Cumulative results of operations are also part of net position. This account reflects the net difference between (1) expenses and losses and (2) financing sources, including appropriations, revenues and gains, since the inception of the activity.

- Future Funding Requirements reduce net position to reflect the excess of unfunded liabilities over any offsetting assets, which will require future funding. These unfunded liabilities include amounts related to pre-1992 loan guarantees, Foreign Service National Separation Pay, accrued leave, and actuarial liabilities not covered by available budgetary resources.

R. Restated **Data**

Credit Program Liquidating Fund 1996 Loans Receivable have been restated to correct an error between general and subsidiary ledgers.

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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

S. Comparative Data

Comparative data is presented in order to provide an understanding of changes in the financial position and operations of USAID.

Certain amounts for 1996 have been reclassified to conform with their 1997 presentation of these amounts.

NOTE 2. FUND BALANCES WITH TREASURY

Entity and Non-Entity Fund Balances with Treasury consisted of the following as of September 30, 1997:

[Dollars in thousands)		Appropriated Funds		Trust Funds		Revolving Funds		Other Funds		Total
Entity Assets:										
Obligated	$	7.861.142	$	7.192	$	106.092	$	0	$	7.974.426
Unobligated/Available		1.081.094		1,508		608,360		27		1.690.989
Unobligated/Unavailable		31.872		0		0		3.811		41.683
Total	S	8,974,108	S	8,700	S	714,452	S	9,838	S	9,707,098
Non-Entity Assets:										
Obligated	$	0	$	1.269	$	0	$	0	$	1.269
Unobligated/Available		0		1.357		0		0		1.357
Unobligated/Unavailable		0		0		0		3.702		3.702
Total	S	0	S	2,626	S	0	S	3,702	S	6,328

Entity and Non-Entity Fund Balances with Treasury consisted of the following as of September 30, 1996:

(Dollars in thousands)		Appropriated Funds		Trust Funds		Revolving Funds		Other Funds		Total
Entity Assets:										
Obligated	$	7.951.303	$	8,019	$	69,623	$	27	$	8.028.972
Unobligated/Available		1,247,883		28		390.136		0		1.638.047
Unobligated/Unavailable		19,496		0		0		5.053		24.549
Total	S	9,218,682	S	8,047	S	459,759	S	5,080	S	9.691568
Non-Entity Assets:										
Obligated	S	0	S	1.222	S	0	$	0	S	1,222
Unobligated/Available		0		1,942		0		0		1.942
Unobligated/Unavailable		0		0		0		3.369		3.369
Total	S	0	$	3,164	S	0	$	3369	s	6533

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NOTE 2. FUND BALANCES WITH TREASURY - Continued

Unavailable balances include recovered expired appropriations, and other amounts related to expired authority and holdings which have not been transferred into the general fund and are unavailable for USAID's use.

The cash reconciliation difference between the amount reported in the entity records and the corresponding account balances reported on Treasury's year end balances is $86,571,252. The entity's reported fund balance exceeds Treasury's Fund balance by this amount. During the past year, the agency implemented a new accounting system. Numerous problems were incurred including the processing of payments, producing monthly SF 224-Statement of Transaction reports and retrieving of information from the accounting system. Action was taken during the year to ensure all activity was processed in the new system and to reconcile Fund Balances with Treasury However, problems still remained. Efforts will continue to reconcile the large difference between the Fund Balances of USAID and the Department of Treasury.

NOTE 3. ACCOUNTS RECEIVABLE, NET OF ALLOWANCE

The primary components of USAID's accounts receivable at September 30, 1997 and 1996, are as follows:

(Dollars in thousands)	1997 Accounts Receivable	1997 Allowance	1997 Net Accounts Receivable	1996 Net Accounts Receivable
Eotity Receivables				
Intragovernmental				
Appropriation Reimbursements from Federal Agencies	S 21	s 0	$ 21	s 2,084
Accounts Receivable from Federal Agencies	28.8 13	0	28.8 13	10.046
Disbursing Authority Receivable from USDA	486.684	Ø	486,684	3 15.348
Total	515.518	0	515.518	327.47%
Governmental				
Accounts Receivable	10.097	(7.601)	2.496	4.654
Total	10.097	(7,601)	2.496	4.654
Total Entitv Receivables	S 525.615	S (7.601)	S 518.014	S 332.132

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NOTE 3. ACCOUNTS RECEIVABLE, NET OF ALLOWANCE - Continued

	1997			1996
(Dollars in thousands)	Accounts Receivable	Allowance	Net Accounts Receivable	Net Accounts Receivable
Non-Entity Receivables				
Governmental				
Due to Treasury	$ 3.168	$ (2,768)	$ 400	$ 193
Total Non-Entity Receiva bies	$ 3,168	$ (2,768)	$ 400	$ 193

Entity Intragovernmental accounts receivable consist of amounts due from other US. Government agencies. No allowance has been established for the intragovernmental accounts receivable. which are considered to be 100 percent collectible. Disbursing Authority Receivable from USDA consists of obligational authority from the U.S. Department of Agriculture's Commodity Credit Corporation. The authority is for payment of transportation costs incurred by USAID associated with the shipment of P.L. 480 Title II and III commodities; Farmer-to-Farmer Technical Assistance Programs; and for assistance to private voluntary organizations, cooperatives. and international organizations. Collections against this receivable are realized when USAID requests a transfer of funds from USDA to cover incurred expenses.

Entity and Non-Entity Governmental accounts receivable consist of amounts due from the mission for $2.5 million and $0.4 million, respectively. The receivables consists of non-program related receivables such as: overdue advances, erroneous payments, audit findings, and any interest related to these types of receivables. A 100 percent allowance for estimated uncollectible amounts was established for governmental accounts receivable which are more than one year past due. Entity accounts receivable from missions are collected and recorded to the respective appropriation. Non-Entity receivables are miscellaneous receipts which are transferred to the general fund of the U.S. Treasury when collected.

NOTE 4. ADVANCES AND PREPAYMENTS

Advances and Prepayments consisted of the following at September 30, 1997 and 1996:

(Dollars in thousands)		1997		1996
Intragovernmental:				
Allocations to Other Federal Agencies	$	0	$	198,829
Advances to Federal Agencies		50,951		78,131
Total	**$**	50,951	**$**	276,960
Governmental:				
Advances to Contractors/Grantees	$	1,022,203	$	1,320,036
Travel Advances		3,740		4,376
Advances to Host Country Governments and Institutions		113,193		85,167
Prepayments		2,237		6,697
Other		1,568		999
Total	**$**	**1,142,941**	**$**	**1,417,275**

The $198.829 decrease from FY 1996 to FY 1997 in Allocations to Other Federal Agencies is the result of an accounting standard change. In FY 1996, the allocations were recorded as advances and adjusted as activity occurred. In FY 1997, in compliance with the revised SGL standards, the allocations were recorded as adjustments to Appropriated Capital. Therefore, the Allocations to Other Federal Agencies is zero in FY 1997.

Advances to Host Country Governments and Institutions represents amounts advanced by USAID missions to host country governments and other in-country organizations. such as educational institutions and voluntary organizations. Other consists primarily of amounts advanced for salaries, living quarters, and home service.

NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES

USAID operates the following loan and/or loan guarantee programs:

- Direct Loan Program (Direct Loan or DL)
- Housing Guarantee Program (HGP)
- Micro and Small Enterprise Development Program (MSED)
- Ukraine Export Insurance Credit Program (Ukraine)
- Israeli Loan Guarantee Program (Israeli Loan)

Direct loan obligations or loan guarantee commitments made prior to FY' 1992, and the resulting direct loans or loan guarantees, are reported net of an allowance for estimated uncollectible loans or estimated losses.

Direct loan obligations or loan guarantee commitments made after FY 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act. The Act provides that the present value of the subsidy costs (i.e. interest rate differentials, interest subsidies, estimated delinquencies and defaults, fee offsets and other cash flows) associated with direct loans and loan guarantees be recognized as a cost in the year in which the direct or guaranteed loan is disbursed.

An analvsis of loans receivable, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy costs associated with the loans and loan guarantees are provided in the following sections.

The following net loan receivable amounts are not the same as the proceeds that USAID would expect to receive from selling its loans. Actual proceeds may be higher or lower depending on the borrower and the status of the loan.

A. Direct Loans Obligated Prior to FY 1992

[Dollars in thousands)	1997			
Loan Program	Loan Receivable	Interest Receivable	Allowance for Loan Losses	Value of Assets Related to
Direct Loans	$ 12,277,757	$ 378,526	$ (5,241,694)	$ 7,414,589
MSED	4,456	28	(3,296)	1,188
Total	**$ 12,282,213**	**$ 378,554**	**$ (5,244,990)**	**$ 7,415,777**

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NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES - Continued

A. Direct Loans Obligated Prior to FY 1992 - Continued

[Dollars in thousands)		1996						
Loan Program		Loan Receivable		Interest Receivable		Allowance for Loan Losses		Value of Assets Related to Loans
Direct Loans	$	12,893,872	$	403,984	$	(5,980,03 1)	$	7,317,825
MSED		4.4 15		127		(3,291)		1,251
Total	$	12,898,287	$	404,111	$	($983,322)	$	7,319,076

B. Direct Loans Obligated After FY 1991

(Dollars in thousands)		1997						
Loan Program		Loan Receivable		Interest Receivable		Allowance for Subsidy Cost		Value of Assets Related to
Direct Loans	$	339,890	$	0	$	(154,223)	$	185,667
MSED		2,097		27		(182)		1,942
Total	$	$ 341,987	$	27		(154,405)	$	187,609

[Dollars in thousands)		1996						
Loan Program		Loan Receivable		Interest Receivable		Allowance for Subsidy Cost		Value of Assets Related to
Direct Loans	$	396,441	$	0	$	(169,096)	$	227,345
MSED		2,000		85		(330)		1,755
Total	$	398,441	$	85	$	(169,426)	$	229,100

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NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES - Continued

C. Defaulted Guaranteed Loans from Pre-1992 Guarantees

(Dollars in thousands)

Loan Program		Defaulted Guaranteed Loans Receivable	Interest Receivable	Allowance for Loan Losses	Defaulted Guaranteed Loans Receivable, Net
HGP, 1997	$	496,982 $	19.280 $	(323,762) $	192.500
HGP. 1996	$	473.01 1 $	32.835 $	(224228) $	281.618

D. Defaulted Guaranteed **Loans from Post-1991 Guarantees**

There have been no defaults on Post-l 991 Guarantees as of September 30, 1997.

E. Guaranteed Loans Outstanding

[Dollars in thousands]

	1997			
Loan Program		Outstanding Principal, Guaranteed Loans, Face Value		Amount of Outstanding Principal Guaranteed
HGP	$	2,553,389	$	2,553,389
MSED		143,500		7 1,750
Ukraine Export		150,000		150,000
Israel		8,300,000		8,300,000
Total	$	11,146,889	$	11,075,139

[Dollars in thousands)

	1996			
Loan Program		Outstanding Principal, Guaranteed Loans, Face Value		Amount of Outstanding Principal Guaranteed
HGP	$	2,188,700	$	2,188,700
MSED		28,000		28,000
Ukraine Export		8 1,000		81,000
Israel		6.564000		6,564,000
Total	$	8,86 1,700	$	8,86 1,700

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SOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES - Continued

F. Liability for Loan Guarantees (Estimate Future Default Claims, Pre-1992)

(Dollars in thousands)	1997		
Loan Program	Liabilities for Losses Pre-1992 Loan Guarantees, Estimated Future Default Claims	Liabilities for Loan Guarantees for Post-1991 Guarantees, Present Value	Total Liabilities for Loan Guarantees
HGP	$ 376.22 1	$ 36.94 1	$ 413,162
MSED	121	1,267	1,388
Ukraine Export	0	26,339	26,339
Israel	0	422,384	422,384
Total	$ 376,342	$ 486,931	$ 863,273

(Dollars in thousands)	1996		
Loan Proeram	Liabilities for Losses Pre-1992 Loan Guarantees, Estimated Future Default Claims	Liabilities for Loan Guarantees for Post- 1991 Guarantees, Present Value	Total Liabilities for Loan Guarantees
HGP	$ 385,489	$ 37,172	$ 422,661
MSED	630	1,693	2,323
Ukraine Export	0	11,952	11,952
Israel	0	341,103	341,103
Total	$ 386,119	$ 391,920	$ 778,039

G. Subsidy Expense for Post-1991 Direct Loans

1. Current Year's Direct Loans

There have been no new direct loans disbursed in the past two years.

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NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES - Continued

G. Subsidy Expense for Post-1991 Direct Loans - Continued

2. Direct Loan Modification and Re-estimates

(Dollars in thousands]	Modification	Re-estimates
Loan Proeram		
MSED, 1997	0 $	(59)
MSED. 1996	0 $	0

3. Total Direct Loan Subsidy Expenses

(Dollars in thousands\	1997	1996
Loan Program		
MSED	$ 0	$ 117

As no new loans have been disbursed for direct loans for the past two years, there have been no re-estimates made for direct loans for the past two years. The re-estimate for MSED has had a negative effect on the subsidy balance. Hence, no subsidy expense has been recorded for the current year.

H. Subsidy Expense for Post-1991 Loan Guarantees

1. Current Year's Loan Guarantees

(Dollars in thousands)	1997				
Loan Program	**Defaults**	**Fees**	**Interest Supplement**	**Other**	**Total**
HGP	$ 17,676	$ (6,735)	$ 0	$ 0	$ 10,94 1
MSED	1,318	(658)	0	0	660
Ukraine Export	22,536	(5,964)	0	0	16,572
Israel	56,250	(56.250)	0	0	0
Total	$ 97,780	$ (69,6$7)	0	!s 0	$ 28,173

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NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES - Continued

H. Subsidy Expense for Post-1991 Loan Guarantees - Continued

1. Current Year's Loan Guarantees

(Dollars in thousands)	1996				
Loan Program	**Defaults**	**Fees**	**Interest Supplement**	**Other**	**Total**
HGP	$ 14,731	$ (3.470)	$ 0	$ 0	$ 1 1.26 1
MSED	1,377	(611)	0	0	766
Ukraine Export	2,822	(745)	0	0	2,077
Israel	99,343	(99,343)	0	0	0
Total	**$ 118,273**	**$ (104,169)**	**$ 0**	**$ 0**	**$ 14,104**

2. Loan Guarantee Modification and Re-estimates

(Dollars in thousands)	1997		1996	
Loan Program	**Modification**	**Re-estimates**	**Modification**	**Re-estimates**
HGP	$ o!§	(16,016)	$ 0%	**3,562**
MSED	42	(704)	0	(152)
Total	**$ 42**	**$ (16,720)**	**$ 0**	**$ 3,410**

3. Total Loan Guarantee Subsidy Expense

(Dollars in thousands)	1997	1996
Loan Program		
HGP	$ (5,075)	$ 14,823
MSED	(2)	614
Ukraine Export	16,572	10,612
Total	**$ 11,495**	**$ 26,049**

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NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES - Continued

I. Administrative Expense

(Dollars in thousands)		1997		1996
Loan Proeram				
Direct Loan	$	0	$	919
HGP		5.32 1		7,506
MSED		129		55
Ukraine Export		206		459
Total	$	5,656	$	8,939

NOTE 6. CASH AND OTHER MONETARY ASSETS

Cash and Other Monetary Assets as of September 30, 1997 and 1996 are as follows:

(Dollars in thousands\		1997		1996
Entity				
Imprest Funds with Cashier	$	70	$	70
HGP and MSED Other Cash		388		402
Foreign Currencies with U.S. Treasury		1,273		15,581
Total	$	**1,731**	$	**16,053**
Non-Entity				
Foreign Currencies with U.S. Treasury	$	247,978	$	234,940
Total	$	**247,978**	$	**234,940**

In addition to the domestic Imprest Funds, USAID also has imprest funds in various overseas locations. These funds are provided by the Department of State overseas U.S. Disbursing Officers to which USAID is liable for any shortages. USAID's portion of the Department of State imprest funds provided to USAID is $2.5 million. These imprest funds are not included in USAID's Statement of Financial Position. Foreign Currencies with U.S. Treasury included $247.9 million of Non-Entity assets related to Foreign Currency Trust Funds

NOTE 7. OPERATING MATERIALS AND SUPPLIES

Operating Supplies and Materials as of September 30, 1997 and 1996 are as follows:

(Dollars in thousands)		1997		1996
Items held for use:				
Office supplies	$	1,897	$	2,720
Items held in reserve for future uses:				
Disaster assistance materials and supplies		6,183		6.312
Birth control supplies		11.028		0
Total	$	19,108	$	9,032

Operating Materials and Supplies are composed of office supplies held for use and disaster assistance materials and supplies and birth control supplies held in reserve for future use. They are valued at historical cost and considered not held for sale. The disaster assistance supplies were reported as stockpile materials in the 1996 financial statements and have been reclassified and restated to comply with SFFAS # 3. The birth control supplies were not reported in the 1996 financial statements.

NOTE 8. PROPERTY, PLANT AND EQUIPMENT (PP&E)

The components of PP&E at September 30,1997 and 1996 were:

(Dollars in thousands)		1997		1996
Equipment	$	30,010	$	21,289
Structures, Facilities and Leasehold Improvements		20,574		13,914
Software		1,512		1,521
Land		3,581		902
Capitalized leases		136		0
Construction in Progress		0		79
Total	$	55,813	$	37,705

USAID PP&E includes assets located in Washington, D.C. offices and overseas field missions.

- Equipment consists primarily of furniture, ADP hardware, vehicles and equipment located at the overseas field missions.
- Structures and Facilities includes USAID owned office buildings and residences at foreign missions. including the land on which these structures reside. These structures are used and maintained by the field missions. USAID does not separately report the cost of the building and the land on which the building resides.
- Land consists of property owned by USAID in foreign countries. Usually the land is purchased with the intention of constructing an office building at the site.
- The capitalized leases are four bungalows in Kenya that USAID has exercised its lease purchase options on that are in litigation. They were not recorded in the 1996 financial statements.

USAID does not record depreciation.

NOTE 9. ACCOUNTS PAYABLE

At September 30. 1997 and 1996. the Accounts Payable Covered by Budgetary Resources consisted of the following:

(Dollars in thousands)		1997		1996
Intragovernmental				
Accounts Payable	$	188.662	$	108.799
Disbursements in Transit		0		52
Total	$	188,662	$	**108,851**
Governmental				
Accounts Payable	$	1,711,194	$	1,606,011
Disbursements in Transit		1,737		0
Total	**$**	**1,712,931**	**$**	**1,606,011**

Intragovernmental Accounts Payable are those payable to other federal agencies and consist mainly of unliquidated obligation balances related to interagency agreements between USAID and other federal agencies. The amount is calculated based on the expiration dates of the various interagency agreements. For those agreements expiring at or before September 30, 1997, all of the remaining unliquidated obligation balance was accrued. Amounts were accrued on a prorata basis for those agreements expiring after September 30,1997.

Governmental Accounts Payable represent liabilities to other non-governmental entities.

NOTE 10. DEBT

USAID Intragovernmental Debt as of September 30, 1997 consisted of borrowing from Treasury for post-1991 loan programs, as follows:

(Dollars in thousands)	1997		
Loan Program	**Beginning Balance**	**Net Borrowing**	**Ending Balance**
Housing Guaranty Program	$ 110,000	$ (25,000)	$ 85,000
Direct Loan	228,339	5,818	234,157
MSED	1,807	292	2,099
Total	**$ 340,146**	**$** (18,890)	**$** 321,256

USAID Intragovernmental Debt as of September 30, 1996 consisted of borrowing from Treasury for post- 1991 loan programs, as follows:

(Dollars in thousands)	1996		
Loan Program	**Beginning Balance**	**Net Borrowing**	**Ending Balance**
Housing Guaranty Program	$ 125,000	$ (15,000)	$ 110,000
Direct Loan	214,169	14,170	228,339
MSED	1,507	300	1,807
Total	**$ 340,676**	**$ (530)**	**$ 340,146**

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NOTE 11. OTHER LIABILITIES

At September 30, 1997 and 1996. Other Liabilities consisted of the following:

(Dollars in thousands)		1997		1996
Liabilities Covered by Budgetary Resources:				
Intragovernmental				
Liability for Subsidy Related to Undistributed Loans		0	$	3.640
Accrued Interest Due to Treasury		4.671		5.3 19
OPAC Suspense		6.73 1		3.- '49
Deposit and Clearing Accounts		6,782		5,173
Other		60		0
Total	$	18,234	$	**17,38 1**
Governmental				
Accrued Funded Payroll/Benefits	$	11,124	s	14,041
Deferred Credit		181		172
Unamortized Origination Fees		2,194		2,284
Foreign Currency Trust Funds		247,950		245,648
Other Trust Fund Balances		11,326		0
Due to Treasury		400		0
Total	$	273,175	$	262,145

Intragovernmental Liabilities represent amounts due to other federal agencies. Other Governmental Liabilities are liabilities to non-federal entities.

NOTE 12. ACCRUED UNFUNDED ANNUAL LEAVE AND SEPARATION PAY

Accrued unfunded benefits for annual leave and separation pay as of September 30, 1997 and 1996 are:

[Dollars in thousands)		1997		1996
Accrued Annual Leave	S	22,992	$	22,219
FSN Separation Pay		1,506		1,100
Total	**$**	**24,498**	**$**	**23,319**

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NOTE 13. ACCRUED UNFUNDED WORKERS' COMPENSATION BENEFITS

The provision for the uorkers'compensation benefits payable as of September 30, 1997 and 1996 are as follows:

(Dollars in thousands)		1997		1996
Current Liability	$	6.741	$	5,819
Future Liability		38,741		34,220
Total	$	**45,482**	$	**40,039**

The Federal Employees Compensation Act (FECA) program is administered by the U.S. Department of Labor (DOL) and provides income and medical cost protection to covered Federal civilian employees who have been injured on the job or have incurred a work-related occupational disease. Beneficiaries of employees whose death is attributable to a job-related injury or occupational disease receive compensation. DOL initially pays valid FECA claims for all of the Federal government and seeks reimbursement two fiscal years later from the Federal agencies employing the claimants.

USAID's total FECA liability is $45 million as of September 30, 1997 and comprises unpaid FECA billings in the amount of $6.7 million and estimated future FECA costs of $38.7 million. Estimated future FECA costs were determined by the Department of Labor. This liability is determined using the paid losses extrapolation method calculated over the next 37 year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value. The interest rate assumptions used for discounting ranged from 6.24 % in year one to 5.40 % in year five and thereafter.

NOTE 14. NET POSITION

Net position by fund type at September 30, 1997 consisted of the following:

(Dollars in thousands)	1997				
	Appropriated Funds	Revolving Funds	Trust Funds	Other Funds	Total
Unexpended Appropriations	$ 8.831.962	$ 184,328	$ 0	$ 0	$ 9.016.290
Unobligated:					
Available	1.066.515	165,567	0	0	1.232.082
Unavailable	42.119	0	0	0	42,119
Undelivered Orders	7.723.328	L8.761	0	0	7.742.089
Invested Capital	54.619	7.215,750	0	0	7.270.369
Cumulative Results of Operations	0	258,387	0	0	258,387
Future Funding Requrements	(68.473)	(376.343)	(1.506)	0	(446.322)
Net Positioa	$ 8,818,108	$ 7,282,122	$ (1,506)	$ 0	$ 16,098,724

Net position at September 30, 1996 consisted of the following:

(Dollars in thousands)	1996				
	Appropriated Funds	Revolving Funds	Trust Funds	Other Funds	Total
Unexpended Appropriations	$ 9,322.873	$ 452,230	$ 0	$ 0	$ 9.775.103
Unobligated:					
Available	1.272.637	390.136	0	0	1.662.773
Unavailable	20.994	0	0	0	20.994
Undelivered Orders	8.029.242	62.094	0	0	8.091.336
Invested Capital	37,708	7.450.277	0	0	7.487.985
Cumulative Results of Operations		(137.358)	0	0	(137.358)
Future Funding Requirements	(20.799)	(427.579)	(1.100)	0	(449,478)
Net Position	$ 9,339,782	$ 7337,570	$ (1,100)	$ 0	$ 16,676,252

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NOTE 15. INTEREST AND PENALTIES, NON-FEDERAL

Interest and Penalties. Non-Federal as September 30.1997 and 1996 consisted of the following:

(Dollars in thousands)		1997		1996
Income - Interest	$	387.131	$	393.403
Income - Subsidies		0		17.968
Income - Penalties		3,174		853
Income - Fees		0		7.127
Transfers to Treasury		(289,556)		0
Total	$	101,749	$	419,351

NOTE 16. OTHER REVENUE AND FINANCING SOURCES

&her Revenue and Financing Sources as of September 30, 1997 and 1996 are as follows:

(Dollars in thousands)		1997		1996
Change in Allowance on Uncollectible	$	738,545	$	0
Foreign Currency Trust Fund		75,936		95,954
Imputed Financing-Pension and Other Retirement Benefits		14,812		0
Proceeds from Sale of Personal Property		2,792		3,488
Foreign Service Separation Pay		1,890		0
Loan Fees		7,866		0
Loan Guarantee Recoveries		187		119
Other		340		945
Total	$	842,368	$	100,506

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NOTE 17. EXPENSES

Program and operating expenses bv object classification for the year ending September 30, 1997 and 1996 are estimated as follows:'

(Dollars in thousands)	1997	1996
Personal Services and Benefits	$ 362.836	$ 391,754
Travel and Transportation	34.619	34.276
Rent, Communication and Utilities	69,702	69.012
Printing and Reproduction	1,360	1,347
Contractual Services	113.090	111,971
Supplies and Materials	9,329	9,237
Equipment not Capitalized	49,423	48,934
Grants, Subsidies and Contributions	2,356	2,332
Insurance Claims and Indemnities	723	716
Total General & Administrative Expenses	643.438	669.579
Program Expenses - USAID	6,090,759	7,499,386
Total Expenses	**$ 6,734,197**	**$ 8,168,965**

Not all of USAID's accounting systems capture object classification for actual expenses incurred. The total general and administrative expenses have been allocated to object class categories based upon actual FY 1997 and 1996 obligations by object class, with the exception of the unfunded expenses for workers' compensation and severance pay which are included as part of Personal Services and Benefits. Therefore, this estimation was made for financial statement purposes. Additionally, program expenses are not included in the object classification breakout.

NOTE 18. ADJUSTMENTS

Prior Period Adjustments consisted of the following amounts for the period ending September 30, 1997 and 1996:

(Dollars in thousands)	1997	1996
Prior Period Adjustment		
Ukraine Subsidy Expense	$ (8.535)	$ 0
Total	$ (8,535)	$ 0

The Ukraine Credit Program had an adjustment to the beginning balance of net position for fiscal year 1997. The prior period adjustment was for the overstatement of the Ukraine subsidy expense.

NOTE 19. NON-OPERATING CHANGES

Non-Operating Changes consisted of the following amounts for the period ending September 30, 1997 and 1996:

(Dollars in thousands)		1997		1996
Increases:				
New Appropriation Warrants	$	6,198,126	$	6,309,555
Transfers from USDA		381,336		356,202
Appropriations Transferred In		173,252		35,339
Property and Operating Materials		23,459		0
Other		7,066		0
Total Increases		**6,783,239**		**6,701,096**
Decreases:				
Appropriated Capital Used		(6,501,045)		(6,365,144)
Funds Returned to Treasury		(47,015)		(11,150)
Allocations to Other Agencies		(549,808)		(424,344)
Recission of Unobligated Carryover		0		(1,992)
Appropriations Transferred Out		(418,693)		(250,520)
Portfolio Reconciliation, net		(78,315)		0
Loan Collections, net		(527,639)		0
Restatement of Liquidating Fund Receivables		0		(261,701)
Unfunded Foreign Separation Pay		(406)		0
Other		(13,865)		0
Total Decreases		**(8,136,786)**		**(7,314,851)**
Total Non-Operating Changes	**$**	**(1,353,547)**	**$**	**(613,755)**

The Recovery of Appropriated Capital Used is shown as a component of Appropriated Capital Used. An adjustment of $16,016 million for a downward re-estimate of subsidy in the Housing Guaranty Program is not included above in Appropriated Capital Used.

NOTE 20. CONTINGENCIES

USAID is involved in certain claims. suits and complaints that have been filed or are pending. These matters are in the ordinary course of the Agency's operations and are not expected to have a material adverse effect on the *Agency's financial position.

USAID has no pending bid protests filed with the agency or the General Accounting Office.

USAID has ten contract appeals totally $19.858.000 currently before the Armed Services Board of Contract Appeals. It is reasonably possible that damages will be assessed against USAID. but the amount can not be estimated.

USAID has four cases pending before the U.S. Court of Federal Claims. It is reasonably possible that damages will be assessed against USAID in three of the cases up to the claimed amount of $3.325.000. but it is normal practice within the Federal government for the Department of Justice's Judgement Fund to pay these amounts. The-other case only has a remote likelihood of damage assessment.

USAID has several cases filed in the U.S. Federal Courts and as mentioned above it is normal practice for the Department of Justice's Judgement Fund to pay these amounts. None of these cases have been assessed with a probable likelihood of award against the agency, those that have been assessed with a possible likelihood are not for significant amounts and the remainder have been assessed with a remote likelihood.

USAID also has thirty-four cases filed against them in overseas courts. The Department of Justice retains local counsel and manages these cases. Again, the Judgement Fund is available to pay these awards, if USAID's actions have been reasonable. It is not possible to assess the likelihood of awards against USAID in these cases nor is it possible to estimate the amount of the awards, if any.

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SUPPLEMENTAL FINANCIAL INFORMATION

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
ACQUISITION OF PROPERTY REVOLVING FUND
STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30,
(In Millions)
(Unaudited)

	1997	1996
Assets		
Entity Assets:		
Intragovernmental Assets:		
Fund Balances With Treasury	$ 1	$ 2
Total Entity Assets	1	2
Total Assets	$ 1	$ 2
Net Position		
Cumulative Results of Operation	1	2
Total Net Position	1	2
Total Liabilities and Net Position	$ 1	$ 2

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USAID
U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

February 27, 1998

MEMORANDUM

TO: IG, Jeffrey Rush, Jr.

FROM: AA/M, Richard C. Nygard (Acting)
AA/PPC, Thomas H. Fox

SUBJECT: Audit Report on USAID's Consolidated Financial Statements, Internal Controls, and Compliance for Fiscal Years 1997 and 1996

This memorandum provide6 the Agency's formal response to the audit of USAID's financial statements, internal controls, and compliance for Fiscal Years 1997 and 1996.

We would like to commend your staff for the collaborative and constructive manner in which this audit was conducted. The work will greatly facilitate our efforts to establish effective internal. controls, and to ensure compliance with applicable laws and regulations.

We believe that the financial statements, as required by the Government Management and Reform *Act* of 1994, are as accurate a reflection as possible of the financial condition of the Agency. We faced a significant challenge in producing timely financial statements due to the difficulties in implementing the New Management System (NMS). Full implementation of NMS was expected to resolve problems identified in the FY 1996 financial statements audit and to address the longstanding material weaknesses *in* the core accounting system.

In the absence of a fully integrated system, we made a concerted effort to capture the financial condition of the Agency using the AID Worldwide Accounting and Control System (AWACS), legacy systems and a variety of manual approaches. This approach required the dedicated efforts of financial managers throughout the world and we believe that the quality of the financial statements is the result of that dedication.

We now have the results from an independent verification and validation (IV&V) of NMS which provides options for moving forward to complete an integrated financial and performance measurement system. This system is essential if the Agency is to comply with the Government Performance and Results Act, the Federal Financial Management Improvement Act (FFMIA) and other government-wide standards. Once we have evaluated the options

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from the IV&V effort, we will develop a remediation plan which outlines the resources, remedies and intermediate target dates necessary to bring the financial management systems into substantial compliance. We will also develop a comprehensive plan that will assure that the nission critical systems meet year-2000 compliance standards.

The Agency continues to emphasize performance measures as a tool in managing resources. Under the direction of the Bureau for Policy and Program Coordination, we continue to improve in our ability to strategically plan the functions of USAID and report results in both our Annual Performance Report and the Agency's financial statements. Our reports are an effective tool to permit Agency management insight to overall operations and to report to our stakeholders. However, continued improvements are needed to ensure the validity of results data, tie obligation and expenditure data to Agency strategic goals and match resource inputs with measurable results.

We have been advised by the Office of General Counsel that the requirements of the CFO Act can be effectively implemented without a realignment of responsibilities for the performance measurement system. We are taking steps to improve collaboration between our respective bureaus to ensure that the Agency's Chief Financial Officer(CFO) reports complete and consistent program performance information in the overview section of the financial statements.

Enclosure A outlines our response to the 10 recommendations in the audit. Enclosure B provides comments regarding USAID's compliance with applicable laws and regulations and other issues

ENCLOSURE A

MANAGEMENT RESPONSE TO RECOMMENDATIONS

Recommendation 1: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer ensure that the account balances for appropriations are reviewed for validity at least annually to properly certify obligated and unobligated balances pursuant to Title 31 of the United States Code, Section 1108.

We agree with the recommendation and will reinstitute the necessary reviews and certifications in FY 1998.

As a part of headquarters re-engineering efforts in 1996 and 1997, the Agency reviewed financial functions and delegated responsibility for recording obligations when and where they occur, As a result, the Office of Financial Management no longer records contract/grant (obligation) actions into the ledgers of the Agency.

Delegation of the responsibilities for recording obligations and unexpected problems with implementation of the core accounting system has led to a degradation of USAID practices related to annual performance of certifying obligated balances as required by Title 31 of the United States Code, Sections 1108c and 1501(A). However, the office of the General Counsel determined that the Agency has not violated the legal requirements for these Statutes. The systems used by the Agency, albeit less than desirable in results, do provide for financial controls from which Agency financial managers derive sufficient information to provide certification to the annual FMS-2108 submission to the Department of Treasury. Further, the Office of the General Counsel has advised us that existing statutes have no provisions for a comprehensive annual review of obligations, unliquidated balances, or the unobligated balances calculated from the preceding obligations.less disbursements.

Nonetheless, we continue to believe that performance of annual reviews and certifications are a good business practice. To achieve such certifications, the Acting Chief Financial Officer has concurred with an auditor recommendation to issue policy that will require each individual office to annually review current year obligations and issue a certification of the integrity of those obligations. This certification will be the baseline information upon which the Agency will certify to the existence of "proper existing obligations", as required by 31 U.S.C. 1501(A).

Recommendation 2: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Finanaial Officer implement a tracking system for Letter of Credit Financial Status Report8 and ensure that all transactions are promptly recorded.

We agree with the recommendation. A new informal tracking system has been implemented as a temporary solution until the LOCSS system can be replaced with a system that provides for the recommended tracking capability. Upon receipt of a voucher, it is recorded in a Lotus spreadsheet. The spreadsheet is then updated when the voucher has been processed and posted to the appropriate accounting systens, thereby maintaining an updated log of the status of all letter of credit vouchers received.

The letter of credit voucher log has not been properly maintained or utilized since the implementation of NMS. Therefore, we adopted a more useful system of tracking vouchers with complete and updated information to address this recommendation.

Recommendation 3: Until USAID implements a compliant accounting and financial *management* system, we recommend that the Chief Financial Officer develop and implement a methodology to accrue expenditures and adjust outstanding advances and prepayments to ensure that the financial statements are not materially overstate&

We do not agree with this recommendation. The recording of advances to grantees in a pooling arrangement is common practice in the federal government. The advances associated with each letter of credit are properly recorded, but the advances cannot be properly attributed to the correct appropriations until liquidated by the grantee. Until further guidance is issued by the CFO Council or a regulatory body, the Agency will continue to record advances against letters of credit,

This issue also relates to the process of providing **funds to non-profit** organizations. While the Office of Financial Management is intent on properly recording accounting transactions, we are also caught in a tight position between the needs of non-profit organizations to obtain funds to maintain their operations and appropriate financial management representation. Recently five Senators have introduced a bill for consideration that addresses the concerns of states, local governments and non-profit organizations on how funds are funneled from federal programs to the implementers of various programs. In addition, the federal government operates under strict guidelines that exempt non-profit organizations from overwhelming paperwork that restricts the ability of non-profit organizations from meeting their primary 'missions. Therefore, the Agency will carefully navigate the balance between accounting and stakeholders needs before acting on this recommendation that would require non-profit organization& to alter their accounting systems and provide information relating each request for funds to individual grants,

We encourage the office of the Inspector General to research the effects of requiring non-profit organizations to associate advances with individual grants as a collaborative exercise between the Agency and IG.

Recommendation 4: We recommend that the Chief Financial Officer:

4.1 Ensure that reports transmitted to the Department of Treasury and Office of Management and Budget are prepared by USAID financial management staff and reviewed by a second party;

1.2 Require that figures be adequately supported by the general ledger before transmission to the regulatory agencies.

The Office of Financial Management is currently investigating the differences in the unobligated balances reported to the Department of Treasury and those reported to the Office of Management and Budget.

We appreciate the purpose of recommendation 4.1, but do not believe that the solution is increased oversiqht. Rather the solution is more related to Recommendation 4.2 suggesting that figures be adequately supported by the general ledger. It has been M/FM's expectation for over three years that AWACS would provide the integration and reliability necessary to ensure accuracy of all financial reports. As represented throughout this audit and in managements comments, our expectations have proven to be too lofty.

M/FM/CAR is pursuing additional human resources for the general ledger team and for greater attention to presentation of the financial statements of the Agency. It is expected that by strengthening the general ledger team, it will be empowered to perform effectively and with sufficient ability to inject peer reviews of all work leaving the office. Therefore.; general guidance will be issued with M/FM/CAR requiring peer review of all work intended for distribution outside of USAID.

We concur with recommendation 4.2. USAID efforts continue to address major systems problems in the AWACS systems. As described elsewhere in management comments, we are moving forward to evaluate solutions to current accounting systexn conditions,

Recommendation 5: We recommend that the Assistant Administrator/Bureau for Polioy and Program Coordination establish a common set of indicators for use by operating units to measure progress in achieving USAID's strategic goals and objectives and that allow for the aggregation of program results reported by operating units.

We fully agree that USAID needs appropriate indicators for measuring progress in achieving strategic goals and objectives in a manner consistent with GPRA and GMRA requirements. In this regard we have developed severaldozen standard indicators and assembled performance data covering all of the Agency's goals and objectives. We have also implemented consistent procedures and standard indicators for assessing the performance of every one of USAID's operational objectives in terms of whether it is exceeding, meeting, or falling short of its performance targets. We agree that the quality of performance data and documentation needs improvement, although we feel that very substantial progress has already been made.

However , we disagree in the strongest terms that USAID's performance measurement requirements can be met by developing and imposing a new set of "common" indicators on USAID's operational programs. The OMB and the GAO have both expressed support for USAID's approach to attribution of development results to Agency interventions by demonstrating plausible association through analysis, rather than by directly aggregating (rolling up) lower level indicators into higher level results. Measuring the performance of development assistance is not, in other words, the functional equivalent of measuring the delivery of municipal services. The IG's recommendation in this regard is both unrealistic and inappropriate.

While such "common" indicators may be useful and are already being used for some USAID activities (particularly in areas such as population, health, and education), in most program areas USAID's development assistance programs encompass a diverse range of approaches (appropriate to different circumstances) for achieving relatively high-level results. In programs concerned with democracy and governance, for example, there are a wide variety of approaches to strengthening civil society (for which we have a standard measure) and a wide range of shorter term results that reflect these different approaches (and for which we have a variety of measures). Imposing "common," annual performance measures at the operational level would result either in inappropriate program designs (with indicators driving programming) or would require the development of a whole new system of indicators (likely costing tens of millions of dollars, if feasible at all) to uniformly track very specific program outputs (such as number of years of technical assistance delivered, miles of road built, etc.) which may not provide much additional insight into whether the larger objective is being achieved.

Recommendation 6: We recommend that the Chief Financial Officer develop plans and time frames far USAID's financial management system to permit tracking of obligation8 and expenditures according to USAIDs overall strategic goals and objcativea and in support of each operating unit's strategic objective and intermediate results,

We concur with this recommendation. Throughout fiscal year 1997 and into the beginning of 1998, USAID management has continued to pursue the vision of fully integrating the suite of systems of the New Management Systems (NMS).

Only recently has it been determined, as a result of the IV&V exercise, that continuation of full implementation of the core financial system (AWACS)is not a cost effective method to pursue. It is also worthy to note that the IV&V suggested continued development of the Operations module of the NMS since no commercial packages could be procured to meet the Agency's needs.

Despite our most dedicated system development efforts, the Agency has recognized that it must evaluate procurement of a Commercial Off-the-Shelf (COTS} package as a solution to the current core financial system requirements. Upon evaluation of COTS financial systems and implementation decisions, the Agency will make every effort to develop plans and schedules to fully implement the core accounting system, and then to integrate the accounting system with the remaining modules of the NMS.

Recommendation 7: We recommend that USAID:

7.1 Establish a *policy* that requires (1) operating units to report results for the year ended September 30 and (2) results reported in the overview section of USAID's financial statements and Annual Performance Report be clearly shown as achievements for that year.

7.2 Require the Chief Financial Officer to fulfill his responsibility under the Chief Financial Officers' Act for obtaining and reporting complete, reliable, timely, and consistent program performance information for the overview section of USAID's financial statements (fiscal year) report.

We strongly disagree that USAID needs a new policy to impose new results reporting requirements on our operating units, as implied by this recommendation. These operating units already report annually on their program results and USAID systematically and consistently assesses the progress of every operating unit objective. PPC and CFO staff may need to work more closely together, however, to ensure that this information is fully reflected in GMRA reporting-.

Overall, the Agency continues to make major improvements in collecting results data for preparation and submission of the Annual Performance Report (APR) required under the Government Performance and Results Act (GPRA). From these reports are generated performance information that is used to develop the Performance Measures and selected Overview information for the Financial Statements.

Matching performance and results directly to financial information is not an easy task given the nature of USAID's work. Generally, resources expended by USAID in one year produce results that can only be measured over several subsequent financial periods. As an example, delivery of contraceptives into a host country could not reasonably yield population reductions or reduction in the number of cases of sexually transmitted diseases in the first year. Instead, introduction of contraceptives and marketing of those tools will yield results that can be measured several years from introduction.

While we recognize the need to further improve result gathering and to accumulate that information into APR and financial statement that more effectively presents performance information for the most recent year, it will be impossible to meet the requirements of this Recommendation in FY 1998. However, the Agency will focus attention on meeting the intent of GPRA performance measurement and reporting. Data generated for the GPRA-inspired systems will be incorporated into the financial statements for FY 2000.

At the present time, the Acting Chief Financial Officer of the Agency is not responsible for gathering program performance information for the Agency. That responsibility rests with the Assistance Administrator for the Bureau for Program and Policy Coordination (PPC). There is no expectation that the organizational structure of the Agency will be modified, but rather that the CFOs responsibility will be carried out through close collaboration with PPC.

The Acting CFO will continue to work collaboratively with PPC to obtain reliable, timely, accurate and consistent program performance information that can be correlated with the financial resources delivered. In addition, the Acting CFO will continue to be responsible for the preparation of the overview and performance sections of the annual financial statements, with specific information from PPC.

Recommendation 8: We recommend that the Chief Finanaial officer:

8.1 Implement a comprehensive policy that will incorporate an automatic assessment of interest charges against all delinquent receivables, and that these assessments be actively monitored for managerial and statutory reporting purposea; and

8.2 Ensure that the required filing for all receivable categories is accomplished.

We agree with these recommendations. It is the intent of the Agency to incorporate interest assessment and collection into the core financial systems of the Agency. AWACS is building that capability for headquarters operations and will be used more extensively throughout fiscal year 1998. Overseas, our controllers are responsible for the active monitoring of bills for collection and for assessment of interest.

We recognize the reported deficiency related to reporting outstanding public receivables and will work to address this issue in the near future. As with many other problems reported, the Agency is heavily reliant on AWACS to provide a useful core accounting system that can retain accurate accounting information and can then be used to provide accurate accounting information for external reporting.

Recommendation 9: We recommend **that the Chief** Fiaanaial Officer develop and **implement policies and** procedures to ensure **adherence** to the requirements of the Debt **Collection** Act **(DCA)** of 1982 **and** the Debt Collection Improvement Act of 1996. These policies and procedures should at a **minimum** ensure **that**:

9.1 All billing offices incorporate due process rights into demands **for payment**.

9.2 All delinquencies in excess of 180 days are identified in a timely **manner, and** referred to the United States Treasury;

9.3 The issuance or guarantee of **consumer** credit is reported to consumer credit reporting agencies.

We agree with these recommendations. The Office of Financial Management recognizes the lack of compliance with the DCIA as a serious condition and one which requires significant attention to policy building and engagement to the collection tools available through the Department of Treasury. A policy team has been detailed to M/FM/CAR and tasked with development of DCIA as one of its highest priorities.

A new staff member is investing a great deal of time into overseeing the overaged bills for collection in M/FM/CAR, In addition, she is currently incorporating due process rights Fnto procedures for Treasury offsets, and directing efforts to refer commercial debt aged in excess of 180 days to the Department of

Treasury. We will also investigate the steps necessary to refer debt to consumer credit agencies.

However, even our best efforts to manage debt are not going to be useful for management of the bulk of the Agency's debt. Obviously, the largest value of debt owed to the U.S. Government, managed by USAID pertains to outstanding loans. In addition, a large portion of debt is sovereign debt, debt that is owed to USAID by host governments and potentially governments with which diplomatic relations have been severed. In both of these non-commercial debt conditions, the DCIA does not apply and we have few effective tools to leverage collection.

The other category is commercial debt that is collectible from organizations outside of the United States. In our discussions with the Department of Treasury, they have made it quite clear that they can provide little support in collecting that 'debt. Access to the IRS, offset against other U.S. Government payment, collection agencies and consumer credit reporting agencies are virtually worthless tools to collecting this debt.

Combined between sovereign and foreign commercial debt, these constitute the overwhelming balance of USAID outstanding debt.

Recommendation 10: We recommend **that the** Assistant Administrator/Bureau for Program and **Policy** Coordination, *in* preparing the next **Bureau** submission to the **Administrator** under the Federal Managers' **Financial** Integrity Act, perform an assessment: of the **internal control weaknesses on performance** measures **identified** in **this report and report** the material **weakness.**

We agree to perform an internal control assessment on performance measures for the FY 1998 FMFIA review and to report any material weaknesses identified to the Administrator. However, we do not accept that all the weaknesses identified in this report are material, Hence, any weaknesses reported next year may or may not include those identified in this report.

ENCLOSURE B

ADDITIONAL COMMENTS

1. Letter of Credit Disbursements

While we believe that the Office of the Inspector Genera1 has properly reflected existing federal requirements pertaining to the proper matching of disbursements to valid obligations and associated obligating documents, management disagrees with the comments pertaining to matching disbursements to specific obligations at the time of drawdown. We suggest that there is a critical difference between disbursements and advances in the context of this finding. The findings inappropriately apply federal requirements for properly matching disbursements to obligations against the Agency's practice of advancing funds against a higher level, a letter of credit.

To explain this position, we refer to the report itself that indicates that a representative from the GAO has recognized that this practice of advancing funds to non-profit grantees at a letter of credit level is a common practice among federal agencies and a "problem" that is recognized within other government agencies. At the present time, a sub-committee of the Chief Financial Officers Council is addressing issues associated with advancing grantees in a pooling method. As further evidence of the nature of pooling, our research indicates that the Department of Health and Human Services provides cross-servicing to various federal agencies and offers "pooling" as an appropriate method of performing business, and has obtain unqualified opinions on their financial statements in recent years. And finally, note that the current Agency Letter of Credit system is an outgrowth of the Department of Treasury's Federal Reserve Letter of Credit system, from which grantees were provided advances on a pooled basis.

At the present time, we are engaged in efforts to evaluate options to cross-service our letter of credit functions. We have met with both the Department of Treasury's Financial Management Service and with the Department of Health and Human Services and are intent on embarking on a cross-servicing agreement in fiscal year 1998. However, this cross-servicing effort may not result in the ruatching of obligations and advances as recommended.

We are quite hopeful that the CFO Council will provide more definitive guidance in this area in the near future, at which time we will evaluate our business practices.

2. Federal Financial Management Improvement Act of 1996

The conditions described in this audit, related to the Report on Compliance, are substantially correct and the Agency appreciates the recognition by the Inspector General of significant changes in direction to identify deficiencies and chart corrective courses.

However, it is important to recognize the conditions that have lead the Agency to its current conditions. On two separate occasions, the Agency issued a request for Letters of Interest (LOI) to vendors interested in competing for USAID's business in purchasing and implementing a core financial accounting system. The need for a client servers based environment to meet our worldwide accounting conditions and the lack of qualified vendors on the GSA schedules led to a determination that no vendor could meet the requirements of the Agency. Struggling with a number of legacy system, the Agency did chart an aggressive course to build various modules of the NMS, including a core accounting system, AWACS. In hindsight, the aggressive tactics can certainly be evaluated as highly risky, but were necessary to achieve expected results while minimizing costs. The gamble failed and the Agency is now taking steps to consider replacing AWACS.

We wish to recognize that three NMS modules will be retained and will become critical to full integration with the core financial systems. In the IV&V report from IBM, it was suggested that Acquisition and Assistance, Budget, and Operations modules be retained. In fact, IBM suggested that the Operations module could not effectively replaced with any commercial solution, at present.

Several immediate concerns will lead the Agency towards another aggressive implementation schedule. The first is the recognition by the Agency that our current financial systems are not in compliance with current federal requirements. The second is the new millennium and the effect of the year 2000 on computer operations. Combined, the Agency faces the daunting task of procuring and implementing a new core financial accounting system by October 1, 1999.

3. <u>Budget Accounting and Procedures Act of 1950:</u>

USAID concurs that additional work is required to improve financial systems to meet the requirements described.

4. <u>Anti-Deficiency Act:</u>

M/FM has been actively investigating these conditions and has found that obligations were recorded twice in the case of one appropriation and in the second there was a financial error in the recording of appropriations transfers to the Department of Treasury, thereby resulting in the over-obligation conditions reported on the FY 1997 FMS-2108.

We continue to investigate one more appropriation to confirm our expectation that we are not anti-deficient, but have duplicate obligations. Final results will be available before the end of March 1998 and corrective actions will be recorded.

5. Chief Financial Officers Act of 1990:

As described throughout management's responses, the Agency is acutely aware of the deficiencies of the core accounting system and the Agency is proceeding with corrective actions.

6. Supplemental Appropriations Act of 1955:
As described in our response to Recommendation 1, USAID will take action in 1998 to issue policies and train users to understand their responsibilities as financial managers in the reengineered USAID. However, our response to this recommendation also indicates that the Office of General Counsel finds no legal requirement for the depth of unliquidated obligation reviews as suggested by this audit.

7. Prompt Payment Act of 1992:

obtaining information from AWACS to meet the Prompt Pay data requirements was not a successful exercise. After several failed iterations, we were able to obtain a report to provide general details to meet the reporting requirement. However the data is suspect and we have recognized that the AWACS system does not fully address all requirements of the Prompt Pay Act.

8. Foreign Assistance Act, As Amended in 1968

We believe that with the submission the Strategic Plan (9/97) and Annual Performance Plan (2/98), and preparation of the Annual Performance report, USAID is designing and implementing a system that is compliant with GPRA. It is our understanding that this system is also in compliance with the intent of the Foreign Assistance Act, as amended.

9. OIG characterization of performance reporting

We conclude that part of the analysis of performance reporting in the audit appears misleading, Labeling data from 1995 instead of 1996 (or from 1992 through 1996) as "incorrect," rather than "not current," for example, is misleading. It fails to recognize that without such data it would be impossible to assess USAID's broader impacts, since most developing country (and domestic U.S.) data are simple not available quicker. Clearly, some examination of longer term and higher level results is intended under both GMRA and GPRA. Yet every data entry that is not current or that reflects multi-year intervals is labeled "incorrect." Similar issues could be cited concerning the reports treatment of "reliability," "precision," "objective measure," etc.

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USAID'S FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT REPORT FOR FISCAL YEAR 1997

The following describes each material weakness and completed actions as directly reported in USAID's fiscal year 1997 Federal Managers' Financial Integrity Act (Integrity Act) report.

USAID's Primary
Accounting System

USAID lacks an integrated financial management system. USAID completed the following actions to correct this material weakness.

> Deployed New Management System worldwide on October 1, 1996. After a series of technical problems, suspended the AID Worldwide Accounting and Control System and Acquisitions and Assistance components in field missions, while continuing full New Management System operations in Washington.
>
> Signed an agreement with the Federal Systems Integration and Management Center (Center) to conduct an independent verification and validation (IV&V) of New Management System. Center will review the financial management systems to evaluate (1) compliance with the Federal Financial Management Improvement Act (FFMIA); (2) progress towards USAID's goal for a worldwide accounting system that captures transactions when and where they occur; and (3) the ability to provide accurate and timely management information. USAID will make a management decision on the lowest management risk and cost alternative to meet its financial management system requirements in 1998 based on the work of the Center contractor.
>
> New Management System development activities were suspended on October 31, 1997 in order to support the IV&V effort, focus on Year 2000 compliance, correct deficiencies, and address high management risk requirements. Worldwide implementation of USAID's new integrated financial management system recommended by Center will not occur until all major issues have been resolved.

<u>Data Reconciliation</u>

Lack of up-to-date reconciliations, such as subsidiary data to general ledger account totals by appropriation and 1221 reconciliations in missions (differences in USAID payment records and those of the U.S. Disbursing Officer, the U.S. Treasury's payment agent overseas), lead to potential loss of funds, potential for funds control violations, qualified audit opinions, and inaccurate reporting. USAID completed the following actions to correct this material weakness.

> Continued placing emphasis on the reconciliation of undistributed proprietary and budgetary expense entries in the 4650 account to improve the integrity of accounting data. Efforts are underway to correct unidentified undistributed expenses and to properly record the expenses in the general ledger in 58 appropriations with a net value of $1.1 million. (September 1997)

<u>Accounts Receivable</u>

Accounting for worldwide accounts receivable is not included in the general ledger of USAID, lacks coordination and integration of various systems, lacks adequate policy and procedural guidance and is not part of an integrated financial management system. USAID completed the following actions to correct this material weakness.

> Efforts are being applied to enhance USAID's ability to pursue collections using various alternatives. Following implementation of the Accounts Receivable modules of the new system, a systematic and recurring reconciliation will be expanded to ensure the accuracy of receivables in the system. (FY 2000)

<u>Financial Management Procedures</u>

FM managers and USAID officials worldwide do not have documented, standardized financial management policies and procedures. Policy guidance and regulations are not available from a current, complete and easily accessible source. USAID completed the following actions to correct this material weakness.

> Efforts to improve and expand the electronic financial management library were completed. All USAID/W Financial Management staff have desk-top access to the library. (September 1996)

The Intranet was established to handle information contained in the library. It contains such information as the General Accounting Office's Yellow Book, Office of Management and Budget documents, Department of Treasury Bulletins, U.S. Code, and other financial management materials and documents.

Automated Directive System developed and issued on obligation concepts and policy. (July 1997)

Direct Loan Program

According to USAID's fiscal year 1997 Integrity Act, An effective system of checks and balances has not been established. The general ledger system is not maintained and sufficient subsidiary records and source documents do not exist. The program does not have an integrated financial management system. Additionally, data entry controls have not been implemented and information in systems is not reconcilable. Formal comprehensive policies and procedures have not been formulated to ensure that the program is operated effectively. USAID completed the following actions to correct this material weakness.

- Audited balances for 232 loans. The dollar amount represents 66% of the total loan portfolio. (September 1995)

- Reviewed approximately 1,357 files to ensure the supporting documentation is included. (September 1995)

- Delegated the Deputy Division Chief of Loan Management as the USAID Loan Management Representative to participate in the monthly Paris Club Meetings, which includes traveling to Paris when countries request rescheduling of loan debt. (June 1996)

- Completed a review of the staff duties for all three loan programs. Assigned staff to closely monitor all accounts including the unapplied account. Re-aligned division to ensure adequate controls and clear segregation of duties. (June 1996)

- Prepared monthly trial balances, monthly financial statements (unadjusted), and quarterly consolidated financial statements (adjusted) and provided them to the Accounts and Reports team leader for detailed review and approval. (June 1996)

- Clearly outlined reporting requirements responsibility and due dates for the staff. (June 1996)

- Reviewed the internal desk top practices. Completed revision and expansion, including the distribution of a loan management operations guide to update them for current (pre-AID Worldwide Accounting and Control System) operations. (June 1996)

- Sent verification letters to 17 borrowers, in a pilot program, to confirm direct loan balances as of June 30, 1996. (August 1996)

- Sent verification letters to remaining 39 borrowers, in a pilot program, to confirm direct loan balances as of June 30, 1996. (May 1997)

USAID's New Management System
<u>Security and Access Controls</u>

USAID reported the design of access control techniques were not integrated across New Management System components. The material weakness pertains to the level at which controls were implemented in the system, design of access control roles, audit trails of system activity, user ID and password administration, and access to sensitive Privacy Act information.

USAID completed the following actions to correct this material weakness.

- Entered into an agreement with the Center. (November 1997)

- Initiated a parallel analysis of New Management System security and access control vulnerabilities to determine which deficiencies can be corrected immediately and which will require further analysis following the first phase deliverables under the Center IV&V effort. (November 1997)

- Hired a senior Computer Security Advisor who will commence work on 1/5/98 and oversee a review of New Management System policies, procedures and software controls for security and access controls. (November 1997)

USAID's New Management System
<u>Reporting and Resource Management Capabilities</u>

New Management System generated reports were viewed by users of the information as not being timely, accurate or sufficiently useful to manage USAID's business. The financial management components of New Management System are perceived by users as not producing reliable obligation and expenditure information. As a result, users frequently employ "cuff record" systems to serve as backups to New Management System. In relying on these "cuff record" systems, users run a high risk of over obligation, under obligation or improper stewardship of USAID resources. These informal financial, pipeline and procurement systems compensate for the deficiencies in New Management System but are still viewed as insufficient to manage and safeguard some USAID resources and meet statutory reporting requirements. The data migration of active and historical information on USAID business from legacy systems to New Management System encountered substantial difficulties. This has made it difficult for some USAID offices to access or attribute historical information to New Management System data schemas leading to inaccurate reporting and delays in payments. USAID completed the following actions to correct this material weakness.

- Implemented numerous query capabilities and reports in New Management System for financial management and procurement planning and tracking. Significant progress was made in addressing data migration problems as well. (September 1997)

- Designated a technical administrator for reporting to facilitate a more coordinated response to addressing reporting requirements. (September 1997)

- Implemented basic functionality to support emphasis area coding (the process USAID uses to code activities). (September 1997)

- Suspended New Management System development activities to focus USAID resources on high management risk mitigation work, correcting system deficiencies, year 2000 compliance renovations, and supporting the Center IV&V efforts. (October 1997)

- Entered into an agreement with the Center to conduct an independent verification & validation (IV&V) of New Management System. (November 1997)

Information Resources
Management Processes

Organizational and management deficiencies exist in USAID's information resources management practices. The Clinger-Cohen Act of 1996 mandates that agencies implement a disciplined process to manage information technology investments. The Act requires that the heads of Executive agencies implement a process to maximize the value and assess and manage risks involved in information technology investments. The process is to include: (1) procedures to select, manage, and evaluate investments; and (2) a means for senior managers to monitor progress in terms of costs, system capabilities, timeliness, and quality.

USAID completed the following actions to correct this material weakness.

- Established a Capital Investment Review Board for information technology to provide broad management oversight for investments in information technology in accordance with the Clinger-Cohen Act. (March 1997)

- Appointed a new Director of the Office of Information Resources Management who focuses exclusively on managing USAID's information resources activities. (July 1997)

- Developed a strategy for improving USAID's software acquisition process. In the near term, a more rigorous contracting and software ordering process is being applied to existing New Management System contracts to provide quality maintenance and operation support. In the long term, new software development contracts issued by USAID will be performance-based. (December 1997)

<u>Computer Security Program</u>

USAID has not implemented an effective security program that meets the requirements of the Computer Security Act of 1987 or Office of Management and Budget Circular A-130. This includes: 1) identifying and documenting critical and sensitive systems; 2) identifying, documenting and assigning security responsibilities; 3) requiring and implementing security plans for all sensitive systems; and 4) conducting a vulnerability assessment of all sensitive systems to ensure that they are protected from waste, loss, or mismanagement. USAID completed the following actions to correct this material weakness.

- USAID had not completed any corrective actions for this material internal control weakness as of the date of the Financial Management Integrity Report for Fiscal Year 1997.

PREVIOUSLY IDENTIFIED MATERIAL CONTROL WEAKNESSES

This appendix discusses the previously identified material control weaknesses that still exist.

USAID's Primary Accounting System

USAID's primary accounting system did not comply with the Federal Financial Managers' Improvement Act. Specifically, USAID's primary accounting system did not (1) meet the Federal financial management system requirements, (2) comply with applicable Federal accounting standards, and (3) implement the United States Standard General Ledger at the transaction level. As a result, USAID can not provide financial statements that are complete, reliable, timely, and consistent and effectively manage its assets.

Integrated Financial Management System

USAID lacked an integrated financial management system. USAID commenced operation of the New Management System in October 1996. However, due to serious problems, USAID/Missions were instructed to discontinue using the New Management System and go back to using the Mission Accounting and Controls System. USAID/Washington continued to use the New Management System, but also used the Financial Accounting and Controls System for mission activity that was accounted for by USAID/Washington. In addition to these systems, USAID used many lesser systems, such as the Loan Accounting Information System, General Ledger Accounting and Reporting System, Letter of Credit Support System, and various informal records. These systems required data re-entry, supplementary accounting records, and lengthy and burdensome reconciliation processes without sufficient discipline, effective internal controls, and reliable information. As a result, the USAID had insufficient assurance that the financial information reported was complete, reliable, timely, and consistent.

Manaeement of Resources

USAID/Washington paid approximately $.37 million in late payment interest penalties[32] during fiscal year 1997. This represented a 28 percent increase from fiscal year 1996. According to USAID's fiscal year 1997 Prompt Payment Report, "the Agency has suffered through one of the most troubling financial years since the introduction of the Prompt Payment Act." This is because of the decision to begin entering transactions in the AID Worldwide Accounting and Controls System (the system) at the beginning of the fiscal year. However, the system was not run parallel to the Legacy systems and the Accounts Payable module was not fully complete. USAID Financial Management Officials were instructed to stop making payments until the system was fixed. As a result, USAID/Washington is not able to effectively manage its resources.

Data Integrity

USAID had data integrity problems with transactions recorded in the New Management System. For instance:

> Modules of the New Management System did not always transfer correct data between subsystems, causing obligation and allowance data in New Management System to be inaccurate. For example, a user entered four related transactions obligating a total of $12,916 in Acquisition and Assistance, but the total amount shown as obligated in the AID Worldwide Accounting and Controls System was $90,066. This situation illustrates that transactions were not being properly recorded in the 'New Management System, increasing USAID's vulnerability. Without accurate processing of critical financial transactions and events, USAID managers did not have reasonable assurance that the resources for which 'they are accountable were being used appropriately and in compliance with laws, regulations, and USAID policy.
>
> The New Management System lacked reliable monthly and year-end closing procedures including those for annual financial reporting due at the end of fiscal year 1997. Because the New Management System could not accommodate normal end-of-period closing requirements, alternative procedures were implemented to attempt to provide the necessary reports. However, monthly reports must be qualified because their accuracy cannot be assured. Further, year-end closing

[32] In fiscal year 1996, USAID reported that interest penalties due to late payments amounted to about $290,000.

procedures were not expected to be available until late in fiscal year 1998. These deficiencies raise serious questions about USAID's ability to generate complete, reliable, timely, and consistent financial information--a basic objective of internal controls.

USAID Washington asked missions to decommit funds for internal control purposes, because funds once committed can be obligated from either Washington or the field. Thus, it is possible that the funds could be obligated twice. This situation could result in an Anti-Deficiency Act violation.

Data Reconciliation

USAID did not always perform data reconciliations in a timely manner. This occurred because USAID had not developed and implemented an integrated financial management system. As a result of these unreconciled differences, USAID can not provide financial statements that are complete, reliable, timely, and consistent

Suspense Appropriation 72F3875

USAID had an unidentified balance of over $29 million in suspense appropriation 72F3875. USAID did not properly identify and post the transactions to the correct appropriation. Instead, the transactions were posted directly to suspense appropriation 72F3875. Thus, USAID avoided the receipt of a Statement of Difference from the Department of Treasury, which is required to be reconciled on a monthly basis. Treasury Financial Manual, Part 2, Chapter 3900, states that Agencies should:

> 1) Verify the amounts of transactions and transaction codes to ensure that each transaction is correct, 2) Adjust any differences in the agencies records and 3) Notify the United States Treasury of any processing discrepancies.

As a result, USAID can not provide financial statements that are complete, reliable, timely, and consistent.

Differences in the General Ledger and the Letter of Credit Support System

USAID had an unreconciled difference of approximately $46 million between the general ledger and the Letter of Credit Support System. This occurred because USAID had not taken action to identify and correct prior year differences. As a result, USAID's Advances and Prepayment balance may be misstated in the financial statements .

Advices of Charge

Because of the lack of adequate reconciliations, outstanding Advice of Charge expenditures of over $238 million as of September 30, 1997, were not properly applied against an appropriate obligation. This amount represents a 345 percent increase from the September 30, 1996 balance of $69 million. As a result, no means exist to readily determine whether these expenditures were made for goods or services received by USAID until the advices of charge are cleared.

Fund Balance with Treasury

USAID has material unreconciled differences of over $1.94 billion in the Fund Balance with Treasury account. USAID did not properly research and reconcile differences identified between its general ledger balances and the Department of Treasury's balances throughout the fiscal year. In attempt to ensure that the balances maintained in USAID's general ledger agreed with balances maintained by the Department of Treasury, USAID improperly adjusted the differences into Account No. 4801, Undelivered Orders, thereby overstating USAID's obligations. Department of Treasury Bulletin No. 97-06 states that agencies should verify their records each month against the transactions recorded by the Department of Treasury, as shown on the Department's monthly reports.[33] This bulletin further states that if agencies do not perform the monthly reviews, errors may be discovered during budget preparations and year end certifications. As a result, USAID's Fund Balance with Treasury is potentially misstated.

Accounts Receivable

USAID did not recognize and record accounts receivables as the transaction occurred. This is because the Accounts Receivable module of the New Management System was not fully operational during fiscal year 1997. Further, USAID did not establish supplemental procedures for effectively recognizing and recording accounts receivables. As a result, USAID has insufficient assurance that all funds due to USAID are properly recognized and

[33] These forms are Financial Management Services Form 6653, "Undisbursed Appropriation Account Ledger," and Financial Management Services Form 6655, "Receipt Account Ledger."

recorded. Additionally, sufficient controls do not exist to prevent and/or detect the misappropriation of voluntary accounts receivables.[34]

Use of United States Standard
General Ledger at the Transaction Level

USAID did not record Accounts Receivables in accordance with the United States Standard General Ledger at the transaction level. USAID did not have an integrated financial management system which included Accounts Receivable.

USAID relied on data calls[35] to obtain the total amounts of outstanding Accounts Receivable because USAID did not have an integrated financial management system. These data calls were posted to the General Ledger at the summary level as opposed to the transaction level as required. By using data calls to determine outstanding Accounts Receivable, USAID was at risk that the information obtained is not complete. For instance, USAID's summarization of the data calls improperly omitted the Office of Procurement's outstanding Accounts Receivables. As a result USAID had insufficient assurance that the financial statements were complete, reliable, timely, and consistent.

Timely Recording of Collections

USAID did not timely record over $8.1 million of collections against outstanding Accounts Receivable. This occurred because the Accounts Receivable module of the New Management System was not fully operational during the fiscal year, thus causing a backlog. As a result, USAID's Accounts Receivable balance may be overstated and the Fund Balance with Treasury may be understated in the financial statements.

Financial Management Procedures

USAID did not develop and implement formal financial management policies and procedures. USAID's management had not recognized this area as a high priority. As a result, USAID

[34]Voluntary receivables are funds received for which no bill was issued. Therefore, no easy way exists to detect the misappropriation of these funds (See "USAID's Inspector General Report on Internal Controls").

[35]Data calls is a term used to describe the process of requesting various offices to provide outstanding balances as of year end.

can not provide consolidated financial statements that are complete, reliable, timely, and consistent and effectively manage its assets.

Accrual Methodology

We previously reported[36] that USAID's accrual methodology was not in accordance with Federal financial accounting standards and generally accepted accounting principles. Further, the accruals methodology used for fiscal year 1996 was not subject to any written USAID policy. As discussed in "USAID-Imposed Restrictions" in the "USAID Inspector General's Report on Financial Statements," USAID management provided us a copy of their fiscal year 1997 accruals methodology on February 2, 1998. However, this did not give us time to review and test this methodology. Therefore, we have no evidence that this material weakness has been corrected. Further, USAID Financial Management Officials have informed us that they intend to implement a different accrual methodology for fiscal year 1998.

Manually Processed Journal Vouchers

USAID continued to have a high number of manually processed journal vouchers. USAID did not establish and implement procedures to ensure continual supervision of these journal vouchers to ensure that adjusting entries are correct. As of September 3, 1997,[37] 27 percent of the 301 manually processed journal vouchers were recorded to correct previously posted data. Seventy-one percent of those vouchers did not have supervisory approval.

Debt Collection Acts of 1982 and 1996

USAID did not implement policies and procedures to ensure compliance with the requirements of the Debt Collection Acts of 1982 and 1996. Specifically, USAID did not (1) always provide debtor with "due process rights" when demanding payment on outstanding debts, (2) always automatically refer delinquent debts in excess of 180 days to the United States Treasury for the recovery of agency debts, (3) did not provide information regarding

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[36] Audit Report No. 0-000-97-001-C, dated February 24, 1997, Reports on USAID's Financial Statements, Internal Controls, and Compliance for Fiscal Year 1996.

[37] Note that although September 30, 1997, ended the fiscal year, journal vouchers continued to be posted through January 1998.

the issuance or guarantee of credit to consumer credit reporting agencies (See "USAID Inspector General's Report on Compliance).

Reconciliations of Budget Clearing Accounts

USAID/Washington had not reconciled balances in its budget clearing accounts as of September 30, 1997. These balances had not been cleared because USAID's Office of Financial Management, had not established and implemented written procedures for reconciling and clearing outstanding differences within the budget clearing accounts. Treasury Financial Manual Bulletin No.97-06, Volume 1, requires Federal agencies to clear out all budget clearing accounts at year-end.[38] Further, all amounts contained in budget clearing accounts must be transferred to the proper account on the September 1997, Statement of Transactions submission. As a result of the untimely reconciliations, the appropriation balances for fiscal year 1997 are potentially misstated by over $29 million.[39] In addition, uncleared differences distort the budget results of the United States Government in government-wide financial statements and could effect USAID's appropriation requests. Furthermore, the ability to discover possible loss, fraud, or irregularities is limited if the discrepancies are not reconciled and cleared.

Direct Loan Program

USAID's Loan Management lacked an integrated financial management system. This deficiency exists because the New Management System has not worked as intended. As a

[38] When differences exist between the amounts an agency reports and the amounts recorded by the Department of Treasury, the Department of Treasury sends a statement—Financial Management Services Form 6652, Statement of Differences-to the agency on the disbursement and deposit transactions. If the agency does not reconcile the within six months of the accomplished date, as reported on this statement, the Department of Treasury automatically charges the difference to the budget clearing accounts.

[39] As of September 30, 1997, USAID/Washington had the following balances in its budget clearing accounts: (1) Account 72F3879 (Disbursements) - $150.00; (2) Account 72F3878 (Deposits) - $43,725.00; and (3) Account 72F3875 (Agency Suspense Account) - $29,846,161.

result, unreconciled differences of $133 million[40] continue to exist between the general ledger[41] and the subsidiary ledger.[42]

This reconciliation problem continues to exist because the two systems used to record and report loan activity are not integrated. In addition, adequate reconciliations are not performed to ensure of the accuracy and consistency of the data in both systems.

Differences between the two system arise when financial data is processed in one system and not in the other system. Differences also arise when financial data is manually entered in the systems without proper supporting documentation.

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[40]The General Ledger Accounting and Reporting System and the Loan Accounting and Information System show differences in the loan balances that total to an absolute value of $242 million. Of this amount, the personnel explained that a $109 million balance for the Enterprise for the America Initiative loans was recorded in one system but not in the other. Therefore, we reduced the difference between the two systems by that amount to estimate a $133 million unreconcilable difference between the General Ledger Accounting and Reporting System and the Loan Accounting and Information System.

[41]The General Ledger Accounting and Reporting system serves as the general ledger for the Direct Loan Program. Loan information in the Loan Accounting and Information System is saved on a magnetic tape and uploaded monthly to the General Ledger Accounting and Reporting System. The system does not track balances by loan number, but only by funding type.

[42]The Loan Accounting and Information System serves as the subsidiary ledger for the Direct Loan Program. Daily loan activity is manually entered into this system.

STATUS OF UNCORRECTED FINDINGS AND RECOMMENDATIONS FROM PRIOR AUDITS THAT AFFECT THE CURRENT AUDIT OBJECTIVES

Office of Management and Budget Circular No. A-50 states that resolution of audit recommendations shall be made within a maximum of six months after issuance of a final report. Corrective action should proceed as rapidly as possible. The following audit recommendations directed to USAID have not been resolved.

Reports on USAID's Financial Statements, Internal Controls, and Compliance for Fiscal Year 1996
Audit Report No. 0-000-97-001-C, dated February 24, 1997

Recommendation No. 1: We recommend that USAID's Chief Financial Officer:

1.1 Develop and implement procedures to ensure that journal vouchers for the general ledger are properly prepared by accounting staff and reviewed by supervisors;

1.2 Require that journal vouchers be adequately supported prior to entering the financial data into the general ledger; and

1.3 Provide adequate supervision to ensure that all adjusting entries entered into the general ledger system are supported and authorized.

Recommendation No. 1 awaits a management decision.

Recommendation No. 2: We recommend that USAID's Chief Financial Officer:

2.1 Identify and reconcile all suspended and unapplied balances;

2.2 Develop and implement detailed written procedures which provide adequate guidance to the financial management staff for properly recording transactions as they occur;

2.3 Develop and implement detailed written procedures to ensure that personnel perform timely reconciliations and the identified differences are resolved;

2.4 Provide qualified and continuous supervision to ensure that personnel properly perform reconciliations; and

2.5 Require documentation of the second party reviews to ensure that personnel properly perform reconciliations and resolve the differences.

Recommendation No. 2 awaits a management decision.

Recommendation No. 3: We recommend that USAID's Chief Financial Officer:

3.1 Establish an internal committee within the Financial Management Division responsible for ensuring that applicable accounting standards and Office of Management and Budget requirements are properly implemented;

3.2 Develop written procedures and methodologies which are in compliance with the applicable standards established as required by the committee mentioned above;

3.3 Investigate and resolve the apparent over-expended obligations; and

Recommendation No. 3 awaits a management decision.

Audit of USAID/Washington's Review and Certification of Funds Obligated for Operating Expenses
Audit Report No. A-000-97-001-P dated February 7, 1997

Recommendation No. 1: We recommend that M/FM/CONT:

1.2 ensure adequate staffing and supervision for the Section 13 11 review process in Bureau for Management Operating Branch and Loan Management Division.

1.3 ensure that Bureau for Management Accounting Division completes its management control and risk assessment of the Operating Expense Branch and takes action to correct any deficiencies noted.

Recommendation No. 1 Received request for Management Decision on 1/16/98, which is currently under evaluation.

Audit of USAID's Housing Guaranty Program Financial Statements for the Year Ending September 30, 1995, Audit Report No. O-000-96-019. dated July 18. 1996

Recommendation No. 1: We recommend that:

1.1 the Office of Financial Management/Loan Management Division re-institute appropriate monitoring procedures over the Agent on at least a quarterly basis that includes periodic site visits to the Agent's location by staff who possess appropriate training or experience;

1.2 the Center for Environment/Office of Environment and Urban Programs in conjunction with the Office of Financial Management/Loan Management Division continue to work towards updating and/or revising the pre Credit Reform loss methodology for incorporation into the Fiscal Year 1996 Agency-wide financial statements;

1.3 the Office of Financial Management/Loan Management Division: (a) continue its efforts towards correcting inaccurate balances in the Housing Guaranty Portfolio Management System, (b) after work on the subrogated claims and rescheduled loans has been completed, work with Office of the Inspector General personnel to perform agreed upon procedures with respect to these balances prior to migration to Agency-wide Accounting and Control System, and (c) make a serious attempt to perform reconciliations of affected balances at the subsidiary level (e.g. by individual balance) at least quarterly, and identify and resolve balances within 30 days following the reconciliations;

1.4 the Office of Financial Management/Loan Management Division continue its efforts towards improving and more clearly defining the Division's responsibilities and operations, including (a) identifying key transactions and events and assuring that appropriate management oversight procedures are integrated into activities, and (b) strengthening controls over transaction authorization and incorporating cross-checking internal controls where appropriate;

1.5 USAID's Chief Financial Officer address the question of USAID's labor charging practices in preparation for USAID's Agency-wide financial statements; and

1.6 USAID's Chief Financial Officer ensure that continuous and adequate supervision be incorporated into the Office of Financial Management/Loan Management Division's daily operations and be maintained by adding appropriate internal controls.

Recommendation No. 1 Received request for Management Decision on 12/29/97, which is currently under evaluation.

Audit of USAID's Micro and Small Enterprise Development Program for the Year Ending September 30, 1995, <u>Audit Report No. O-000-96-018, dated July 1, 1996</u>

<u>Recommendation No. 1</u>: We recommend that USAID's Chief Financial Officer ensure that financial management staff receive adequate training and sufficient supervisory oversight to process and record MSED financial transactions within the framework of an internal control structure that permits the preparation of financial statements in accordance with Office of Management and Budget Bulletin No. 94-01.

Recommendation No. 1 awaits a management decision.

Audit of USAID's Direct Loan Program Financial Statements for the Year Ending September 30, 1995, <u>Audit Report No. 0-000-96-017, dated July 1, 1996</u>

<u>Recommendation No. 1</u>: We recommend that Direct Loan Program Division Chief:

1.1 Establish detailed policies and procedures which provide adequate guidance to Direct Loan Program employees to properly execute day-to-day transactions;

Recommendation No. 1.1 Received request for Management Decision on 12/23/97, which is currently under evaluation.

1.2 Train Direct Loan Program Personnel to properly execute day-to-day transactions;

1.3 Reconcile applicable subsidiary ledger balances to the general ledger; and

1.4 Establish internal controls, with the proper segregation of duties and checks and balances that will ensure, to a higher level, that transactions are properly recorded.

Recommendation No. 1.2 through 1.4 Received request for Management Decision on 2/23/98, which is currently under evaluation.

Audit of USAID's Miscellaneous U. S. Dollar Trust Funds Financial Statements for the Years Ending September 30, 1995 and 1994, Audit Report No. O-000-96-013, dated April 1, 1996

Recommendation No. 1: We recommend that USAID's Chief Financial Officer establish procedures to assure that receipts, expenditures and balances of the U.S. Dollar Advances from Foreign Governments Trust Fund are periodically verified with the participating host governments.

Recommendation No. 1 Received request for Management Decision on 2/12/98, which is currently under evaluation.

Audit of the Fiscal Year 1994 Annual Financial Statement for USAID's Housing Guaranty Program Under the CFO Act, Audit Report No. O-000-95-037, dated June 30, 1995

Recommendation No. 1: We recommend that the USAID Chief Financial Officer fully develop and implement adequate claims and receivable controls which address the concerns raised in the FY 1994 Deloitte and Touche audit report.

Recommendation No. 1 awaits a management decision.

Audit of Fiscal Year 1993 Annual Financial Statement for USAID's Direct Loan Program Under the CFO Act, Audit Report No. O-000-94-004, dated June 30, 1994

Recommendation No. 1: We recommend that the Assistant Administrator for the Bureau of Management, within 60 days, develop and implement a plan and timetable to address the deficiencies in the internal control structure for the Direct Loan Program. At a minimum, the plan should address the following:

- Reconciliation of all direct loan activity.
- Retention and training of accounting personnel.
- Establishment of an adequate internal control system.
- Establishment of a detailed policies and procedures manual.

- A comprehensive system needs analysis that is appropriately coordinated with plans for implementing a new over-all accounting system (i.e. Agency-wide Accounting and Control System).

Recommendation No. 1 awaits a management decision.

The following recommendations are less than six-months old, and corrective action has not been taken.

Audit of USAID's Status in Implementing the Government Performance and Results Act of 1993, Audit Report No. 9-000-97-003-P, dated September 30, 1997

Recommendation No. 1: We recommend that the Acting Assistant Administrator/Bureau for Policy and Program Coordination develop a detailed work plan, including tasks, responsible offices/individuals and timelines, on how the Bureau will oversee the implementation of the Results Act.

Recommendation No. 1 USAID management concurred with the recommended action but has not yet developed the recommended work plan.

Audit of USAID's Compliance with Federal Computer Security Requirements Audit Report No. A-000-97-008-P

We recommend that the Acting Assistant Administrator for Management demonstrate support for an effective computer security program by taking action to:

Recommendation No. 1: Appoint a senior manager, reporting to the Chief Information Officer, to be responsible for implementing an effective computer security program and provide the manager the authority and resources needed to do so.

Recommendation No. 1 A management decision has bee reached but final action has not yet been taken.

Management decisions were made on the following audit recommendations, but the action taken was not sufficient to correct the deficiencies.

Audit Report on USAID's Systems
for Measuring Program Results,
Report No. l-000-95-006, dated June 30, 1995

Recommendation No. 1: We recommend that the Deputy USAID Administrator:

1.2 define the roles of the regional and central bureaus to ensure that missions and other operating units implement systems for measuring program performance in accordance with prescribed guidance;

1.3 issue specific directions to USAID/Washington bureaus and overseas missions on establishing baseline data, quantifiable indicators (as well as objectively verifiable and measurable indicators) including interim and long-range targets, and reporting systems for comparing actual results of USAID-funded programs against what was anticipated when the programs were undertaken;

1.4 develop plans and time frames for establishing and monitoring a set of specific indicators for USAID's four overall strategic goals to enable USAID and others (e.g., Congress) to better measure trends and progress in accomplishing these overall goals;

1.5 establish procedures to ensure that baseline data and actual results reported on program performance are reliable and documented; and

1.6 develop plans and time frames for USAID's financial accounting systems to permit tracking of obligations and expenditures according to USAID's overall strategic goals and in support of each mission's and other operating unit's strategic objectives and program outcomes.

USAID management concurred with the recommendations and believed that the above recommended actions were completed by April 1997. For example, USAID management closed Recommendation Nos. 1.2, 1.3 and 1.5 based on the issuance of new policies and procedures. Recommendation No. 1.4 was closed based on the issuance of a time frame for establishing the recommended indicators. Recommendation No. 1.6 was closed based on the New Management System being designed and programmed to link obligations and expenditures to strategic goals and objectives. However, the actions taken (e.g., establishing new procedures and systems) were not sufficient to correct the problems.