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FINANCIAL
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Sustained Effort Needed to
Resolve Long-Standing
Problems at U.S. Agency
for International
Development

Statement of Gregory D. Kutz, Director
Financial Management and Assurance





Highlights of [GAO-03-1170T](#), a testimony before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

Why GAO Did This Study

GAO has long reported that the U.S. Agency for International Development (USAID) faces a number of performance and accountability challenges that affect its ability to implement its foreign economic and humanitarian assistance programs. These major challenges include human capital, performance measurement, information technology, and financial management. Effective financial management as envisioned by the Chief Financial Officers Act of 1990 (CFO Act) and other financial management reform laws is an important factor to the achievement of USAID's mission. USAID is one of the federal agencies subject to the CFO Act.

In light of these circumstances, the Subcommittee asked GAO to testify on the financial management challenges facing USAID, as well as the keys to reforming USAID's financial management and business practices and the status of ongoing improvement efforts.

www.gao.gov/cgi-bin/getrpt?GAO-03-1170T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory D. Kutz at (202) 512-9505 or kutzg@gao.gov.

FINANCIAL MANAGEMENT

Sustained Effort Needed to Resolve Long-Standing Problems at U.S. Agency for International Development

What GAO Found

USAID has made some progress to improve financial management, primarily in achieving audit opinions on its financial statements. Through the rigors of the financial statement audit process and the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA), USAID has gained a better understanding of its financial management weaknesses. However, pervasive internal control weaknesses continue to prevent USAID management from achieving the objective of the CFO Act, which is to have timely, accurate financial information for day-to-day decision making.

USAID's inadequate accounting systems make it difficult for the agency to accurately account for activity costs and measure its program results. Compounding USAID's systems difficulties has been the lack of adequate financial management personnel. Since the early 1990s, we have reported that USAID has made limited progress in addressing its human capital management issues.

While some improvements have been made over the past several years, significant challenges remain. Transforming USAID's financial and business environment into an efficient and effective operation that is capable of providing timely and accurate information will require a sustained effort. USAID has acknowledged the challenges it faces to reform its financial management problems and has initiatives underway to improve its systems, processes, and internal controls. USAID has also recognized the need for a specific human capital action plan that addresses financial management personnel shortfalls.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before you today to testify on the U.S. Agency for International Development (USAID). USAID's financial management challenges have been the subject of prior oversight hearings by this Subcommittee's predecessor. GAO has long reported¹ that USAID faces a number of performance and accountability challenges that affect its ability to implement its foreign economic and humanitarian assistance programs. These major challenges include human capital, performance measurement, information technology, and financial management. Today our testimony will focus on the financial management challenges at USAID.

USAID serves a critical role by providing nonmilitary international aid to further U.S. interests abroad. For fiscal year 2003, USAID received about \$12 billion in total program funding that is spent in six principle areas: economic growth and development, population health and nutrition, environment, democracy and governance, education and training, and humanitarian assistance. USAID carries out its assistance role primarily through grants, contracts, and loan guarantees to foreign governments and to humanitarian organizations. With current rebuilding efforts in Iraq and Afghanistan and increased efforts towards HIV/AIDS relief, the amounts of funds flowing through USAID have increased significantly. USAID's role is critical to the success of these rebuilding efforts.

My statement today will provide an overview of USAID's progress in addressing its financial management challenges. Effective financial management as envisioned by the Chief Financial Officers Act of 1990² (CFO Act) is an important factor to the achievement of USAID's mission. USAID has made some progress, primarily in achieving audit opinions on its financial statements. However, pervasive internal control weaknesses continue to prevent USAID management from achieving the primary objective of the CFO Act—which is to have relevant, timely, and accurate financial information for day-to-day decision making. As a result, much of the progress USAID achieved in getting improved opinions has been based on heroic efforts rather than systems that routinely generate timely and reliable financial information. USAID has a number of initiatives underway

¹U.S. General Accounting Office, *Major Management Challenges and Program Risks: U.S. Agency for International Development*, GAO-03-111 (Washington, D.C.: January 2003).

²Pub. L. No. 101-576, 104 Stat. 2838 (1990).

intended to improve its financial management, including the implementation of a new financial management system. Our analysis is based on USAID Inspector General (IG) reports and limited meetings with USAID management and the IG.

USAID is one of the federal agencies subject to the CFO Act as expanded by the Government Management Reform Act of 1994³ and the Federal Financial Management Improvement Act of 1996⁴ (FFMIA). The CFO Act envisions that agencies have financial management leadership, systems, and practices in place to provide complete, consistent, reliable, and timely information to agency management and other decision makers. Through the rigors of the financial statement audit process and the requirements of FFMIA, agencies such as USAID have gained a better understanding of their financial management weaknesses and the impetus to resolve problems caused by those weaknesses. At the same time, agencies are slowly making progress in addressing their problems. However, while most agencies are receiving “clean” audit opinions on their financial statements, remaining weaknesses in internal controls and the continued widespread noncompliance with FFMIA show that there is still a long way to go to reach the end game—that is, having systems, processes, and controls that routinely generate reliable, useful, and timely information for managers and other decision makers. In addition, reaching this “end game” should provide management, the Congress, and taxpayers with reasonable assurance that fraud, waste, and abuse are minimized.

In the federal government, many of the clean opinions in fiscal year 2002 were achieved as a result of time-consuming, ad hoc programming and analysis of data produced by inadequate systems that are not integrated and often require significant audit adjustments. Such time-consuming procedures, which often represent “heroic efforts,” prevent financial management staff from doing other financial-related work such as financial analyses, which could directly support strategic decision making and ultimately improve overall business performance. In contrast, for most private sector corporations, the clean opinion confirms the fact that management has timely, reliable information to manage daily operations in

³Pub. L. No. 103-356, title IV, 108 Stat. 3412 (1994).

⁴Pub. L. No. 104-208, div. A, sec. 101(f), title VIII, 110 Stat. 3009-389 (1996).

a competitive environment. In our *Executive Guide: Creating Value Through World-class Financial Management*,⁵ we identified the success factors, practices, and outcomes associated with world-class financial management efforts. We found that many leading finance organizations have a goal to reduce the time spent on routine accounting activities, such as financial statement preparation, so that financial management staff can spend more time on activities such as business performance analysis or cost analysis. These organizations also had clear, strong executive leadership, that when combined with factors such as effective organizational alignment, strategic human capital management, and end-to-end business process improvement, were critical for ensuring their financial management staff delivered the kind of analysis and forward-looking information needed to effectively manage their programs. As discussed in the executive guide, to reap the full benefit of a modern, integrated financial management system, USAID must go beyond obtaining an unqualified audit opinion toward (1) routinely generating reliable cost and performance information and analysis, (2) undertaking other value-added activities that support strategic decision making and mission performance, and (3) building a finance team that supports the agency's mission and goals.

Progress Towards Financial Management Reform

In May 2001, the Subcommittee's predecessor held a hearing⁶ on USAID financial management. Using that hearing as a baseline, we evaluated, using primarily USAID IG reports, the progress made to improve USAID's financial management systems, processes, and human capital (people) in the past 2 years. At the time of the May 2001 hearing, USAID was one of three federal agencies subject to the CFO Act that had such significant problems that they were unable to produce financial statements that auditors could express an opinion on. The hearing focused on actions needed to resolve USAID's financial management issues. At that time, the Acting Assistant Administrator for the Bureau of Management told the Subcommittee that actions to correct reported material weaknesses in

⁵U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000).

⁶House Committee on Government Reform, Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, *The U.S. Agency for International Development: What Must Be Done to Resolve USAID's Longstanding Financial Management Problems?* 107th Cong., 1st Sess., May 8, 2001.

financial management were completed or in process and that all reported weaknesses would be resolved by 2002.

While USAID has made progress in its financial management since that hearing, it has not achieved the success that it had expected. Rather, its progress relates primarily to improved opinions on USAID’s financial statements. Table 1 below shows that USAID has been able to achieve improved opinions on its financial statements over the past 3 years.

Table 1: Audit Opinions on USAID’s Financial Statements in Fiscal Years 2000 Through 2002

Financial statements	Type of opinion		
	Fiscal year 2000	Fiscal year 2001	Fiscal year 2002
Balance sheet	Disclaimer ^a	Qualified ^b	Unqualified ^c
Statement of net costs	Disclaimer	Disclaimer	Qualified
Statement of changes in net position	Disclaimer	Qualified	Unqualified
Statement of budgetary resources	Disclaimer	Qualified	Unqualified
Statement of financing	Disclaimer	Disclaimer	Unqualified

Source: USAID Inspector General reports.

^aA disclaimer of opinion means that the auditor does not express an opinion on the financial statements. A disclaimer is appropriate when the audit scope is not sufficient enough to enable the auditor to express an opinion or when there are material uncertainties involving scope limitations.

^bA qualified opinion means that, except for the effects of the matter to which the qualification relates, the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with generally accepted accounting principles.

^cAn unqualified, or clean, opinion means that the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with generally accepted accounting principles.

Fiscal year 2001 marked the first time that the USAID IG was able to express an opinion on three of USAID’s financial statements—the Balance Sheet, Statement of Changes in Net Position, and Statement of Budgetary Resources. However, as noted above, the opinions were qualified and achieved through extensive efforts to overcome material internal control weaknesses. Further, the IG remained unable to express an opinion on USAID’s Statement of Net Cost and Statement of Financing.

Fiscal year 2002 marked additional improvements in the opinions on USAID’s financial statements. All but one of USAID’s financial statements received unqualified opinions. The Statement of Net Cost received a qualified opinion. The IG reported that “...on the Statement of Net Cost, the

opinion was achieved only through extensive effort to overcome material weaknesses in internal control” and “[a]lthough these efforts resulted in auditable information, [they] did not provide timely information to USAID management to make cost and budgetary decisions throughout the year.”⁷

Compounding USAID’s systems difficulties has been the lack of adequate financial management personnel. Since the early 1990s, we have reported that USAID has made limited progress in addressing its human capital management issues. A major concern is that USAID has not established a comprehensive workforce plan that is integrated with the agency’s strategic objectives and ensures that the agency has skills and competencies necessary to meet its emerging foreign assistance challenges. While a viable financial management system is needed, and offers the capacity to achieve reliable data, it is not the entire answer for improving USAID’s financial management information. Qualified personnel must be in place to implement and operate these systems.

In addition to the improved opinions for fiscal year 2002, the IG reported that while USAID had made improvements in its processes and procedures, a substantial number of material weaknesses,⁸ reportable conditions,⁹ and noncompliance with laws and regulations¹⁰ remain. The report also noted that USAID’s financial management systems do not meet federal financial system requirements. Table 2 shows that while USAID’s opinions on its financial statements improved, reported material weaknesses, reportable conditions, and noncompliance increased.

⁷USAID Office of Inspector General, *Report on USAID’s Consolidated Financial Statements, Internal Controls, and Compliance for the Fiscal Year 2002*, Audit Report No. 0-000-03-001-C (Washington, D.C.: Jan. 24, 2003).

⁸A material weakness is a condition that precludes the entity’s internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

⁹Reportable conditions are matters coming to the auditor’s attention that, in the auditor’s judgment, should be communicated because they could adversely affect the entity’s ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

¹⁰ The auditor determined that the agency was not in compliance with selected provisions of applicable laws and regulations that could have a direct and material effect on amounts reported in the financial statements.

Table 2: Weaknesses Reported by the USAID Inspector General in Fiscal Years 2000 Through 2002

	Fiscal year		
	2000	2001	2002
Reported material weaknesses			
Reconciling fund balance with Treasury			X
Recognizing, recording, and reporting accounts receivable	X		X
Calculating and reporting accounts payable	X		X
Recording and classifying advances to grantees and related expenses	X	X	X
Computer security deficiencies	X	X	Reported as a Compliance with Laws and Regulations Condition
Process for preparing the Management's Discussion and Analysis needs improvement	X		Now a Reportable Condition
Allocating program expenses on its Statement of Net Costs			X
Reviewing, analyzing, and deobligating unliquidated obligations		X	X
Calculating credit program allowances			X
Reportable conditions			
Reconciling fund balance with Treasury	X		
Calculating and reporting accounts payable		X	
Recognizing, recording, and reporting accounts receivable		X	
Establish monthly closing procedures			X
Improve controls and management of property at overseas missions			X
Process for preparing the Management's Discussion and Analysis needs improvement		X	X
Compliance with laws and regulations			
Chief Financial Officers Act of 1990	X		
Federal Financial Management Improvement Act of 1996	X	X	X
Computer Security Act of 1987	X	X	X
Debt Collection and Improvement Act of 1996			X

Source: USAID Inspector General reports.

The increase in reported material weaknesses, reportable conditions, and noncompliance is, in part, due to the full scope audits that were not possible in prior years. As financial information improved over the years, it has assisted the USAID IG in identifying additional internal control and system weaknesses. Identifying these additional weaknesses is constructive in that they highlight areas that management needs to address in order to improve the overall operations of the agency and provide accurate, timely, and reliable information to management and the Congress.

Several of the weaknesses reported by the USAID IG are chronic in nature and resolution has been a challenge. For example, similar to the USAID fiscal year 2002 material weakness, in 1993 we reported¹¹ that USAID did not promptly and accurately report disbursements. At that time, USAID could not ensure that disbursements were made only against valid, preestablished obligations and that its recorded unliquidated obligations balances were valid. Additionally, we reported USAID did not have effective control and accountability over its property.

The chronic nature of the reported weaknesses at USAID reflect challenges with people (human capital), processes, and financial management systems. USAID management represented to us that, over time, they have lost a significant number of staff in this area and face challenges recruiting and retaining financial management staff. Further, according to IG representatives, many of the individuals that financial managers must depend on to provide the data that are used for financial reports are not answerable to the financial managers and often do not have the background or training necessary to report the data accurately. Also contributing to the challenge are USAID's nonintegrated systems that require data reentry, supplementary accounting records, and lengthy and burdensome reconciliation processes.

¹¹ U.S. General Accounting Office, *Financial Management: Inadequate Accounting and System Project Controls at AID*, GAO/AFMD-93-19 (Washington D.C.: May 24, 1993).

Financial Management Reform Will Require a Long-term Commitment

Transforming USAID's financial and business management environment into an efficient and effective operation that is capable of providing management and the Congress with relevant, timely, and accurate information on the results of operation will require a sustained effort. Improved financial systems and properly trained financial management personnel are key elements of this transformation. While these challenges are difficult, they are not insurmountable. Without sustained leadership and oversight by senior management, the likelihood of success is diminished.

In its fiscal year 2002 *Performance and Accountability Report*, USAID noted that it was in the process of implementing an agencywide financial management system. USAID reported that the system has been successfully implemented in Washington. In June 2003, USAID awarded a contract for the implementation of the system overseas. According to USAID officials, they anticipate this effort to be completed by fiscal year 2006. While we are encouraged by USAID's progress toward implementing an integrated system, it should be noted that this is the second attempt in the past 10 years to implement an agencywide integrated financial management system. To provide reasonable assurance that the current effort is successful, top management must be actively involved in the oversight of the current project. Management must have performance metrics in place to ensure the modernization effort is accomplished on time, within budget, and provides the planned and needed capabilities.

In this regard, in fiscal year 2002, USAID redesigned its overall governance structure for the acquisition and management of information technology. Specifically, USAID created the Business Transformation Executive Committee, chaired by the Deputy Administrator and with membership including key senior management. The committee's purpose is to provide USAID-wide leadership for initiatives and investments to transform USAID business systems and organizational performance. The committee's roles and responsibilities include:

- Guiding business transformation efforts and ensuring broad-based cooperation, ownership, and accountability for results.
- Initiating, reviewing, approving, monitoring, coordinating, and evaluating projects and investments.

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- Ensuring that investments are focused on highest pay-off performance improvement opportunities aligned with USAID's programmatic and budget priorities.

Active, substantive oversight by this committee over USAID's information technology investments, including its agencywide integrated financial management system initiative, will be needed for business reform efforts to succeed.

In addition to improved business systems, it is critical that USAID have sustained financial management leadership and the requisite personnel and skill set to operate the system in an efficient and effective manner once it is in place. We have reported for years and USAID acknowledges that human capital is one of the management challenges that must be overcome. As previously noted, since the early 1990s we have reported that USAID has made limited progress in addressing its human capital management issues. Within the area of financial management, progress in this area has also been slow, with no specific plan of action on how to address shortages of trained financial managers. USAID represented to us that as part of its agencywide human capital strategy, it plans to specifically address its financial management personnel challenges.

In addition to addressing systems and human capital challenges, USAID is working to improve its processes and internal controls. Effective processes and internal controls are necessary to ensure that whatever systems are in place are fully utilized and that its operations are as efficient and effective as possible. USAID is working to eliminate the material weaknesses, reportable conditions, and noncompliance reported by the USAID IG in fiscal year 2002. For fiscal year 2003, the Administrator of USAID and the IG agreed to work together to provide for the issuance of audited financial statements by November 15, 2003, in line with the Office of Management and Budget's accelerated timetable for reporting. To meet this tight timeframe, the CFO must provide timely and reliable information that can withstand the test of audit with little to no needed adjustment. However, given the continued financial management system, process, and human capital challenges, meeting this goal will be difficult.

Conclusion

USAID appears to be making a serious attempt to reform its financial management, as evidenced by initiatives to improve its human capital, internal controls, and business systems. However, progress to date is most evident in the improvement in the opinions on its financial statements,

which reflect USAID's ability to generate reliable information one time a year, rather than routinely for purposes of management decision making. Through fiscal year 2002 these improved opinions reflect a significant "heroic" effort to overcome human capital, internal control, and systems problems. Although these improved opinions represent progress, the measures of fundamental reform will be the ability of USAID to provide relevant, timely, reliable financial information and sound internal controls to enable it to operate in an efficient and effective manner.

Mr. Chairman, this concludes my statement. I would be pleased to answer any questions you or other members of the Subcommittee may have at this time.

Contacts and Acknowledgments

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