

USAID

OFFICE OF INSPECTOR GENERAL

**Audit of USAID's Advances and Related Internal Controls
for Fiscal Year 2000**

**Audit Report (Report No. 0-000-01-003-F)
February 15, 2001**

**U.S. Agency for
International Development**





U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MEMORANDUM FOR CFO, Michael T. Smokovich

FROM: IG/A/FA, Alvin A. Brown

SUBJECT: Audit of USAID's Advances and Related Internal Controls for
Fiscal Year 2000 (Report No. 0-000-01-003-F)

This memorandum audit report is our report on U.S. Agency for International Development's (USAID) advances. This report is part of our review of USAID's consolidated financial statements as required by the Government Management Reform Act of 1994. This Act requires USAID to prepare and submit audited financial statements for the preceding fiscal year that covers all accounts and associated activity of the agency. This report is one in a series of reports that communicate the results of our audit.

This audit was performed to determine whether USAID's advance account balance was reliable as of September 30, 2000. We were unable to determine whether USAID's advance account balance was reliable as of September 30, 2000.

We identified four internal control weaknesses without final corrective action that were reported in our previous audit report¹, and two new internal control weaknesses. This report makes one recommendation to improve USAID's accounting for advances and strengthen related internal controls. In responding to our draft audit report and its recommendation, the Chief Financial Officer has agreed with our recommendation and taken action to improve USAID's accounting for advances, strengthen internal controls, and to comply with applicable laws and regulations.

Based on Management's acceptance of the audit recommendation and action taken, we accept your Management's decision and the corrective action taken as final action for the audit recommendation. Refer to Appendix II "USAID Management Comments".

I would like to express my sincerest appreciation for the courtesies extended by your staff to the auditors.

¹ Audit of USAID Advances and Related Internal Controls for Fiscal Year 1999 (Audit Report No. 0-000-00-003-F, February 1, 2000).

Background

USAID was created in 1961 to facilitate the United States' foreign policy interests by promoting broad-based sustainable development and providing humanitarian assistance. USAID has an overseas presence in over 70 countries, which include 42 fully operational missions.

The Office of Management and Budget² describes advances as a payment disbursed from Treasury funds made by a check or via electronic transfer to a grantee prior to actual outlays of cash for grant expenses. These advances are primarily made to grantees through USAID's Letter of Credit Support System and the Department of Health and Human Services' (DHHS) Payment Management System.

In previous years, the Office of Inspector General's (OIG) ability to express an opinion was impaired by inadequate financial accounting systems and related material weaknesses in internal controls. The OIG concluded that these deficiencies in the financial accounting systems³ created risks that the financial statements could contain material misstatements. The amount of substantive testing required to express an opinion on the fairness of the financial statements would have been prohibitive and unattainable by the statutory deadline of March 1 for submitting the audited financial statements to the Office of Management and Budget (OMB). Accordingly, the OIG did not express an opinion on the fairness of the financial statements.

In our previous audit report⁴, we reported that USAID did not properly identify, record, and report the \$1.1 billion of advances made to grantees through its letter of credit system.

In fiscal year 1999, we reported that USAID's grant financial system did not provide effective control and accountability over advances disbursed through its letter of credit system. This condition was attributed to USAID's continued use of the cash pooling method to account for its advances to grantees. Under this method, the Office of Financial Management does not record the advance against the grant for which the original obligation was made. Instead, advances are pooled together and recorded at the grantee level, without

² Office of Management and Budget Circular A-110, dated August 29, 1997, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations.

³ According to OMB Circular A-127 and the Chief Financial Officers' Act, a financial management system includes supporting systems that contain the information needed to carry out financial management functions, manage financial operations, and report financial status information. The systems provide the information managers need to (1) carry out their fiduciary responsibilities; (2) deter fraud, waste, and abuse; and (3) relate financial consequences to agency program performance. Thus, in addition to basic accounting functions, USAID's financial management system includes supporting systems that perform performance measurement, budget, and procurement functions.

⁴ Audit of USAID Advances and Related Internal Controls for Fiscal Year 1999 (Audit Report No. 0-000-00-003-F, February 1, 2000).

regard to the corresponding grant obligation. The OIG considers this method of accounting for advances to grantees as a material weakness in USAID's internal control system. This material weakness impacts USAID's ability to prepare auditable financial statements. The weakness further limits USAID's ability to (1) provide its managers with financial and budgetary information, and (2) estimate expenditures against the outstanding advances at fiscal year-end. In addition to the impact on USAID financial statement-producing capabilities, USAID does not have an audit trail to trace specific disbursements through liquidation at the appropriate obligation level.

USAID agreed with our prior recommendations to move to grant level advances, pending a final decision on this matter, the Agency will continue to use the pooled advance method for its letter of credit advances.

Because of the problems noted in previous years' audits, we agreed with USAID's management to focus our fiscal year 2000 audit efforts on selected material line items reported on the balance sheet.

Audit Objective

This audit is part of our annual review of USAID's consolidated financial statements as required by the Government Management Reform Act of 1994. For fiscal year 2000, the Office of Inspector General agreed with USAID's Management to concentrate our audit on selected major balance sheet line items.

In planning and performing our audit of USAID's Advances and Related Internal Controls for fiscal year 2000, we considered its internal control structure in order to determine our auditing procedures for the purpose of reporting an opinion on the reliability of the advance balance and not to provide assurance on the internal control structure. This report does not contain an opinion about the fairness of the statements taken as a whole.

The objective of this audit is:

Was USAID's Advance Account Balance Reliable as of September 30, 2000?

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- Transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability over assets.;
- Funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that the Office of management and Budget or USAID management has identified as being significant for which compliance can be objectively measured and evaluated.

Our consideration of internal control would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect USAID's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

See Appendix I for a discussion of the scope and methodology for the audit.

Audit Findings

Was USAID's Advance Account Balance Reliable as of September 30, 2000?

We were unable to determine whether USAID's advance account balance was reliable as of September 30, 2000. This occurred because of the following deficiencies:

- (1) USAID's continued use of the cash pooling method of accounting for advances hinders its ability to report the accurate status of financial and budgetary resources at the obligation and appropriation level.
- (2) USAID did not promptly record 603 grant agreements and modifications in the grant payment processing system totaling approximately \$633 million.
- (3) USAID transferred unliquidated obligations totaling about \$1.3 billion in fiscal year 1999 to DHHS's Payment Management System without verifying the accuracy of the transferred balances.
- (4) USAID did not follow its established policy of performing a monthly reconciliation between the advance subsidiary ledger and the USAID general ledger. At September 30, 2000, there was an unexplained difference of \$126 million between USAID's general ledger and its advance subsidiary ledger.
- (5) USAID's general ledger system did not provide an adequate audit trail for the \$1.4 billion advances.
- (6) USAID did not promptly record expenditures totaling about \$767 million to its general ledger.

USAID agreed with our prior recommendations to change its methodology for disbursing advances to grantees, which would have corrected items one to four above that were previously reported. However, in fiscal year 2000, OMB issued a proposed amendment to Circular A-110 that proposed mandatory requirements for Federal Agencies to offer the pooled advance method to grantees. Because of this proposed change in regulations, USAID decided, with our concurrence, that the only practical course of action was to suspend its conversion of grantees to the obligation method of disbursing advances to grantees pending a final ruling by OMB. Therefore, USAID continues to use the pooled method for disbursing advances to grantees.

To date, OMB has not issued a final ruling on the pooling of advance issue. However, per the Federal Register Notice on the Federal Financial Assistance Management Improvement

Act of 1999 dated January 17, 2001, the CFO Council's Grants Management Committee is clarifying differing positions on the pooled method issue for advances and will specify when pooling is applicable.

The following section presents our detailed findings and one new recommendation to improve USAID's accounting for advances, strengthen its related internal controls, and comply with applicable laws and regulations.

Disbursing Advances under Cash Pooling Method Hinders Financial Statement Preparation

In our previous audit report⁶, we reported that USAID's Financial Management System does not provide effective control and accountability over advances disbursed through its letter of credit system. USAID records do not reflect reliable, current, and complete disclosure of information on the awards, authorizations, obligations, advances, and expenditures.

Under USAID's present system, letter of credit advances are processed using DHHS's Payment Management System. In this system, recipients are allowed to receive advances⁷ based on the obligated balance (cash pool amount) available for all grants awarded to their organization. At the time of their advance request, recipients are not required to identify the source and application of requested advances. Instead, advances are charged using a billing algorithm that arbitrarily charges the advances at the obligation level based on the originally established date of the grant obligation agreements. Then recipients are instructed to submit their advance liquidation reports outlining their actual cash disbursements 45 days after each fiscal quarter end. These expenditures are recorded in the financial system based on actual disbursements; however, the initial charges that were based on the billing algorithm are not adjusted to reflect these actual reported expenditures. Therefore, in DHHS's Payment Management System, the obligation amount for one grant will be reduced to account for the reported expenditures of another grant.

At September 30, 2000, we attempted to confirm the advance balances for 64 recipient organizations valued at \$123 million. The USAID advance subsidiary ledger, maintained by DHHS, showed approximately \$798 million for the 301 recipient organizations in the universe. To confirm the accuracy of the advance balance, we used a two-tier approach: (1) confirming at the individual grant level and (2) confirming at the recipient organization level.

We noted the following:

⁶ Audit of USAID Advances and Related Internal Controls for Fiscal Year 1999 (Audit Report No. 0-000-00-003-F, February 1, 2000).

⁷ A payment made to a grantee upon its request either before the grantee has made outlays or through the use of predetermined payment schedules. Advances represent cash drawdowns made by the grant recipient to meet immediate cash needs.

1. We were unable to confirm the accuracy of the \$123 million advances for the 439 grants selected at the individual grant level because of differences in the information reported by USAID and the recipient organizations.
2. We were unable to confirm the accuracy of advances reviewed at the aggregate level for 51 recipient organizations (80 percent) because of differences in the information reported by USAID and the recipient organizations.

As result of our inability to confirm the advance balance of the recipient organizations, the OIG was unable to determine the accuracy of the \$1.254 billion of advances processed using DHHS's Payment Management System reported in USAID's general ledger at September 30, 2000.

As agreed to in our previously issued report, USAID is in the process of converting recipients to a grant-by-grant methodology, which will require recipients to identify requested advances at the obligation and appropriation level. The status of the conversion is outlined in Chart 1 on page 9 of this report.

Updating Systems with Grant Award Information

In our previous report⁸, we reported that the USAID had not updated its grant payment processing system to reflect grant agreement and amendments recorded in the New Management System (NMS) or Mission Accounting and Control System (MACS). At September 30, 1999, USAID had a backlog of 881 grant agreements and/or amendments with a value of \$1.2 billion. We recommended that USAID develop procedures to ensure that grant agreements and amendments are promptly recorded in its grant payment processing system and further develop ways to integrate its various financial systems. USAID concurred with our recommendation but has not resolved this deficiency.

At September 30, 2000, our audit showed USAID still has a backlog of 603 grant agreements and/or amendments with a value of \$633 million. USAID personnel stated the following caused this backlog:

1. USAID does not have a fully integrated financial accounting system that is capable of interfacing with its grant payment processing system; and
2. USAID overseas missions do not consistently forward copies of grant amendments and/or modifications to the USAID Office of Financial Management.

Approximately 355 of 603 grant agreements and/or amendments with a value of \$293 million were received by USAID, but were not recorded in its grant payment processing system. These grant agreements and/or amendments have remained unrecorded for a period in excess of 120 days. The OIG considers USAID's continued failure to promptly record grant

⁸ Audit of USAID Advances and Related Internal Controls for Fiscal Year 1999 (Audit Report No. 0-000-00-003-F, February 1, 2000).

agreements and/or amendments in its grant payment processing system as a material internal control weakness. Table 1 on the following page illustrates the status of the grant agreements or amendments:

**Table 1
Status of Grant Agreements/Modifications
At September 30, 2000**

<u>Number of Agreements</u>	<u>Absolute Value</u>	<u>Number of Days Outstanding</u>
147	\$198,933,967	60-90
101	141,942,792	91-120
355	292,878,644	121-270
<u>603</u>	<u>\$633,755,403</u>	

USAID agreed to implement our previous recommendation; therefore, this report does not contain a recommendation for further management action in this area. We will continue to monitor the progress of this area in our fiscal year 2001 audit.

Reconciling Letter of Credit Balances

In our previous audit report⁹, we reported that USAID transferred an estimated \$1.3 billion of unliquidated obligations for 301 recipient organizations to DHHS’s Payment Management System without verifying the accuracy of the transferred balances. We recommended that USAID perform a reconciliation to verify the accuracy of balances transferred to DHHS. USAID concurred with our finding and recommendation and proposed corrective action for this deficiency.

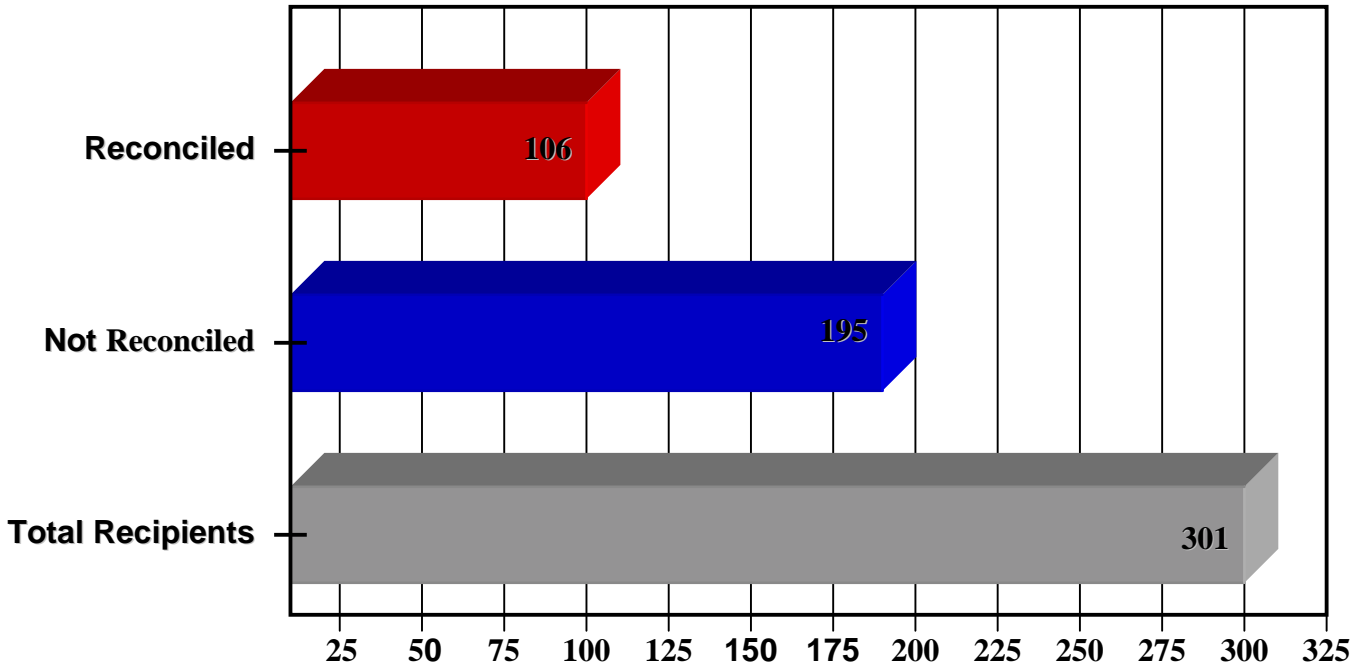
Our current audit covering fiscal year 2000, showed that USAID reconciled unliquidated obligation balances for 106 of the 301 recipient organizations transferred to DHHS’s Payment Management System. USAID/FM stated that a reconciliation would be completed by December 31, 2000; however, due to the large amount of resources needed to perform this reconciliation, USAID/FM has revised this date to September 30, 2001. As a result, the OIG has been unable to determine the accuracy of the following:

1. The \$1.254 billion advance balance reported in USAID’s general ledger. Refer to additional information on page 6 of this report.
2. The \$135 million advance balance processed by USAID using the old Letter of Credit System that they have not been able to liquidate. USAID discontinued disbursing advances through this system as of December 31, 1998.

⁹ Audit of USAID Advances and Related Internal Controls for Fiscal Year 1999 (Audit Report No. 0-000-00-003-F, February 1, 2000).

USAID agreed to implement our previous recommendation; therefore, this report does not contain a recommendation for further management action in this area. We will continue to monitor the progress of this reconciliation in our fiscal year 2001 audit. Chart 1 on the following page illustrates the progress of the reconciliation.

**Chart 1
Reconciliation of Recipient Organizations
(As of September 30, 2000)**



Reconciling the General Ledger to the Advance Subsidiary Ledger

In our previous audit report¹⁰, we reported that USAID’s subsidiary ledger did not reconcile to its general ledger. We recommended that USAID perform periodic reconciliations between its subsidiary ledger and general ledger. USAID concurred with our finding and recommendation and proposed corrective action for this deficiency.

At September 30, 2000, USAID had not provided an explanation for the \$126 million difference between the \$924 million¹¹ advance balance reported in its general ledger and the \$798 million advance balance reported in the advance subsidiary ledger. This occurred because USAID did not follow its procedure that requires a monthly reconciliation between its general ledger and subsidiary ledger. USAID informed us that the lack of resources

¹⁰ Audit of USAID Advances and Related Internal Controls for Fiscal Year 1999 (Audit Report No. 0-000-00-003-F, February 1, 2000).

¹¹ Account No. 1410.75 “Letter of Credit Advance-HHS processed” \$1.254 billion of letter of credit advances adjusted for unrecorded 3rd quarter expenditures of \$330 million.

impaired its ability to perform the monthly reconciliation. As a result, the OIG has been unable to determine the reliability of the advance balance reported in USAID's general ledger.

USAID agreed to implement our previous recommendation; therefore, this report does not contain a recommendation for further management action in this area. We will continue to monitor the progress of this reconciliation during our fiscal year 2001 audit.

Supporting Advance Transactions – Audit Trail

USAID's financial accounting system does not provide an adequate audit trail for its letter of credit advances as required by the Joint Financial Management Improvement Program (JFMIP) and the Standard General Ledger. This deficiency was caused by the continued use of the cash pooling method to account for advances (See page 4 for additional details), and the lack of integrated financial accounting systems within USAID. As a result, the OIG was unable to follow the transactions trail and determine the reliability of the \$1.4 billion advances reported in the general ledger.

Under USAID's present system, recipients are allowed to receive advances based on the obligated balance (cash pool amount) available for all grants awarded to their organization. At the time of request, recipients are not required to identify the source and application of requested advances. Instead, advances are allocated using a billing algorithm that arbitrarily charges the advances at the obligation level based on the established date of the grant agreements. Recipients are required to submit their advance liquidation reports outlining their actual cash disbursements 45 days after each fiscal quarter. These expenditures are recorded in the financial system based on actual disbursement; however, the advances charged based on the billing algorithm are not adjusted to reflect these actual reported expenditures. The advance and expenditure information is electronically transmitted to USAID. This information is summarized and recorded in USAID's general ledger through the use of journal vouchers.

The Standard General Ledger System and the JFMIP "Core Financial System Requirements" provide the following guidance:

1. The United States Standard General Ledger requires transactions be traced back to the source/point of entry in the feeder systems and to supporting documentation as required by the Federal Financial Management Improvement Act of 1996.
2. The JFMIP "Core Financial System Requirements" requires that a core system:
 - a) Provide audit trails to trace transactions from source documents, original input, other systems, system-generated transactions and internal assignment transactions through the system, and provide transaction detail to support account balances.

- b) Provide audit trails to trace source documents and transactions through successive levels of summarization to the financial statements and the reverse.
- c) Select items for review based on user-defined criteria by type of transaction.

USAID has agreed to implement our previous recommendation to convert recipients to a grant-by-grant methodology and integrate its financial accounting systems; therefore, we make no recommendation in this area. Refer to page 6 for additional detail.

Recording Expenditures to the General Ledger

USAID was unable to promptly record third (3rd) and fourth (4th) quarter expenditures of about \$767 million to its general ledger. USAID noted that the expenditures were not promptly recorded because of the following:

1. DHHS experienced delays in processing 3rd and 4th quarter expenditures during the implementation of its new Payment Management System. DHHS submitted the 3rd quarter expenditures on November 6, 2000, approximately 67 days after the deadline of August 30, 2000.
2. USAID's financial accounting system was unable to interface directly with various financial accounting systems. USAID used a manual process to analyze and record expenditures to its General Ledger System.
3. DHHS experienced delays in receiving liquidation reports from recipients within the established reporting deadlines.

As a result, USAID made year-end adjustments of \$767 million (61 percent) to the \$1.254 billion of letter of credit advance balance reported at September 30, 2000 to reflect recipient expenditures of \$330 million for the 3rd quarter (April-June.) and an estimated \$437 million¹² for the 4th quarter (July-September). Due to time constraints, we were unable to determine the reasonableness of these adjustments. We believe that a 61 percent adjustment is material to the advance and prepayment line.

USAID provided documentation of the procedures used to report fiscal year 2000 expenditures; therefore, this report does not contain a recommendation for further management action in this area.

¹² USAID estimate is based on the advances and subsequent expenditures used to liquidate the advances. A liquidation rate of 82% is applied to fiscal year 2000 4th quarter outstanding advances of \$533 million.

Management Comments and Our Evaluation

In commenting on our draft audit report and its recommendations, the Chief Financial Officer has agreed with our audit findings and one recommendation to improve USAID's accounting for advances, strengthen internal controls, and to comply with applicable laws and regulations.

With regards to recommendation no. 1, management stated they would document the procedure used to estimate the 4th quarter expenditure for fiscal year 2000 as recommended. Management has stated this procedure will be finalized by February 28, 2001.

Based on Management's acceptance of the audit recommendation and action taken, we accept your Management's decision and the corrective action taken as final action for the audit recommendation.

With regards to reconciling letter of credit balances, management stated they would continue the reconciliation work cited in the draft audit report. Once the CFO Council's Grant Management Committee issues final instructions on the "pooling issue", management will consult with the OIG on the next steps.

SCOPE AND METHODOLOGY

SCOPE

The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements taken as a whole. We were unable to obtain sufficient competent evidential matter upon which to base an opinion due to our inability to confirm the advance balance and material weaknesses in internal controls. Accordingly, our audit was not performed in accordance with generally accepted auditing standards and Government Audit Standards, issued by the Comptroller General of the United States.

As a result of the internal control weaknesses noted in our previous audit report, we agreed with USAID's management to focus our fiscal year 2000 audit efforts on selected material line items reported on the balance sheet. We focused our audit effort on the \$1.4 billion of advances issued under the letter of credit system of a total \$1.7 billion of advances reported as a line item for fiscal year ended September 30, 2000. The \$1.4 billion of advance balance consisted of the following:

- (1) "Advances – Letter of Credit (LOC) – Department of Health and Human Services Managed" processed using the Department of Health and Human Services Payment Management System with a reported advance balance of \$1.254 billion as of September 30, 2000.
- (2) "Advances – Contractor/Grantee processed by the USAID Office of Financial Management using the old legacy system with a reported advance balance of \$135 million as of September 30, 2000.

A materiality threshold of 5 percent was calculated. Based on USAID 1999 Net Cost of Operations of \$6.2 billion, any amount over \$335 million will be considered material and included in our review of USAID 2000 financial statements. The advances for fiscal year 1999 were \$1.3 billion. Accordingly, the materiality level for this audit of advances was \$65 million (5 percent of \$1.3 billion).

METHODOLOGY

To accomplish our specific audit objective, we

- obtained an understanding of the components of USAID's internal controls and assessed the level of control risk relevant to the assertions embodied in the class of transactions, the advance balance, and related disclosures in the financial statements;

- performed tests of compliance with laws and regulations that could have a direct and material effect on the advance line items in USAID's financial statements;
- examined, on a test basis, evidence supporting the advance balance and related disclosures;
- assessed the accounting principles used and significant estimates made by management in developing the proposed amounts for the advance balance audited;
- evaluated the overall presentation for the advance balance; and determined compliance with laws and regulations; and
- discussed OIG findings and recommendations for improvement with the Office of Financial Management.

USAID MANAGEMENT COMMENTS



February 2, 2001

MEMORANDUM

TO: IG/A/FA, Alvin A. Brown

FROM: CFO, Michael T. Smokovich

SUBJECT: Audit of USAID's Advances and Related Internal Controls for Fiscal Year 2000

We have reviewed the draft report on your audit of the advances and related internal controls for FY 2000 and agree with your findings and recommendation. We will document the procedure used to estimate the 4th quarter expenditure for FY 2000 as recommended. This procedure will be finalized by February 28, 2001. We will also continue the reconciliation work cited in the draft report. Once the CFO Council's Grant Management Committee issues final instructions on the "pooling" issue, we will consult with you on the next steps.

I would like to thank you and your staff for the professional and cooperative manner in which the audit was conducted.

Cc: M/CFO, S. Owens
M/CFO, T. Cully
M/MPI, S. Malone-Gilmer
M/FM, D. Ostermeyer
M/FM/CAR, T. Vapniarek
M/FM/CAR, E. White
M/FM/A, J. Swan
M/FM/CMP, B. Leonard
M/FM/CMP, B. Maipid-Smith
M/FM/CMP, J. Dubois