

**Risk Assessment of Major Functions Within  
USAID/Ecuador**

**Report No. 1-518-03-001-S**

**October 1, 2002**

**San Salvador, El Salvador**



*RIG/San Salvador*

October 1, 2002

**MEMORANDUM**

**FOR:** USAID/Ecuador Director, Lawrence J. Klassen

**FROM:** RIG/San Salvador, Timothy E. Cox

**SUBJECT:** Risk Assessment of Major Functions Within USAID/Ecuador  
(Report No. 1-518-03-001-S)

This memorandum is our report on the subject risk assessment. This is not an audit report and does not contain any formal recommendations for your action.

Thank you for providing comments to the draft report. Your comments are included in Appendix II of this report.

Once again, I appreciate the cooperation and courtesy extended to my staff during the risk assessment.

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**Background**

Ecuador faces a variety of development challenges. According to the fiscal year 2003 *Budget Justification to the Congress*, USAID noted that, although the economy is improving, inflation and unemployment in 2001 were high at 24 percent and 11 percent, respectively. Furthermore, 70 percent of Ecuador's population lives in poverty, confidence in democracy is dangerously low, and narco-terrorism from Colombia increasingly threatens the northern border region.

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USAID/Ecuador's program areas and their approximate fiscal year 2001 and 2002 funding levels, in millions, are presented in the following table:

	<u>FY 2001</u>	<u>FY 2002</u>
Southern Border Integration	\$ 3.1	\$ 2.3
Northern Border Development	8.0	10.0
Poverty Reduction	3.5	6.9
Democracy	5.3	7.6
Biodiversity Conservation	<u>5.0</u>	<u>7.4</u>
	\$24.9	\$34.2

The U.S. General Accounting Office (GAO) noted in *Standards for Internal Control in the Federal Government* (November 1999) that internal controls should provide reasonable assurance that agency objectives are being achieved, operations are effective and efficient, and assets are safeguarded against loss. Conducting risk assessments is one technique identified by the GAO to enhance internal controls.

The purposes of the risk assessment were to assist the Regional Inspector General in planning future audits and to identify opportunities for improvement in USAID/Ecuador operations. Our scope and methodology are presented in appendix I.

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## **Discussion**

In judging the risk exposure for the major functions in USAID/Ecuador, we considered:

- the amount of funding the individual programs received relative to the overall mission budget (see above details of the mission's \$34.2 million fiscal year 2002 program budget),
- the level of U.S. interest in the program activities,
- the level of involvement and/or support provided by the Government of Ecuador,
- the experience of key staff members in their area of expertise as well as in Ecuador,

- incidences of improper administration or material weaknesses (if any) noted in prior reviews and/or as reported by mission officials,
- management support for internal controls, and
- the level of risk inherently present in an activity that program or administrative objectives will not be met.

Our risk assessment of USAID/Ecuador covered nine functions. We judged two functions to have a “high” risk exposure, four functions to have a “moderate” risk exposure, and three to have a “low” risk exposure. These judgements are discussed in the following tables.

Function Description	Risk Exposure
<b>Southern Border Integration</b> – Income generation, access to social services, natural resources management, and effective local governance	Moderate
<b>Risk Assessment Factors</b>	
<ul style="list-style-type: none"> <li>• This function has been funded at levels lower than originally planned. With fiscal year 2001 and 2002 funding levels of approximately \$3.1 million and \$2.3 million, the function received less funding than the mission’s other program areas.</li> <li>• The function’s activities consist of a mix of lower risk activities, such as technical assistance to micro entrepreneurs, and higher risk activities, such as construction of public health infrastructure.</li> <li>• Activities are implemented through a cooperative agreement with CARE International. The fiscal year 2002 funding for CARE was \$2.2 million. CARE has numerous sub-grantees.</li> <li>• The managers responsible for the function’s activities have at least 10 years of experience with USAID.</li> <li>• CARE is subject to audit under Office of Management and Budget (OMB) Circular No. A-133. Additionally, mission management decided to conduct its own financial review of CARE.</li> <li>• Audits were not obtained for sub-grantees. According to mission officials, sub-grantee expenditures did not reach the threshold that would require an audit.</li> </ul>	

Southern Border Integration (continued)

- Management monitors function activities through review of annual work plans, periodic progress reports, and site visits.

Function Description	Risk Exposure
<p><b>Northern Border Development</b> – Improved health conditions in vulnerable towns, improved infrastructure, and strengthened civil society</p>	<p>High</p>
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• With fiscal year 2001 and 2002 funding levels of approximately \$8 million and \$10 million, the function was the most significant portion of the USAID/Ecuador portfolio.</li> <li>• Funded as part of the Andean Counter-Narcotics Initiative, the function is high profile and sensitive.</li> <li>• The function’s activities consist of a mix of lower risk activities, such as support for land titling for small farmers, and higher risk activities, such as construction of roads, bridges, and irrigation systems.</li> <li>• The manager responsible for the function’s activities has 10 years of experience with USAID.</li> <li>• Activities are implemented through a cooperative agreement with the International Organization for Migration (IOM). The fiscal year 2002 funding for IOM was \$9.2 million. IOM is a public international organization.</li> <li>• Management monitors function activities through review of annual work plans, periodic progress reports, and site visits.</li> </ul>	

Function Description	Risk Exposure
<p><b>Poverty Reduction</b> – Micro-finance development and improved policy and investment climate (macro-economic issues)</p>	<p>Moderate</p>
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• With fiscal year 2001 and 2002 funding levels of approximately \$3.5 million and \$6.9 million, the function was a significant portion of the USAID/Ecuador portfolio.</li> <li>• Micro-finance activities are well defined with solid indicators and data sources.</li> <li>• Macro-economic activities are being undertaken at a high level. Attribution of progress to USAID is difficult to establish.</li> <li>• Success of macro-economic activities is highly dependent upon political will and government support.</li> <li>• Activities are primarily technical assistance and training.</li> <li>• Activities are implemented through contracts with Development Alternatives Incorporated (DAI) and with the World Council of Credit Unions (WOCCU). The fiscal year 2002 funding for DAI and for WOCCU was \$4.5 million and \$1.5 million, respectively.</li> <li>• DAI is subject to audit by the Defense Contract Audit Agency. WOCCU is subject to audit under OMB Circular No. A-133.</li> <li>• Management monitors function activities through review of annual work plans and periodic progress reports.</li> </ul>	

Function Description	Risk Exposure
<p><b>Democracy</b> – Improved transparency and accountability of democratic institutions, greater inclusiveness of democratic processes, and increased policy consensus in key democratic areas</p>	<p>High</p>
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• With fiscal year 2001 and 2002 funding levels of approximately \$5.3 million and \$7.6 million, the function was a significant portion of the USAID/Ecuador portfolio.</li> <li>• The function’s activities are being implemented in a difficult environment. Despite having been a democracy for over 20 years, Ecuador has not institutionalized that form of government. Public confidence in democracy is low.</li> <li>• There may be a lack of political will for reform within government institutions in some areas.</li> <li>• Activities are implemented through a contract with Associates in Rural Development (ARD), through a cooperative agreement with the Esquel Foundation, and through several others including sub-grantees. The fiscal year 2002 funding for ARD and for the Esquel Foundation was \$3.3 million and \$1.5 million, respectively.</li> <li>• The managers responsible for the function’s activities have at least 10 years of experience with USAID.</li> <li>• Staffing constraints have hampered effectiveness. Additional staffing is planned.</li> <li>• ARD is subject to audit by the Defense Contract Audit Agency. A local public accounting firm audits the Esquel Foundation.</li> <li>• Management plans to review the financial and administrative capacity of some sub-grantees.</li> <li>• Management monitors function activities through review of annual work plans, periodic progress reports, and site visits.</li> </ul>	

Function Description	Risk Exposure
<b>Biodiversity Conservation</b> – Protection of Quito’s watershed, conservation of the Galapagos Islands, and protection of habitats in the northern border region	Moderate
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• With fiscal year 2001 and 2002 funding levels of approximately \$5.0 million and \$7.4 million, the function was a significant portion of the USAID/Ecuador portfolio.</li> <li>• Program activities are in a state of transition. Most current activities will be terminating in 2003.</li> <li>• Commercial interests seeking greater access to tuna fishing have opposed activities in the Galapagos Island Marine Reserve.</li> <li>• Activities are implemented through cooperative agreements with CARE International, The Nature Conservancy (TNC), and the Charles Darwin Foundation. The fiscal year 2002 funding for CARE, TNC, and the Charles Darwin Foundation was (in thousands) approximately \$518, \$875, and \$250, respectively.</li> <li>• Other activities are implemented under interagency agreements with the U.S. Department of Interior (DOI). Fiscal year 2002 funding for the DOI was \$2.1 million.</li> <li>• Fiscal year 2002 purchase orders, grants, and contracts in excess of \$2.9 million are pending award.</li> <li>• CARE and TNC are subject to audit under OMB Circular No. A-133. A local public accounting firm audits the Charles Darwin Foundation.</li> <li>• Managers responsible for the function’s activities have at least 10 years of experience with USAID.</li> <li>• Management monitors function activities through review of annual work plans, periodic progress reports, and site visits.</li> </ul>	



Function Description	Risk Exposure
<b>Contracting Office</b> – Contract negotiation, contract drafting, and contract management services	Low
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• USAID/Ecuador does not have a U. S. Direct Hire Contracting Officer. The Regional Contracting Officer in Lima, Peru supports the mission.</li> <li>• The Contracting Office staff member, a contracting specialist, has 13 years of experience with USAID.</li> <li>• Contracting Office staff is a member of the strategic and special objective teams responsible for implementing functions.</li> <li>• The contracting specialist makes periodic site visits and performs analyses of financial data submitted by USAID partners.</li> <li>• A procurement plan has been prepared and is reviewed regularly.</li> </ul>	

Function Description	Risk Exposure
<b>Program Office</b> – Coordinates budget and annual reporting	Low
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• Operations are structured with oversight from USAID/Washington and mission management.</li> <li>• The manager responsible for the office’s activities has 15 years of experience with USAID. However, management is in a state of transition. A replacement office chief has been assigned to post.</li> <li>• Office personnel are members of the strategic and special objective teams responsible for implementing functions.</li> </ul>	

Function Description	Risk Exposure
<b>Executive Office</b> – General services, information systems, personnel, procurement, maintenance, motor pool, and property management	Moderate
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• We judged the function to have a high level of inherent risk due to the high number of regulations and procedures that must be followed in performing functions.</li> <li>• USAID/Ecuador does not have a U.S. Direct Hire Executive Officer. The mission is supported by the Regional Executive Officer in Lima, Peru.</li> <li>• The Regional Executive Officer is authorized to approve procurements and periodically visits USAID/Ecuador.</li> <li>• Local hire Executive Office staff have between 7 and 22 years of experience with USAID.</li> <li>• The Executive Office in Ecuador has a customer service plan that incorporates performance targets.</li> <li>• Draft information systems contingency and security plans have been developed.</li> <li>• Inventory is counted at least annually.</li> <li>• Vehicle usage reports are prepared monthly.</li> </ul>	

Function Description	Risk Exposure
<b>Financial Management Office</b> – Accounting, voucher payment, and financial analysis	Low
Risk Assessment Factors	
<ul style="list-style-type: none"> <li>• USAID/Ecuador is not an accounting station. The mission does not have a U. S. Direct Hire Controller. The Financial Management Office in Lima, Peru supports the mission.</li> <li>• The Deputy Controller in Lima is authorized to certify vouchers and periodically visits USAID/Ecuador.</li> </ul>	

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Financial Management Office (continued)

- Local hire Financial Management Office staff members have between 2 and 18 years of experience with USAID.
- Office personnel are members of the strategic and special objective teams responsible for implementing functions.
- Operations are structured, documented, and periodically reviewed.

During the course of the risk assessment, we noted a number of formal and informal procedures that were incorporated by USAID/Ecuador to manage its programs. We are making, based on our conversations and limited review of mission documentation, the following suggestions for mission management to consider. These are not formal audit recommendations. The suggestions do not necessarily represent deficiencies but involve possible improvements or enhancements to activities already in process.

- Although not required by policy, USAID/Ecuador does not document formal cost/benefit analyses of potential development activities before they are selected for implementation. Enhancement to the new activity selection process could be attained through documenting the costs and benefits of competing activities before determining which to implement.
- USAID policy requires non-U.S. recipients who spend more than \$300,000 in a year to obtain a financial audit. In some cases, these recipients may receive less than the threshold in a year but over several years may still spend a significant amount. Likewise, an audit may be justified based on non-financial implementation risks facing the recipient. USAID/Ecuador could consider whether sub-grantees expending less than \$300,000 per year merit being audited based on the cumulative amount of multi-year awards or other risk factors.
- At times, the initially planned funding levels are reduced over the life of an activity. The mission could, in planning activities, assess the likelihood of funding shortfalls in the implementation design. By anticipating different funding levels, USAID/Ecuador could incorporate contingencies into the activity design to minimize the impact of funding cuts on the effectiveness of planned activities.
- Site visits are an integral part of USAID/Ecuador's monitoring plan. Although activity managers make frequent field visits, they do not select sites

based on a field visit strategy. USAID/Ecuador could enhance the effectiveness of its monitoring and data verification activities by documenting field visit strategies.

- Due to its relatively small size, the mission did not have a proper segregation of duties over the inventory, procurement, receiving, and warehousing functions. Management should ensure that mitigating controls are in place to compensate for the lack of segregation of duties.
- USAID/Ecuador analyzes the month-to-month fluctuations in vehicle performance and operating cost. The mission could benefit by performing a 12-month trend analysis of vehicle performance and operating cost.
- One of the activities at the mission is being implemented by the International Organization for Migration (IOM). Often with activities implemented by public international organizations, donors do not have audit rights. In this instance, since USAID is the sole donor, the agreement grants audit privileges. The mission should consider contracting for a financial audit of the \$17.1 million IOM activity.
- The Executive Office has created a customer service plan that includes performance measures. However, the office does not collect statistics to measure performance against those targets. The office should consider collecting data to measure performance.
- Draft information systems security and disaster recovery/contingency plans have been completed. However, sections of the plan are presented at a general level. The mission could improve the usefulness of the plans by including detailed recovery steps, a testing strategy and a testing schedule in the information systems contingency plan.

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## Conclusion

This review assigned a risk exposure judgement of high, moderate, or low for each major function. The risk assignments are summarized in the table below.

Function Description	Risk Exposure		
	High	Moderate	Low
<b>Southern Border Integration</b>		✓	
<b>Northern Border Development</b>	✓		
<b>Poverty Reduction</b>		✓	

Function Description	Risk Exposure		
	High	Moderate	Low
<b>Democracy</b>	✓		
<b>Biodiversity Conservation</b>		✓	
<b>Contracting Office</b>			✓
<b>Program Office</b>			✓
<b>Executive Office</b>		✓	
<b>Financial Management Office</b>			✓

A higher risk exposure judgement implies that the program objectives for a particular function are more vulnerable to not being achieved or to experiencing irregularities. Appendix I describes in detail our risk assessment's scope and methodology.

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**Scope and  
Methodology****Scope**

The Regional Inspector General/San Salvador conducted a risk assessment of major functions within USAID/Ecuador. The risk assessment considered operations principally for fiscal year 2002. The risk assessment was conducted at USAID/Ecuador from June 3 – 7, 2002.

**Methodology**

We interviewed officials as well as reviewed related documentation of major functions performed by USAID/Ecuador. These documents covered background, organization, management, budget, staffing responsibilities, and prior reviews. Our review of mission documentation was isolated and judgmental in nature and was conducted principally to confirm our discussions with management.

We identified USAID/Ecuador's major functions based on input from the Mission Director, discussions with mission staff, and review of mission reports. We judged risk exposure (e.g., the likelihood of significant abuse, illegal acts, and/or misuse of resources, failure to achieve program objectives, and noncompliance with laws, regulations and management policies) for those major functions. We assessed overall risk exposure as high, moderate, or low. A higher risk exposure simply indicates that the particular function is more vulnerable to not achieving its program objectives or to experiencing irregularities. We considered the following key steps in assessing risk exposure:

1. significance and sensitivity;
2. susceptibility (inherent risk) of failure to attain program goals, noncompliance with laws and regulations, inaccurate reporting, or illegal or inappropriate use of assets or resources;
3. "red flags" such as a history of improper administration or material weaknesses identified in prior audits/internal control assessments, poorly defined and documented internal control procedures, or high rate of personnel turnover;
4. management support and the control environment;
5. competence and adequacy of number of personnel;
6. relevant internal controls; and
7. what was already known about internal control effectiveness.

These risk exposure assessments were not sufficient to make definitive determinations of the effectiveness of internal controls for major functions. As part of the scope of our review, we (a) identified, understood, and documented (only as necessary) relevant internal controls and (b) determined what was already known about the effectiveness of internal controls.

Our risk assessment has the following limitations.

- First, we assessed risk exposure at the major function level only.
- Second, we only assessed risk exposure. Our assessments were not sufficient to make definitive determinations of the effectiveness of internal controls for major functions. Consequently, we did not (a) assess the adequacy of internal control design, (b) determine if controls were properly implemented, nor (c) determine if transactions were properly documented.
- Third, higher risk exposure assessments are not definitive indicators that program objectives are not being achieved or that irregularities are occurring. A higher risk exposure simply implies that the particular function is more vulnerable to such events.
- Fourth, risk exposure assessments, in isolation, are not an indicator of management capability due to the fact that the assessments consider both internal and external factors, some being outside the span of control of management.
- Fifth, comparison of risk exposure assessments between organizational units is of limited usefulness due to the fact that the assessments consider both internal and external factors, some being outside the span of control of management.

## Management Comments

2/11/03

Lars Klassen, USAID/Ecuador Director

Risk Assessment of Major Functions Within USAID/Ecuador (Draft Report)

Tim Cox, RIG/San Salvador

Below are the Mission's comments in response to the suggestions stated in the subject draft report:

1. *Document formal cost/benefit analysis of potential development activities.* The Mission appreciates RIG's suggestion that the Mission document formal cost/benefit analysis. If we were to undertake cost/benefit analysis on future projects, it would easily complicate analysis work we perform regarding factors such as sustainability, environmental, political, and technical considerations. For example, under our Northern Border program a range of criteria are already being designed and used which take into account many selection criteria to give an overall picture. One such element is economic feasibility which addresses cost. However, undertaking such a suggestion Mission-wide has other broader implications.

The current Agency Automated Directives System (ADS), upon which Agency design documentation is outlined, specifies that financial analysis is an optional analysis that an operating unit may undertake during the preparation of its strategy. It also includes non-mandatory guidance on the design of activities wherein documentation flexibility is the key. The ten steps in activity design do not require a cost analysis nor is there reference to same. If you believe RIG's suggestion on cost/benefit analysis has broader application to Agency operations, we would recommend that RIG contact PPC/PC in AIDW to discuss whether such a recommendation should change Agency policy. We are sure you can appreciate that we would not want to commit to implementing such a suggestion across the board if it is not required.

2. *Assess whether sub-grantees expending less than \$300,000 per year merit being audited.* The assessment will be done every year when the audit inventory/plan is being prepared.
3. *In planning activities assess the likelihood of funding shortfalls in the implementation design – be proactive rather than reactive.* Our long term future program funding levels are uncertain. We are currently beginning to conceive the length and size of a possible future program over the next year. In this stage, there are a range of interrelated issues that would affect funding scenarios (GDA, trade, conflict prevention, ESF and INC



levels, etc.) and the timing of the new strategy. Parameters for our future program have also yet to be set. Over the coming two years, we will be working with a newly elected GOE, and of course a new Embassy Front Office in securing mutual agreement with AID/W on future overall planning levels for the program. Given all of the foregoing variables and unknowns, then, we trust that you understand our concerns on this recommendation; we are unable to assess what short falls there might be or when they might occur, at this point.

4. *Document field visit strategies.* The Mission will prepare a document where a methodology will be established to document field visit strategies. Also the document will contain a methodology to document the validation of indicators.
5. *Mitigating controls to compensate the lack of segregation of duties.* The Executive and Controllers Offices will evaluate this and will document the mitigating controls that are in place or will be implemented in the future.
6. *Perform a 12-month analysis of vehicle gas mileage on the mission's vehicles to determine if the mileage is reasonable.* EXO will prepare a 12 month trend analysis of vehicle performance and cost.
7. *Contract for a financial audit of the International Organization for Migrations (IOM).* A two year audit (2002-2003) is planned, and is expected to start the second quarter of FY03.
8. *The Executive Office should consider collecting data to measure performance.* The Executive Office will begin to collect data to track performance measures with respect to its operations.
9. *Include detailed recovery steps, a testing strategy and a testing schedule in the information systems contingency plans.* A recovery and contingency plan has been developed. It was tested during a real situation and worked well. The final version of the plan will be ready after the ISSO clearance.

Finally it is important to note that the Mission found this exercise very useful to identify areas of high, medium and low risk. The Mission will take the necessary measures to reinforce or implement new controls in all areas identified as having a "high" risk exposure. Also, the Mission will try to improve all controls related to areas of "moderate" and "low" risk exposure.

cc. Steve Bernstein, RIG/San Salvador  
John Vernon, RIG/San Salvador