



USAID
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OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID'S MANAGE- TO-BUDGET INITIATIVE

AUDIT REPORT NO. 9-000-09-001-P
October 8, 2008

WASHINGTON, DC



Office of Inspector General

October 8, 2008

MEMORANDUM

TO: USAID/M/MPBP, Director, Angelique Crumbly
USAID/M/ICFO, Chief Financial Officer, David Ostermeyer

FROM: IG/A/PA, Director, Steven H. Bernstein /s/

SUBJECT: Audit of USAID's Manage-to-Budget Initiative (Report No. 9-000-09-001-P)

This memorandum transmits our final report on the subject audit. We have considered your comments on the draft report in finalizing the audit report and have included your responses in appendix II of the report.

The report contains seven recommendations intended to improve USAID's implementation of the manage-to-budget initiative. Based on your comments, management decisions have been reached for recommendation nos. 1, 2, 5, 6, and 7. Please provide USAID's Audit, Performance, and Compliance Division (M/CFO/APC) with the necessary documentation demonstrating that final action has been taken on these recommendations. A management decision for recommendation nos. 3 and 4 can be reached when USAID's Office of the Chief Financial Officer has a plan of action that includes timeframes for completing the actions.

Again, I want to express my appreciation for the cooperation and courtesy extended to my staff during the audit.

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SUMMARY OF RESULTS

In April 2005, Congress and the Office of Management and Budget requested that USAID examine the cost of its operations to provide for better transparency and accountability, and to introduce incentives and benchmarks for efficient management. In response, USAID established the manage-to-budget initiative. The initiative's main objectives were to (1) increase and improve transparency; (2) improve accountability; (3) provide incentives to managers to control costs (i.e., reduce overhead and reduce use of program funds for administrative purposes); and (4) decentralize operating expense budgets to provide greater flexibility so that operating units can manage, control, and account for their own operating expense funds. The purpose of this audit was to determine if USAID's manage-to-budget initiative achieved its intended results and what its impact has been (page 3).

Of the four objectives USAID intended to achieve with the manage-to-budget initiative, USAID met objectives one and two and partially met objectives three and four. Because USAID designed and piloted the manage-to-budget initiative in fiscal year 2006 and implemented it in fiscal year 2007, it is too early to determine the full impact of the initiative (page 4).

Nevertheless, the manage-to-budget initiative has made progress in changing the way USAID budgets and manages costs. The initiative's achievements include the (1) establishment of a new standard set of expanded object class codes to capture both operating expense and program-funded administrative costs to provide a better understanding of the full cost of doing business at USAID; (2) establishment of a compensation tracking system to report on U.S. direct hire budgets of each operating unit and provide managers with complete details of salary and benefit budgets and surpluses realized by each operating unit; (3) establishment of target overhead ratios that helped to control costs; and (4) contributions to the Agency's "green" financial performance rating on the President's Management Agenda scorecard issued by the Office of Management and Budget (pages 5 to 8).

However, in addition to these positive results, this audit identified opportunities to strengthen USAID's implementation of the manage-to-budget initiative: (1) personal incentives have not been provided to motivate managers to meet operational administrative targets used to measure the efficiency of the operating unit, (2) office space and information technology (IT) support costs have not been decentralized, (3) the expanded object class codes were not verified on a regular and timely basis, (4) the impact of efficiency and effectiveness measures have not been linked, and (5) insufficient communication was provided to missions and bureaus/offices (pages 9 to 18).

This report includes five recommendations for USAID's Management Bureau's Office of Management Policy, Budget, and Performance and two for the Office of the Chief Financial Officer:

- Develop an incentive plan for implementation of the manage-to-budget initiative in coordination with the missions and the bureaus/offices, which includes target dates (page 10).

- Develop an action plan with timelines and milestones to decentralize office space and IT support costs, or make formal decisions that office space and IT support costs will not be decentralized (page 11).
- Establish an action plan, with target dates, for verifying the reliability of the object class coding on a regular basis throughout the year (page 13).
- Obtain confirmation from all impacted operating units that the coding errors identified have been corrected (page 13).
- Establish indicators for measuring the success or impact of the manage-to-budget initiative by linking effectiveness and efficiency measures (page 15).
- Revise the project plan for the manage-to-budget initiative, which includes the plan's purpose, overall goals and objectives, current status, achievements to date, short-term and long-term goals, scope and expectations, milestones for meeting those goals, communication plan, and responsible personnel (page 18).
- Conduct a survey or evaluation of the implementation of the manage-to-budget initiative (page 18).

USAID's Management Bureau's Office of Management Policy, Budget, and Performance and the Office of the Chief Financial Officer agreed with the findings and recommendations in the report. Based on the comments from the two offices, management decisions have been reached for recommendation nos. 1, 2, 5, 6, and 7. A management decision for recommendation nos. 3 and 4 can be reached when USAID's Office of the Chief Financial Officer has a plan of action that includes timeframes for completing the actions. Management comments in their entirety are included in appendix II.

BACKGROUND

In the past, USAID centrally managed many of its operating expenses and used program funds for administrative purposes without transparent, comprehensive reporting. The enactment of the Federal Funding Accountability and Transparency Act of 2006 and the opinions of congressional oversight committees have led USAID to introduce an initiative that provides for more control and decisionmaking along with increased transparency for greater management flexibility, more economical management of human and other resources, and greater motivation by individual managers and organizational entities to operate more efficiently and economically.

In April 2005, Congress and the Office of Management and Budget requested that USAID examine its administrative budget process to fully understand the costs of operations and provide managers with incentives to control costs. This exercise was called the “shadow budget.” In April 2006, the USAID Administrator stated in testimony to the House International Relations Committee that USAID would broaden the shadow budget exercise to accelerate the manage-to-budget initiative worldwide in fiscal year (FY) 2007. This initiative would strategically align operating expense resources with program resources to ensure that USAID has the most efficient and effective administrative operations feasible.

The manage-to-budget initiative was established to satisfy the requirements of Congress and the Office of Management and Budget. Its main objectives were to increase and improve transparency; improve accountability; provide incentives to managers to control costs (i.e., reduce overhead and reduce use of program funds for administrative purposes); and decentralize operating expense budgets to provide greater flexibility so that operating units can manage, control, and account for their own operating expense funds.

The initiative was designed and piloted in FY 2006 and fully implemented in FY 2007 by USAID’s Management Bureau’s Office of Management Policy, Budget, and Performance.

AUDIT OBJECTIVE

As part of the FY 2008 annual audit plan, the Office of Inspector General conducted this audit to answer the following question:

Has USAID achieved its intended results for the manage-to-budget initiative, and what has been its impact?

Please refer to appendix I for the audit’s scope and methodology.

AUDIT FINDINGS

Of the four objectives USAID intended to achieve with the manage-to-budget initiative, USAID achieved two and partially achieved the other two.

USAID established the initiative to satisfy the requirements of Congress and the Office of Management and Budget. Its main objectives were as follows:

1. Increase/improve transparency.
2. Improve accountability.
3. Incentivize managers to control costs (i.e., reduce overhead and reduce use of program funds for administrative purposes).
4. Decentralize operating expense budgets to provide greater flexibility so that operating units can manage, control, and account for their own operating expense funds.

USAID met objectives one and two by (a) establishing a new standard set of expanded object class codes to capture both operating expense and program-funded administrative costs to provide a better understanding of the full cost of doing business at USAID; (b) establishing a compensation tracking system to report on U.S. direct hire budgets of each operating unit and provide transparency of salary and benefit budgets and surpluses realized by each operating unit; and (c) establishing target overhead ratios to help control costs.

With respect to the third objective, the target measures were established to control costs, but employee productivity incentives were not implemented.

With respect to the fourth objective, USAID initially planned to decentralize U.S. direct hire salaries and benefits, office space, and information technology (IT). U.S. direct hire salaries and benefits budgets were decentralized to allow managers control over labor resources. However, office space and IT budgets were neither decentralized nor included as part of the operating unit budgets.

USAID designed and piloted the manage-to-budget initiative in fiscal year (FY) 2006 and implemented it in FY 2007. It is too early to determine the full impact of the initiative, although the initiative has made progress in improving transparency and has contributed to the Agency's "green" financial performance rating on the President's Management Agenda scorecard issued by the Office of Management and Budget.¹ USAID has also changed the way it budgets and manages costs and has met the target ratios established to measure the efficiency or cost containment of USAID's program and administrative costs. In addition to the positive results, this audit identified opportunities to strengthen USAID implementation of the manage-to-budget initiative.

¹ The President's Management Agenda is a strategy for improving the management and performance of the Federal Government. A scorecard is used to track how well the departments and major agencies are executing governmentwide management initiatives.

The following three sections discuss the accomplishments, followed by four sections that discuss opportunities for improving the implementation of the initiative.

Greater Transparency and Accountability Were Achieved

Under the manage-to-budget initiative, USAID has achieved greater transparency and accountability by establishing the expanded object class coding, compensation tracking system, and mission overhead ratios.

Expanded Object Class Coding

Since the late 1970s, the Office of Management and Budget (OMB) and Congress have criticized USAID for not being able to demonstrate how its funds are spent (i.e., lack of transparency and accountability). OMB has insisted that USAID expand the use of the OMB accounting classification structure to capture costs in a manner that allows management to use the data to make informed decisions and ensure that resources are used efficiently.

In June 2006, USAID adopted a new standard set of classification codes to move forward with full transparency on funding use and to comply with OMB reporting requirements. Every commitment, subcommitment, obligation, and subobligation, regardless of funding source, is captured at the class code level.

The OMB major object classes fall under five general classifications:

Series 10 – Personnel Compensation and Benefits

Series 20 – Services, Support, and Supplies

Series 30 – Property and Equipment (Real and Nonexpendable Property)

Series 40 – Grants, Subsidies, and Fixed Charges (Developmental Interventions)

Series 90 – Other (Confidential Activities)

Working with OMB, USAID developed additional subclassifications of object classes. In addition to the OMB object classification system, the Office of Personnel Management categorizes personnel compensation and benefits under approximately 40 separate object classes. The Office of Personnel Management object class obligations are reported under approximately 20 separate employee personnel classifications. As a result, USAID's expanded object class code structure is in excess of 400 separate object class codes to enable USAID to meet the requirements of both OMB and the Office of Personnel Management.

The new system that USAID has implemented helps USAID to better meet an OMB requirement to report annually 100 percent of the funding (program and operating expenses) by OMB-mandated class codes. According to the Management Bureau, for

several years USAID could not easily capture the cost of implementing its program activities because it did not have an accounting system that could systematically capture the data. Noncompliance with this requirement prevented USAID from answering questions about the uses of program funds for administrative purposes. Similarly, USAID/Washington did not have a systematic way of tracking missions' actual administrative expenses. However, with the full deployment of Phoenix (USAID's worldwide financial system) in 2006, USAID began to capture all financial actions using the new code structures. According to the Management Bureau, USAID managers use the class codes to obtain more detail regarding administrative operations. The new coding structure was effective in late FY 2006, but FY 2007 marked the first full year when it became mandatory for USAID. Although several coding errors were identified (discussed later in this report), USAID was able to provide more accurate and efficient information on the full costs of administrative operations than it had in the past.

Compensation Tracking System

The compensation tracking system is a database application that integrates payroll information for U.S. direct hires from various data sources. It collects and stores payroll-related information for the manage-to-budget process. It also provides a tool to automate the manual process for uploading information to the national payroll processing center and other payroll files.

After piloting the system in FY 2006, the Management Bureau released the application to all Washington operating units in FY 2007. The compensation tracking system opened U.S. direct hire budgets of each operating unit to allow managers to have complete details of salary and benefit budgets and surpluses of every operating unit.

Mission Overhead Ratios

USAID established targets to ensure the efficient and effective allocation of administrative resources used to measure USAID's cost containment of program and administrative costs. According to the Management Bureau, these ratios were shared with all the regional bureaus and have improved internal transparency and accountability. These ratios are discussed further on page 8.

Financial Performance Has Moved to "Green" Status

The President's Management Agenda (PMA) is a strategy to improve the management and performance of the Federal Government. The PMA contains five Governmentwide goals to improve Federal management and deliver results that matter to the American people:

- Strategic management of human capital.
- Competitive sourcing.
- Improved financial performance.

- Expanded electronic government.
- Budget and performance integration.

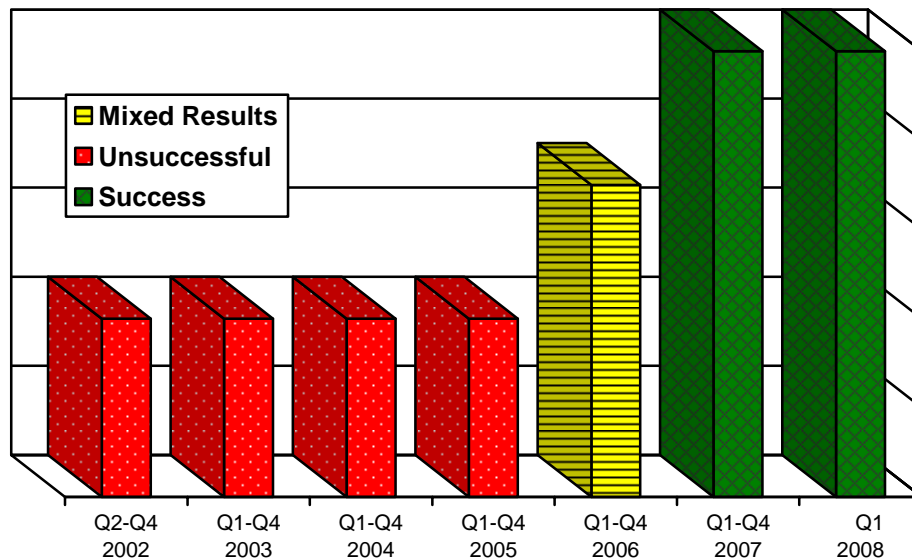
A scorecard tracks how well departments and major agencies meet the five goals. OMB issues the scorecards quarterly and employs a simple grading system common today in well-run businesses:

- **Green** for success.
- **Yellow** for mixed results.
- **Red** for unsatisfactory.

The third goal, “improved financial performance,” requires agencies to report financial information of mission programs and administrative operations in an accurate and timely manner. The President expects a results-oriented Government whose managers actively use financial information for effective and efficient business processes.

For the first time since the implementation of the PMA scorecard in 2002, USAID achieved “green” status for “improved financial performance” in the first quarter of calendar year 2007, as indicated in figure 1:

Figure 1. President’s Management Agenda Scorecard for USAID – Financial Performance



Three manage-to-budget initiatives support the achievement of “green” status for financial performance: (1) expand the object class code to capture program-funded administrative costs; (2) decentralize U.S. direct hire compensation through the compensation tracking system application; and (3) use mission overhead ratios to control costs. With the manage-to-budget initiative, managers evaluate funding decisions in an informed and strategic manner and make difficult choices based on cost/value assessments.

USAID Established Target Ratios

To comply with the OMB requirements and to ensure the efficient and effective allocation of administrative resources, USAID established targets to allocate operational and administrative expenses for all operating units. These target ratios are used to measure the efficiency or cost containment of USAID's program and administrative costs and to give operating units a planning tool for anticipating their operational budgets.

The program administrative cost ratio is total program funds used for operational expenses as a percentage of the program fund's new obligation authority. The total administrative cost ratio is total program funds used for operational expenses and total operating expense, including U.S. direct hire salaries and benefits, as a percentage of the program fund's new obligation authority. The recommended (by the Management Bureau's Office of Management Policy, Budget, and Performance) and estimated cost ratios in FY 2007 for bureaus and missions are shown in table 1:

Table 1. Fiscal Year 2007 Operational Cost Ratios for Bureaus and Missions²

	Target Program Administrative Ratio	Estimated Program Administrative Ratio	Target Total Administrative Ratio	Estimated Total Administrative Ratio
Regional Bureaus and Missions	6%	5%	12%	13%
Bureau for Democracy, Conflict and Humanitarian Assistance	10%	3%	12%	4%
Bureau for Economic Growth, Agriculture, and Trade	44%	17%	55%	25%
Bureau of Global Health	12%	5%	15%	7%

According to the Management Bureau's Office of Management Policy, Budget, and Performance, USAID exceeded seven of the target ratios and almost met one target ratio in FY 2007 (as indicated in table 1), even though several missions fell short of their targets (as discussed later in the report). According to the Management Bureau, the long-term goals for the manage-to-budget initiative are for the estimated percentages to decline over time and for operating units to incorporate these percentages into the planning process.

As FY 2007 was the first full year of implementation, data are not available to determine whether the estimated rates have declined over time. The operational cost ratios for FY 2008 are set at 5 percent and 10 percent as the recommended program administrative and total administrative ratios, respectively, for the regional bureaus and missions.

² The estimated numbers were provided by the Management Bureau and were not audited. The estimated ratios were calculated by the Management Bureau using data uploaded by the operating units into the Foreign Assistance Coordination and Tracking System.

Incentives Should Be Provided

Summary: According to Congress, USAID management, and the U.S. Government Accountability Office, incentives motivate managers to use resources more efficiently and effectively. USAID intended to provide incentives to managers and employees under the manage-to-budget initiative, but has not done so because of a lack of agreement among working group members and senior management on what incentives to provide and how the plan should be implemented. Incentives could motivate mission and bureau employees to meet operational administrative targets used to measure the efficiency of the operating unit.

According to the Management Bureau, the manage-to-budget initiative requires appropriate incentives that motivate managers to use available resources more efficiently and effectively, while eliminating disincentives that undermine the effort. It requires comprehensive and systematic information about operational costs; accurate and timely data on performance, results, and effectiveness; and useful and practical tools for implementing management and budget decisions. In addition, the *Standards for Internal Control in the Federal Government* issued by the U.S. Government Accountability Office states that “Effective management of an organization’s workforce—human capital—is essential to achieving results and an important part of internal control. Only when the right personnel for the job are on board and are provided the right training, tools, structure, incentives, and responsibilities is operational success possible.” Congress supports the idea of USAID’s improving cost-effectiveness by introducing management incentives and benchmarks.

According to the initial plan, USAID was to develop an incentives structure for the manage-to-budget initiative that would implement the following types of incentives:

- **Personal incentives** (such as bonuses, compensatory time, and recognition) that reward individuals who manage-to-budget effectively or who improve morale, effectiveness, customer service, and results within existing budgets; and
- **Organizational incentives** (such as increased budget resources or flexibility) that reward missions, offices, and other organizational units for operating effectively and efficiently.

At the onset of the initiative, the Management Bureau formed a working group to develop an incentive plan to improve productivity. The working group held several meetings that resulted in some recommendations, but did not establish an incentive plan. According to one mission, “If manage-to-budget were implemented properly with appropriate and realistic target rates, it would be a good tool for more effective management of overhead costs. However, there needs to be an effective incentive directly related to this effort.”

According to the Management Bureau, organizational incentives were provided by allowing Washington operating units to control their U.S. direct hire budget and to keep or redirect the “savings” resulting from staff lapse and/or attrition. However, a plan to provide incentives that would improve productivity has not been established, primarily because of disagreements among working group members and a lack of senior management support to establish such a plan. Some still favor the plan, while others

fear that the plan would not work in a Government environment because it would encourage managers to achieve the incentives dishonestly or at the expense of their own mission or bureau/office.

According to the audit team's survey, several missions that cut their staff to meet target ratios reported that they have been left with low employee morale and an increased workload. An award or incentive for those missions could motivate them to meet the targets and offset the low morale. As described in more detail in appendix III, about 60 percent of the missions in each bureau did not meet the target ratios for administrative costs. With an incentive plan, the manage-to-budget initiative could be more effective in motivating managers to use available resources more efficiently and effectively. Therefore, this audit makes the following recommendation:

Recommendation No. 1: We recommend that the Management Bureau's Office of Management Policy, Budget, and Performance develop an incentive plan for implementation of the manage-to-budget initiative in coordination with the missions and the bureaus/offices, which includes target dates.

Plan for Decentralizing Operating Expenses Should Be Updated

Summary: In response to Congress's request to better understand and manage USAID's costs, USAID planned to decentralize more of its operating expense budget. Congress asked USAID to consider decentralizing salaries and benefits, office space, and information technology. USAID decentralized only salaries and benefits for Washington in FY 2007 and deferred decentralization of office space and information technology until FY 2008. However, no communication was made related to decentralizing space and information technology (IT) support costs since FY 2006 because of a lack of resources and changes in Agency priorities, according to the Management Bureau. Decentralizing costs was a goal of manage-to-budget; manage-to-budget may have limited impact if only salaries and benefits are decentralized.

Congress asked USAID to consider decentralizing salaries and benefits, office space, and information technology. In response to Congress's request to better understand and manage USAID's costs, USAID had plans to establish a budget for FY 2007 for all operating units that decentralizes more of its operating expense budget and captures allocations for office space and IT support costs. Eleven working groups were established to assist in developing and implementing the manage-to-budget initiative. They conducted initial analyses and made recommendations on how to expand the scope of manage-to-budget to include decentralization of salaries and benefits, office space, and IT support costs.

Salaries and Benefits – Only salaries and benefits have been decentralized in Washington. Under the initiative, the operating units in Washington now manage the U.S. direct hire payroll, which had been managed centrally by the Management Bureau. Field missions already manage their budgets except for direct hire salaries and benefits, as foreign-service hiring is done centrally to ensure the appropriate mix of individuals with particular skills to support the various sectors across the Agency.

Office Space – A working group reviewed the feasibility of decentralizing office space management in Washington to managers. Field missions already manage budgets for rent and other costs associated with space management. The working group considered areas of space management in Washington, where managerial decisions could have an impact on space costs or efficiency.

The working group agreed that space management should remain centralized in the Management Bureau during FY 2007 because (1) a project is under way to maximize the efficiency and fairness of space allocation in the Ronald Reagan Building, and (2) there would be no immediate cost benefit in providing managers with authority for space management since space is currently a fixed cost for the Agency. However, the working group planned to decentralize space management in FY 2008.

Information Technology Support Costs – A working group considered the feasibility of decentralizing IT management. The centrally managed IT cost center funds the management, operations, and maintenance of the Agency's corporate systems, worldwide telecommunications operations, and network/server platforms in Washington. The group considered IT costs that may be reduced or efficiencies gained by delegating funding decisions to organizational units.

The group determined that it would not be feasible to decentralize the budget for infrastructure services because most of the expenditures for IT are fixed costs that do not vary based on usage by individual employees. The working group also considered whether there would be some benefit in distributing the budgets for corporate applications to responsible offices and decided to explore options for possible decentralization in FY 2008.

However, there has been no discussion or followup of decentralizing office space or IT costs. The most recent communication regarding decentralizing space and IT was in FY 2006. Salaries and benefits remain the only decentralized costs. According to the Management Bureau, most offices were overwhelmed with the rollout of the manage-to-budget initiative and delayed plans for decentralizing space and IT. Also, according to the Management Bureau, priority changes and staffing shortages contributed to the lack of discussion on this issue.

Decentralizing costs is a goal of the manage-to-budget initiative to provide office managers with a better understanding of their operating costs and more responsibility and flexibility to use the resources to the maximum advantage. The initiative may have limited impact if only salaries and benefits are decentralized. Therefore, this audit is making the following recommendation:

Recommendation No. 2: We recommend that the Management Bureau's Office of Management Policy, Budget, and Performance (1) develop an action plan with timelines and milestones to decentralize office space and information technology support costs, or (2) make formal decisions that office space and information technology support costs will not be decentralized.

Expanded Object Class Codes Should Be Verified

Summary: USAID guidance states that periodic reviews for completeness, accuracy, and consistency of data are to be conducted. In FY 2007, the Management Bureau noted that \$1.2 billion was miscoded using the new coding structure. These errors were mostly noted in the Washington bureaus, not the missions, because, according to the Management Bureau, training in Washington was insufficient. In addition, the coding definitions were confusing to some users. The codes are used to produce financial reports and to make management decisions, and unreliable data can lead to poor decisionmaking.

Automated Directives System 203.3.5.2 states that the operating unit should be aware of the strengths and weaknesses of its data and to what extent the data can be trusted to influence management decisions. Also, the *Standards for Internal Control in the Federal Government* issued by the U.S. Government Accountability Office states that agencies should provide reasonable assurance concerning the reliability of financial and other reports used internally and externally.

USAID adopted a new expanded object class code that captured the cost categories at the commitment and obligation levels. FY 2007 was the first full year when USAID used the new coding structure. According to the Office of the Chief Financial Officer, the change was large and susceptible to errors since many bureaus and missions were not familiar with the new codes. At the end of FY 2007, the Office of the Chief Financial Officer generated a report that showed significantly high administrative costs, which resulted in an investigation of the coding problems.

The Office of the Chief Financial Officer assembled a team to review all obligations and subobligations recorded by expanded object class codes in FY 2007. The universe consisted of approximately 160,000 transactions representing close to \$15 billion of activity. The results of the review disclosed approximately \$1.2 billion in coding errors. Most of the coding errors occurred at the Washington bureaus and not at the overseas missions. Since the errors were identified after the end of the year, adjustments were not made for FY 2007. According to the Office of the Chief Financial Officer, individual operating units that had repeated errors received training on the coding structure.

A second review in early FY 2008 revealed approximately \$95.5 million in coding errors. According to the Office of the Chief Financial Officer, most of the errors from one bureau were corrected. However, according to the Management Bureau's Office of Management Policy, Budget, and Performance and the Office of the Chief Financial Officer, because of staffing constraints there has been no followup with the other bureaus to determine whether the errors have been corrected.

According to the Management Bureau, these errors occurred mostly at the Washington bureaus and not the missions because training in Washington was not sufficient. In addition, the coding definitions were confusing to some users.

The expanded object class codes are used to produce financial reports and to make management decisions. Unreliable data can lead to poor decisionmaking. Also, if the classifications are not accurate, reported data for target ratios cannot be relied upon

because the ratios are calculated using the cost data. Therefore, this audit makes the following recommendations:

Recommendation No. 3: We recommend that the Management Bureau's Office of the Chief Financial Officer establish an action plan with target dates to verify the reliability of the object class coding on a regular basis throughout the year.

Recommendation No. 4: We recommend that the Management Bureau's Office of the Chief Financial Officer obtain confirmation from all impacted operating units that the coding errors identified have been corrected.

Efficiency and Effectiveness Measures Should Be Linked

Summary: According to the Foreign Assistance Act, USAID resources should be used effectively and efficiently. Also, according to the Government Accountability Office, both operational and financial data are necessary to determine the effective and efficient use of resources. However, the administrative targets used by USAID to measure efficiency do not take program effectiveness into consideration. The Management Bureau agreed that linking efficiency and effectiveness is important. However, since the manage-to-budget initiative was implemented only a year ago, it has not had sufficient time to focus on this issue. Without full consideration of the impact of efficiency and effectiveness measures, USAID risks making one gain or achievement at the expense of program developmental effectiveness, increased operational vulnerabilities, and other problems.

According to the Foreign Assistance Act of 1961, Congress requires that development concerns be fully reflected in U.S. foreign policy and that development resources be effectively and efficiently utilized. Also, the *Standards for Internal Control in the Federal Government* states that "control activities should be effective and efficient in accomplishing the agency's control objectives." It also states, "Program managers need both operational and financial data to determine whether they are meeting their agencies' strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources."

Effectiveness and efficiency are ways to measure an organization's success. Effectiveness (a measure of quality) is the extent to which the organization accomplishes its purpose or mission. Efficiency (a measure of cost) reflects the relative cost at which the organization is undertaking its activities. To fully achieve an activity or goal, both of these conditions should be inextricably linked.

Efficient organization results in additional resources that can be used to benefit USAID programs. Likewise, an effective organization achieves its goals. Table 2 lists the benefits of an effective and efficient organization.

Table 2: Effective and Efficient Organization Matrix³

	Ineffective Organization	Effective Organization
Inefficient Organization	Goes out of business quickly	Survives
Efficient Organization	Dies slowly	Does well; thrives

Table 2 shows that both efficiency and effectiveness must be linked and function together to achieve an organization's goal. These business concepts also apply to Government agencies.

As discussed earlier in the report, USAID established program-funded operational expense and total administrative expense target levels for all operating units. USAID uses these target ratios to measure efficiency and expects that the target levels will decrease over time. However, the targets do not take program effectiveness into consideration. For example, a mission could reduce its mission support costs but not meet program targets or not monitor activities sufficiently, resulting in fraud, waste, or abuse of Government funds. Conversely, a mission could be effective (i.e., achieve program results) but at a higher mission cost.

The audit team's survey of the missions indicated that some achieved efficiencies as a result of the manage-to-budget initiative, but at the expense of program oversight, increased work requirements, significant staff anxiety, and staff morale issues. Other missions indicated that overly restricting resources and reducing costs could increase the risk of not being able to carry out USAID's development mandate. Also, the reduced costs could negatively impact the mission's ability to preserve program integrity, efficiency, and accountability.

Some missions expressed concerns that reduced administrative costs have yielded short-term savings but could have serious negative consequences in the long term. For example, according to one mission, "While manage-to-budget assisted in overall reduction of management costs related to overhead, the restraints of the perceived 'mandatory' targets limited our flexibility to hire the necessary staff to implement our program effectively and ultimately handicapped the mission."

In other words, although USAID reported that it has generally met its established target ratios, these targets do not provide an overall view of how it is operating as a whole. The target ratios are not a useful measure of efficiency if they are used in isolation from all other factors they affect. USAID needs to measure the program impact—negative, positive, or none—of achieving the efficiency target. USAID should determine whether achieving the targets undermined or otherwise impacted the program's effectiveness.

The Management Bureau agreed that linking efficiency and effectiveness is important. However, the Management Bureau has not had sufficient time to focus on this issue, since it has had only 1 year of implementation. Without full consideration of the impact of efficiency and effectiveness measures, USAID risks making one gain or achievement

³ David Jobber, the author of *Principles in Marketing*, illustrates effectiveness and efficiency from a marketing perspective.

at the expense of program developmental effectiveness and increased operational vulnerabilities.

Recommendation No. 5: We recommend that the Management Bureau's Office of Management Policy, Budget, and Performance establish indicators for measuring the success or impact of the manage-to-budget initiative by linking effectiveness and efficiency measures.

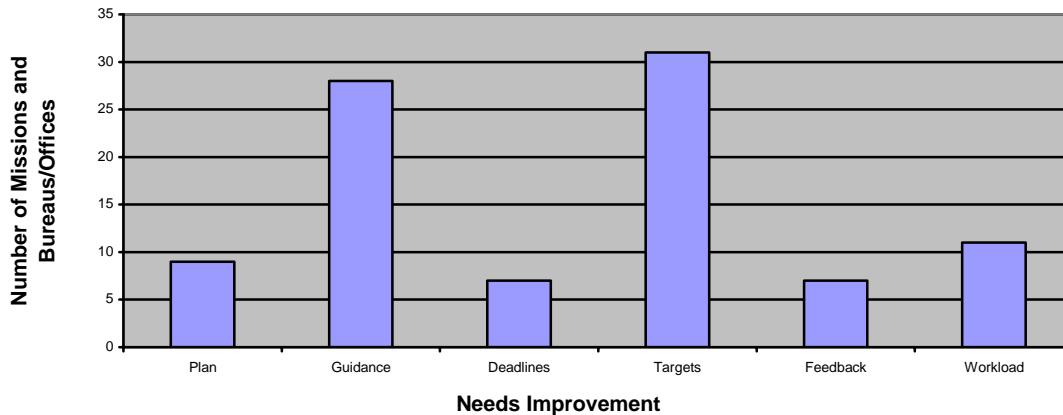
Communication Needs to Be Improved

Summary: USAID guidance states that managing for results means that USAID defines and organizes its work around the end result it seeks to accomplish, which means that it must make intended results explicit. However, in response to the audit survey, some missions and bureaus indicated that plan objectives and guidance were unclear. According to the Management Bureau, insufficient communication and attention to the operating units was primarily due to administration changes since the beginning of the initiative. Without a clear objective (which has been changed over the past 2 years), an update of the status of the initiative, and a plan for the future, the manage-to-budget initiative may not be effective. Also, unclear guidance results in increased costs of eliminating and then rehiring staff, uncertainty for all staff, and low staff morale.

Automated Directives System 200.3.2.1 states that managing for results means that USAID defines and organizes its work around the end result it seeks to accomplish. This means that USAID must make intended results explicit; ensure agreement among partners, customers, and stakeholders that proposed results are worthwhile; and organize day-to-day work and interactions to achieve results as effectively as possible. The *Standards for Internal Control in the Federal Government* states that “effective communications should occur in a broad sense with information flowing down, across, and up the organization.” Additionally, “for an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events. Information is needed throughout the agency to achieve all of its objectives.”

However, in response to the audit survey, some missions indicated that the manage-to-budget plan objectives were not defined; guidance has been sporadic, unclear, and contradictory; deadlines were imposed without adequate time to respond; it was unclear whether targets were mandatory; target ratios were unrealistic; no feedback was requested from missions; and increased workload and less flexibility were noted. Figure 2 shows the number of missions and bureaus/offices that reported these issues (out of 36 missions and 9 bureaus/offices that responded to the survey):

Figure 2. Number of Missions and Bureaus/Offices Reporting That Communication Needed Improvement



Plan objectives and current status – Some missions indicated a lack of clear objectives and goals. One mission stated, “Overall, Washington has not provided adequate information to Missions on what manage-to-budget is, what the requirements are and are not, what flexibility missions have, the basis for the establishment of the target percentages, what the expected result or goal is, and how this methodology is supposed to result in cost savings for the Agency. At the recent Controllers’ conference there was a debate among Controllers about what manage-to-budget was supposed to be and accomplish. No one had the same interpretation. Some missions were not sure if manage-to-budget was still in effect or not.” Another mission stated, “It is unclear how manage-to-budget can be consistent with the objectives of the Development Leadership Initiative. Why hire more staff if we can not afford to under manage-to-budget. Who will mentor the new staff under the Development Leadership Initiative?”

Communication and guidance – Some missions and bureaus/offices pointed to insufficient communication and clear guidance. For example, one mission stated that guidance has been sporadic and inconsistent. Another mission stated that guidance came in bits and pieces in e-mails from various Washington staff. This mission also stated that no training had been provided to overseas staff regarding the manage-to-budget initiative. Some missions indicated that clear guidance, detailed instruction, additional training, and improved support were not provided to accurately implement new accounting procedures at the mission level. Furthermore, USAID/Washington has not clarified how and with whom to discuss issues of concern regarding the initiative. According to another mission, in the past year, very little information was provided about the manage-to-budget initiative.

Furthermore, it was unclear whether target ratios were mandatory. Several missions reduced staff significantly and then found out that they did not need to. According to one mission, “We understood the manage-to-budget targets were mandatory so we had to make some difficult decisions regarding our staffing. We eliminated five positions to achieve our targets.”

Another mission stated, “Guidance from Washington was initially presented as a mandate. The message that was conveyed is that the targets were mandates, not just a goal to strive towards achieving. Even to date it is impossible to get straightforward

clarification from anywhere in Washington as to the nature of the manage-to-budget targets and the consequences of exceeding them.”

Another mission stated, “Recently, the target was reduced by 2 percentage points to 10 percent; however, the reason for the change was never clearly communicated by Washington.”

Deadlines – Some missions indicated that adequate time was not given between exercise announcements and submission dates. One mission stated that Washington provided FY 2008 manage-to-budget instructions after the mission had already finalized its operational plan, and the mission had to make changes to comply with the manage-to-budget guidance. Another mission stated, “At the last minute, targets were dropped from 6 percent and 12 percent to 5 percent and 10 percent. We should have had prior notice.”

Target ratios – It was unclear how the rates were established; specifically, what methodology or criteria were used. Several missions indicated that individualized target ratios should take into full consideration the varying costs of the missions, and that targets need to be established independently on a case-by-case basis.

According to one mission, “Providing fixed targets across USAID does not consider the specifics of each mission and the environment under which they operate. The geographic locations, security levels, management structures, roles and responsibilities, and the political sensitivities and complexities of mission portfolios are completely different, and as such should in no way be considered equal for setting management support cost targets.” Another mission stated, “If these budget targets are negotiated in a transparent manner between Washington and the Mission, then Mission management could be held more accountable for respecting those budget parameters.”

Some missions and bureaus/offices indicated that target levels were not adequate to cover the real costs incurred to keep the mission operational, and that trying to meet an arbitrary ratio could also result in additional costs as missions shift work to contractors or grantees in order to cut program support costs.

According to one mission, “The original target rate of 6 percent (12 percent total) put pressure on our Mission to stretch our existing resources to properly manage our program and operations.” Another mission stated, “manage-to-budget has not allowed for greater flexibility to control or manage costs. To the contrary, we feel that manage-to-budget has led to less flexibility for the mission as we try to force our budget numbers to come close to the pre-established budget targets.”

Mission feedback – Several missions felt that the manage-to-budget initiative was a top-down initiative conducted without any regard for the missions. The missions have had no input into the initiative.

Workload – Some missions and bureaus/offices stated that the manage-to-budget exercise has required considerable staff time because of the additional workload.

According to the Management Bureau, insufficient communication and attention to the issues noted above was primarily due to three administration changes since the beginning of the initiative. As each administration changed, so did the focus of the

manage-to-budget initiative. Also in the past year, a perceived lack of support for the manage-to-budget initiative by senior management has resulted in mixed, conflicting guidance from Washington. In addition, during the same period, USAID underwent a major organizational change with the establishment of the Office of U.S. Foreign Assistance at the State Department.

According to the Management Bureau, disseminating knowledge about the initiative is essential to its success. Participants want to know the initiative's status and how it will affect them. The Management Bureau also states that participants are anxious to participate. The more educated people are about the progress of the initiative and how it will help them in the future, the more likely they are to participate and benefit.

According to the manage-to-budget framework, lessons learned from the pilots would provide valuable learning tools prior to full implementation on October 1, 2006. However, no evaluation of the initiative has been conducted owing to competing priorities in the Management Bureau's Office of Management Policy, Budget, and Performance.

Without a clear objective (which has been changed over the years), an update of the status of the initiative, and a plan for the future, the initiative may not be effective. Also, unclear guidance results in increased costs of eliminating and then rehiring staff, uncertainty for all staff, and low staff morale. Therefore, this audit makes the following recommendations:

Recommendation No. 6: We recommend that Management Bureau's Office of Management Policy, Budget, and Performance revise the project plan for the manage-to-budget initiative to include the plan's purpose, overall goals and objectives, current status, short-term and long-term goals, scope and expectations, milestones for meeting goals, a communication plan, and responsible personnel.

Recommendation No. 7: We recommend that Management Bureau's Office of Management Policy, Budget, and Performance conduct a survey or evaluation of the implementation of the manage-to-budget initiative.

EVALUATION OF MANAGEMENT COMMENTS

USAID's Management Bureau's Office of Management Policy, Budget, and Performance and the Office of the Chief Financial Officer's comments to the draft report are included in their entirety in appendix II.

In response to recommendation nos. 1 and 5, the Office of Management Policy, Budget, and Performance agreed to draft an incentive plan and indicators for measuring success by March 31, 2009. Accordingly, a management decision has been reached for these recommendations.

Regarding recommendation no. 2, the Office of Management Policy, Budget, and Performance agreed to make formal decisions regarding the decentralization of office space and information technology support costs by December 31, 2008. Accordingly, a management decision has been reached for this recommendation.

In response to recommendation nos. 3 and 4, the Office of the Chief Financial Officer agreed to address the recommendations together but will need to conduct further research on the issues to determine how they will be addressed. A management decision for these recommendations may be reached when USAID's Office of the Chief Financial Officer has a plan of action that includes timeframes for completing the actions.

Regarding recommendation no. 6, the Office of Management Policy, Budget, and Performance agreed to revise the project plan by November 30, 2008, and make it accessible on the USAID Web site. Accordingly, a management decision has been reached for this recommendation.

In response to recommendation no. 7, the Office of Management Policy, Budget, and Performance agreed to conduct two separate surveys—one for the Washington bureaus and one for the overseas missions. The Office of Management Policy, Budget, and Performance will explore options for conducting the survey in Washington, DC, and plans to schedule the survey for the overseas missions by March 31, 2009. Accordingly, a management decision has been reached for this recommendation.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General conducted this audit to determine if USAID's manage-to-budget initiative achieved its intended results and what its impact has been. Audit fieldwork was conducted at USAID headquarters in Washington, DC, from April 23 through July 17, 2008. The audit covered the period from the inception of the manage-to-budget initiative, April 2005, through July 17, 2008.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In planning and performing the audit, we assessed management controls related to management review of plan activities and milestones, plan implementation, data verification, and management's annual self assessment of controls as required by the Federal Managers' Financial Integrity Act of 1982. We also interviewed key USAID personnel in the Management Bureau's Office of Management Policy, Budget, and Performance; the Chief Financial Officer; other bureaus/offices in Washington; and missions involved with the manage-to-budget initiative.

Methodology

We reviewed the manage-to-budget project plan, a mandate from Congress, and other requirements from the Office of Management and Budget. The manage-to-budget initiative aimed to achieve the following four objectives: (1) increase/improve transparency; (2) improve accountability; (3) incentivize managers to control costs; and (4) decentralize operating expense budgets to provide greater flexibility so that operating units can manage, control, and account for their own operating expense funds.

To answer the audit objective, we reviewed applicable laws and regulations and USAID policies and procedures pertaining to the manage-to-budget initiative, including the following: the Federal Managers' Financial Integrity Act of 1982, the Federal Funding Accountability and Transparency Act of 2006, the Strengthening Transparency and Accountability in Federal Spending Act of 2008, the President's Management Agenda (PMA) scorecard, the Office of Management and Budget Circular No. A-11 Section 83 Object Classification, ADS 200 Introduction to Programming Policy (Introduction to Managing for Results), ADS 203 Assessing and Learning, and budget and spending reports from USAID's Phoenix Viewer financial system.

We gathered information from USAID personnel and reviewed documentation related to the expanded object class code, compensation tracking system, mission overhead rates, the PMA scorecard, personal incentives for managers under the manage-to-budget initiative, decentralization of operating expenses, and others. In addition, we sent a survey to 78 missions and 18 bureaus/offices to evaluate the progress of the manage-to-budget

initiative' in meeting its objectives. We received responses from 36 missions and 9 bureaus/offices.

MANAGEMENT COMMENTS



MEMORANDUM

September 30, 2008

TO: IG/A/PA, Director, Steven H. Bernstein

FROM: M/MPBP, Angelique Crumbly /s/
M/CFO, David Ostermeyer /s/

SUBJECT: USAID Plan of Action to Resolve Audit Recommendations
IG Audit of USAID's Manage-to-Budget Initiative
(Report No. 9-0000-08-00X-P)

We appreciate the Office of the Inspector General's (OIG) interest and review of progress made under the Manage-to-Budget (MTB) initiative. The MTB initiative was started in 2005 at the request of Congress. It changed the way USAID budgets and manages its administrative costs. The audit report recognizes the successes of MTB and identifies areas that can be strengthened to improve its effectiveness. MTB is a work-in-progress and we are optimistic that FY 2009 will see greater improvements in fiscal management consistent with the President's Management Agenda for improving financial performance by increasing transparency, improving accountability, and controlling costs.

Below are the Office of Management Policy, Budget and Performance's (M/MPBP) Management Decisions to address the seven recommendations contained in the audit report.

Recommendation #1

"Develop an incentive plan for implementation of the MTB initiative in coordination with the missions and the bureaus, which includes target dates."

Recommendation #5

"Establish indicators for measuring the success or impact of the MTB initiative by linking effectiveness and efficiency measures."

Recommendations number 1 & 5 are linked and will be addressed together. A team will be tasked with reviewing these two recommendations and exploring additional incentive plans.

Linking program or operational effectiveness to cost efficiency is a difficult task that the Agency has grappled with for years. The team will review the performance programs already in place and explore ideas about how to link and reward cost efficiencies.

An incentive plan and indicators for measuring success will be drafted by March 31, 2009.

Recommendation #2

"Develop an action plan with timelines and milestones to decentralize office space and information technology support costs, or make formal decisions that office space and information support costs will not be decentralized."

The Agency will prepare a formal decision by December 31, 2008.

Recommendation #3

"Establish an action plan, with target dates, for verifying the reliability of the object class coding on a regular basis throughout the year."

Recommendation #4

"Obtain confirmation from all impacted operating units that the coding errors identified have been corrected."

Recommendations number 3 & 4 are linked and will be addressed together. However, the Office of the Chief Financial

Officer needs to further study the broad issue of data quality and how it will be addressed.

Recommendation #6

"Revise the project plan for the manage-to-budget initiative, which includes the plan's purpose, overall goals and objectives, current status of plan, achievements to date, short-term and long-term goals, scope and expectations, milestones for meeting those goals, a communication plan, and responsible personnel."

M/MPBP will revise the project plan by November 30, 2008 and make it accessible on the USAID MTB web site.

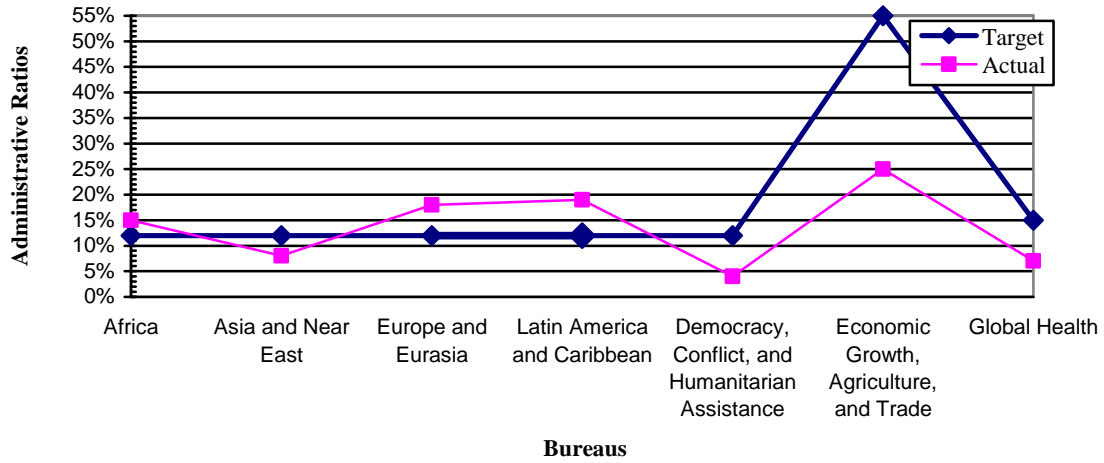
Recommendation #7

"Conduct a survey or evaluation of the implementation of the manage-to-budget initiative."

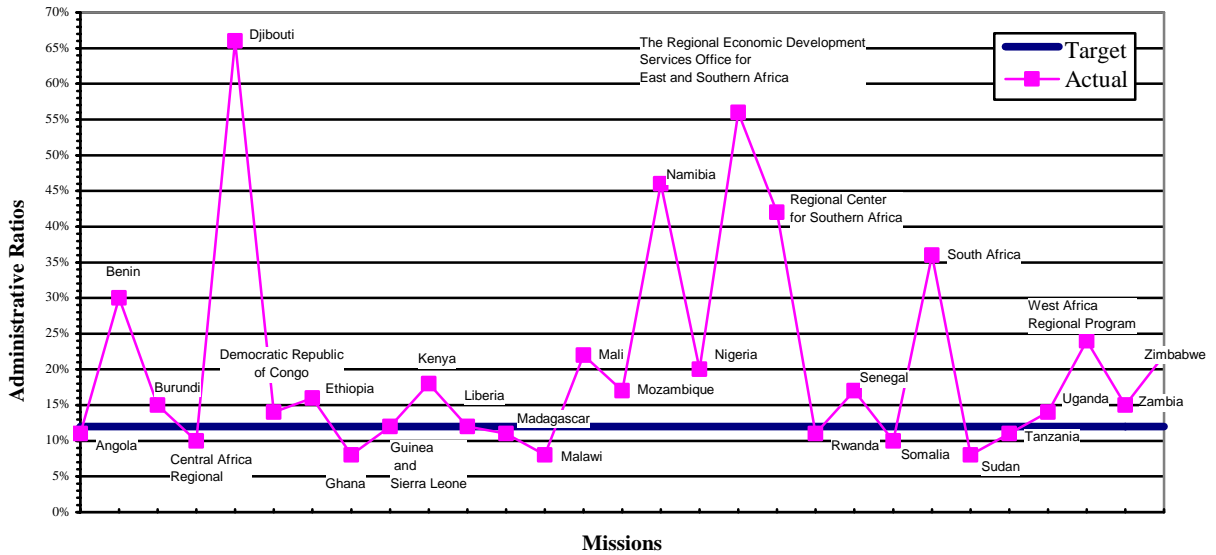
The Performance Division of M/MPBP will conduct two separate evaluations, one for Washington Operating Units and another for field missions. One of the surveys, a customer satisfaction and suggestion survey will be web-based, and targeted to the users of the Compensation Tracking System and the Budget Formulation & Execution Manager. We plan to explore this idea with Office of the Chief Information Officer's Web Team in October 2008 to see what options are available to us. For example, after completing a session in CTS, users might be asked to complete a brief web-based survey. The other survey would be directed to missions to obtain their feedback and understanding of the MTB initiative. Since the OIG just completed an evaluation survey as part of this audit and the point of this evaluation is to assess the improvements in the implementation and communications of MTB initiative, we plan to schedule the field survey by March 31, 2009.

FY 2007 Total Administrative Ratios

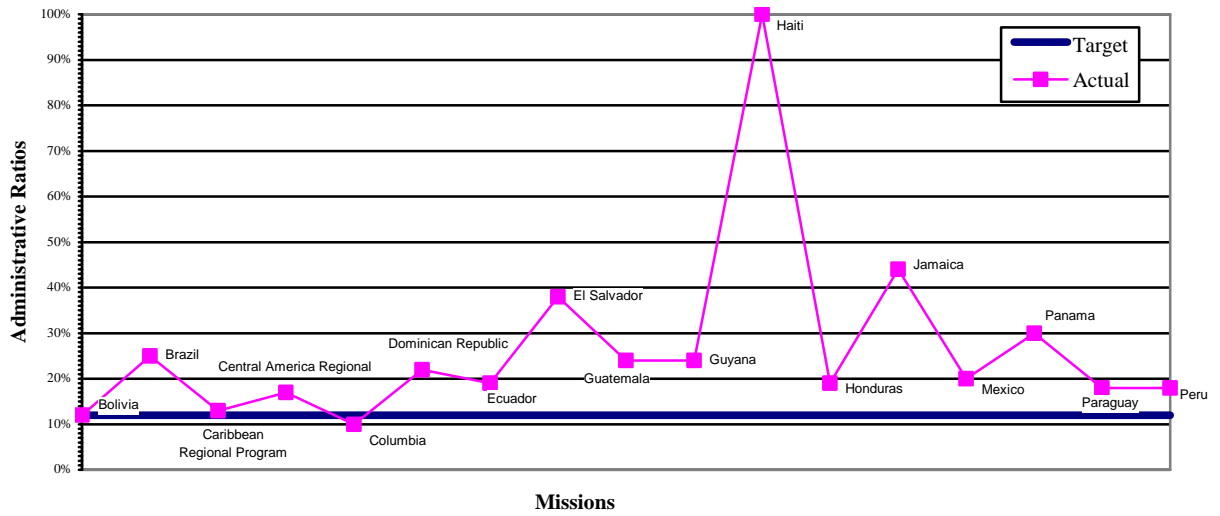
Graph 1: Fiscal Year 2007 Total Administrative Ratios



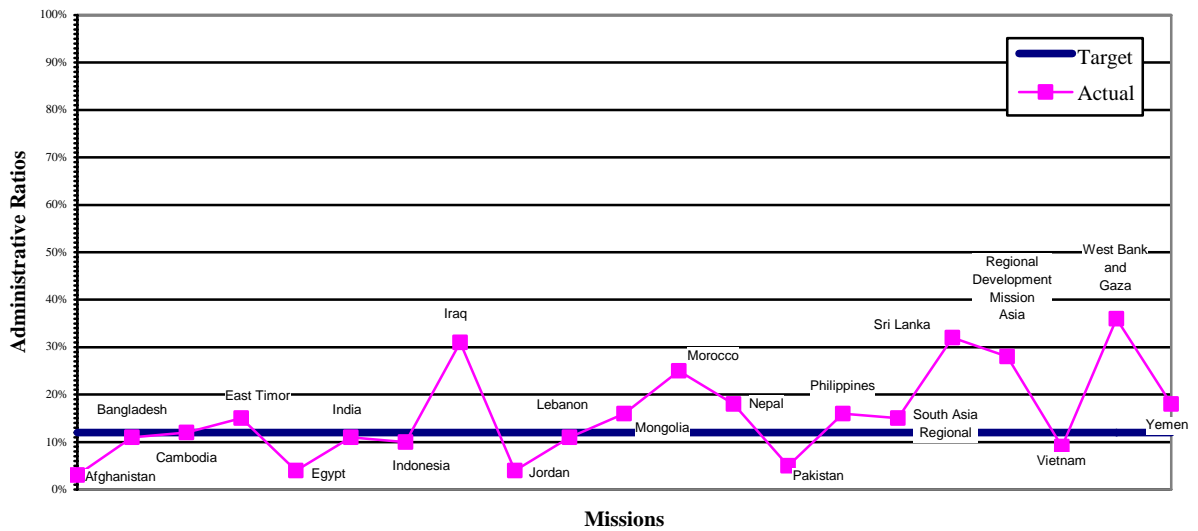
Graph 2: Fiscal Year 2007 Total Administrative Ratios - Africa



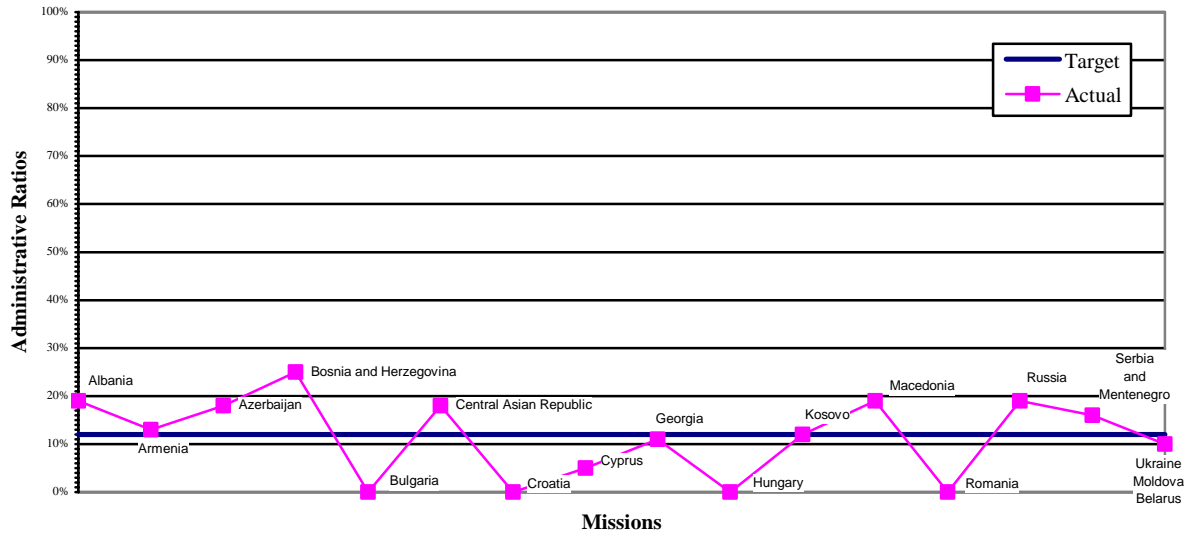
Graph 3: Fiscal Year 2007 Total Administrative Ratios - Latin America



Graph 4: Fiscal Year 2007 Total Administrative Ratios - Asia



Graph 5: Fiscal Year 2007 Total Administrative Ratios - Europe and Eurasia



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