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June 10, 1999

MEMORANDUM

TO: Acting Director, USAID/Philippines, Priscilla del Bosque

FROM: RIG/Manila, Paul E. Armstrong

SUBJECT: Audit of USAID/Philippines' Implementation of the Federal Managers' Financial Integrity Act, Report No. 5-492-99-003-P

This is our final report on the subject audit. We reviewed your comments to the draft report and included them in their entirety as Appendix II. The report contains two recommendations (pages 5 and 6). Both recommendations are closed upon issuance of this report.

I appreciate the cooperation and courtesies extended to my staff during the audit.

Background

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) establishes requirements with regard to management accountability and controls. This law encompasses program, operational, and administrative areas as well as accounting and financial management. Under the authority of the FMFIA, the Office of Management and Budget (OMB) issued Circular No. A-123[1] to provide detailed guidance for assigning federal managers the responsibility for designing management structures that helps ensure accountability and include appropriate cost-effective controls.

OMB Circular No. A-123 states that management controls are the organization, policies and procedures used to reasonably ensure that (1) programs achieve their intended results; (2) resources are used consistent with agency mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and (5) reliable and timely information is obtained, maintained, reported and used for decision making. The Circular provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls.

[1] OMB Circular No. A-123 is Management Accountability and Control.

USAID has issued Automated Directives System (ADS) Chapter 596, Management Accountability and Control, which provides the Agency's policy and procedures for establishing, assessing, correcting, and reporting on management controls under FMFIA and OMB Circular No. A-123. Additional guidance for assessing the adequacy of management controls and annual instructions for reporting the status of management controls is periodically provided by USAID's Bureau for Management's Office of Management Planning and Innovation (M/MPI).

Audit Objectives

The Office of the Regional Inspector General, Manila (RIG/Manila), audited USAID/Philippines to answer the following audit objectives:

- **Has USAID/Philippines established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

- **Has USAID/Philippines reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

- **Has USAID/Philippines taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

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

Audit Findings

Has USAID/Philippines established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/Philippines has established management controls and periodically assessed these controls to identify deficiencies in accordance with the FMFIA and related regulations and guidance.

As stated above, FMFIA and OMB Circular No. A-123 provides guidance for use by agencies and managers to, among other things, establish management controls and to periodically assess the adequacy of those controls. Further, ADS Chapter 596, "Management Accountability and Control" instructs missions and cognizant managers to: (1) appoint a Management Control Official (MCO) to oversee and coordinate management accountability and control issues within the mission; (2) ensure that appropriate and cost-effective management controls are established; (3) continuously perform management control assessments in accordance with instructions issued by USAID's Bureau for Management's Office of Management Planning and Innovation (M/MPI); and (4) establish a Management Control Review Committee (MCRC) to assess and monitor deficiencies in management controls.

Moreover, M/MPI provides annual guidance to missions for conducting FMFIA reviews. In conducting reviews, missions are instructed to use existing sources of information to supplement management's judgment in assessing the adequacy of management controls, including:

1) management knowledge gained from daily operation of Agency programs and systems;

2) management reviews;

3) Office of Inspector General and General Accounting Office reports; and

4) program evaluations.

Missions are also instructed to review the Agency's ADS in determining mission compliance with Agency policies and essential procedures. M/MPI provides a Management Control Checklist to assist in conducting the reviews. The Fiscal Year 1998 Checklist contained 163 control techniques extracted from the ADS.

In implementing the ADS, USAID/Philippines had appointed the Controller as the MCO to oversee and coordinate management accountability and control issues within the Mission. The Mission had also established a MCRC—comprised of Office Managers and headed by the Deputy Mission Director—to provide oversight of its management control process.

According to Mission officials, the Mission primarily follows the policies and procedures as stated in USAID's ADS. When deemed necessary, the Mission issues Mission Orders, General Notices and memos to complement or further clarify the ADS and to establish any needed policies and procedures. For example, Mission Orders were issued to delineate authority and responsibility within the Mission. In other cases, USAID/Philippines' Office of Financial Management (OFM) has written procedures to control processes such as the Section 1311 Review and trust fund clearance.

USAID/Philippines took an organized and thorough approach in completing the Fiscal Year 1998 FMFIA Assessment. As the lead office, OFM prepared a timetable for conducting the review listing milestones and deadlines. The USAID/Philippines' Controller formally transmitted the M/MPI checklist containing the 163 control techniques along with instructions to cognizant offices within the Mission. The following table highlights the areas addressed by these control techniques.

CONTROL TECHNIQUES	
CATEGORY	NUMBER
Program Assistance	37
Organization Management	7
Administrative Management	40
Financial Management	44
Acquisition and Assistance	27
Audit Management Resolution Program	5
Other	3
TOTAL	163

Upon receipt of the checklist, each office or strategic objective team determined whether the controls in their assigned areas were satisfactory and noted any deficiencies. The office/team then summarized their evaluation on a control technique worksheet, which was submitted to OFM. After receiving this evaluation, the cognizant OFM financial analyst reviewed and validated both the ratings of controls and the conclusions reached. These conclusions were subsequently reviewed by the Mission's MCRC, which determined what actions should be taken on deficiencies and whether any deficiencies should be considered material weaknesses which must be reported to the Assistant Administrator for Asia and Near East Bureau (AA/ANE).

In addition to the annual FMFIA review, we determined that the Mission routinely assessed its controls. For example, the Mission's Executive Office (EXO) was concerned over the adequacy of controls within the Motor Pool and asked OFM to conduct a review. OFM performed the review and, as a result, the EXO instituted a time-clock system for Motor Pool personnel.

Risk Assessments Would Further
Strengthen the Mission's FMFIA Process

USAID/Philippines has established the management controls outlined in the ADS and, in some cases, has supplemented those controls. However, we believe the Mission could further strengthen the efficiency of its review of those controls, by performing a formal and systematic risk assessment of its operations and programs.

> **Recommendation No. 1: We recommend that USAID/Philippines determine whether a formal and systematic risk assessment would strengthen the efficiency of its FMFIA process.**

Every Federal agency faces risks that could threaten the achievement of its objectives and USAID is no exception. USAID as a whole, its field missions and even offices within those missions face a variety of risks from both external and internal sources. Risk assessment is the identification and analysis of possible risks to meeting objectives and forming a basis for how those risks should be managed or controlled. Primarily, risk assessment consists of managers asking themselves what positive outcomes need to occur and what negative outcomes need to be prevented in order for their operation/program to succeed. The manager would then:

1) identify conditions that might inhibit positive outcomes and conditions that might foster negative outcomes (identifying risks);

2) determine the probability and impact of those risks (determining the level of risk - generally high, medium or low); and

3) based on the level of risk, set in place appropriate management controls to mitigate those risks.

For example, inaccurate information in progress reports can lead to erroneous decisions. Accordingly, inaccurate reporting from USAID contractors and grantees would be a risk—one that could have significant ramifications (a high risk). A manager might mitigate that risk by verifying reported information during periodic site visits.

The benefits of risk assessment are two-fold. First, by conducting risk assessments, Mission managers can ensure that they have established management controls that are appropriate to their unique situation (ADS Section E596.5.1a requires that cognizant managers establish appropriate controls). Second, by identifying the level of risk in operations and programs, senior Mission management can focus more resources on high risk areas and less resources on low risk areas, thereby increasing its efficiency and effectiveness.[2]

During our audit, we found that certain mission managers were already conducting "intuitive" risk assessments. When a vulnerability came to their attention, they would set in place an appropriate control. We believe that the Mission as a whole could benefit from conducting a formal and systematic risk assessment and using that assessment as a component of their FMFIA review—a change which ultimately would make the review more effective and efficient.

Has USAID/Philippines reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/Philippines did not identify any material weaknesses to report in accordance with the FMFIA and related regulations and guidance. However, the Mission's reporting could have been improved by disclosing major concerns that were unresolved at the time of the submission of its FMFIA certification. We believe that USAID/Philippines could add value to its future FMFIA certifications by not only reporting on material weaknesses but also disclosing major concerns that are unresolved at the time its certification is made.

Recommendation No. 2: We recommend that USAID/Philippines disclose all unresolved major concerns in its future FMFIA certifications.

OMB Circular No. A-123 requires that a deficiency should be reported if it is or should be of interest to the next level of management. This allows the chain of command

[2] The U.S. General Accounting Office (GAO) recognizes the benefits of risk assessment and states that Management should be comprehensive in its identification of risks at both the entity-wide and activity level. (GAO's December 1997 proposed revision of the Standards for Internal Control in the Federal Government).

structure to determine the relative importance of each deficiency. Along these lines, USAID's ADS Chapter 596 and M/MPI's Fiscal Year 1998 FMFIA Instructions require that missions provide a FMFIA certification to the cognizant Assistant Administrator,[3] with a copy to M/MPI, on the overall adequacy and effectiveness of management controls. This certification should identify deficiencies determined to be material weaknesses,[4] including those that are not correctable within the mission's authority and resources. Additionally, we recognize that Missions may have issues of major concern[5] that cannot be definitively categorized as material weaknesses at the time of their FMFIA certification. We believe that disclosing such issues in their FMFIA certifications would add value to the FMFIA process by alerting the next level of management about potential problems.

In complying with M/MPI's guidance, USAID/Philippines submitted a Fiscal Year 1998 FMFIA certification to the AA/ANE that did not identify any material weaknesses. The Mission did not report the following two unresolved major concerns that, in our opinion, were or should have been of interest to the AA/ANE and could have made its certification more informative.

- The Year 2000 (Y2K) problem and
- Physical Security at USAID/Philippines.

Concerning the Y2K problem, an audit[6] conducted by RIG/Manila in 1998 concluded that USAID/Philippines-funded critical systems—such as air navigational systems provided to 13 provincial airports and a National Human Immunodeficiency Virus Surveillance system—were at risk of failure and, thus, USAID/Philippines' development assistance accomplishments could be affected by the Y2K problem. The audit recommended that the Mission establish a Y2K Working Group and develop an action plan in cooperation

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[3] For USAID/Philippines, the cognizant Assistant Administrator is the AA/ANE.

[4] A material weakness would (1) significantly impair the organization's ability to achieve its objectives; (2) result in the use of resources in a way that is inconsistent with Agency mission; (3) violate statutory or regulatory requirements; (4) result in a significant lack of safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; (5) impair the ability to obtain, maintain, report and use reliable timely information for decision making; or (6) permit improper ethical conduct or a conflict of interest.

[5] We define a major concern as a issue which has a high probability of (1) significantly impairing the organization's ability to achieve its objectives; (2) resulting in the use of resources in a way that is inconsistent with Agency mission; (3) violating statutory or regulatory requirements; (4) resulting in a significant lack of safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; (5) impairing the ability to obtain, maintain, report and use reliable timely information for decision making; or (6) permitting improper ethical conduct or a conflict of interest.

[6] Audit of USAID/Philippines' Program-Funded Year 2000 Sensitive Activities, Audit Report No. 5-492-99-001-P, dated November 30, 1998.

implementing this recommendation. Therefore, based on the Mission's plan to conduct risk assessments, Recommendation No. 1 is closed upon issuance of this report.

Recommendation No. 2 calls for the Mission to disclose all unresolved major concerns in future FMFIA certifications. USAID/Philippines management agreed to disclose such concerns in the future and, again, presented a systematic plan on their approach to implementing the recommendation. Based on the Mission's plan to disclose unresolved major concerns in future FMFIA certifications, Recommendation No. 2 is closed upon issuance of this report.

SCOPE AND METHODOLOGY

We audited USAID/Philippines' implementation of the Federal Managers' Financial Integrity Act (FMFIA). The audit was performed in accordance with generally accepted government auditing standards and was conducted from February 25 through April 30, 1999, at USAID/Philippines.

We audited the Mission's Fiscal Year 1998 FMFIA assessment and deficiencies noted under its Fiscal Year 1997 assessment. The audit was not designed to identify all the material weaknesses not reported by the Mission; however, if any previously unreported weaknesses came to our attention during the audit, we included these in our audit report. Also, the scope of this audit did not include a detailed analysis of individual management controls to determine their effectiveness.

The audit work included reviewing the Mission's system for establishing, assessing, reporting and correcting management controls. To accomplish the audit objectives, we used the FMFIA, Office of Management and Budget Circular No. A-123, General Accounting Office's (GAO) "Standards for Internal Control in the Federal Government," USAID's Automated Directives System (ADS) Chapter 596 on Management Accountability and Control, other ADS Chapters relating to Agency policies and essential procedures, and guidance for assessing the adequacy of management controls and annual instructions for reporting the status of management controls provided to missions by USAID.

We developed and used a questionnaire when interviewing the Mission's Management Control Official, members of the Mission's Management Control Review Committee and operating unit managers. We also reviewed available documentation on the Fiscal Year 1998 FMFIA review, including the listing of management control deficiencies and management action plans for correcting those deficiencies. We reviewed the Mission's Fiscal Year 1998 FMFIA certification to the AA/ANE on the overall adequacy and effectiveness of management controls, noted any material weaknesses identified, and reviewed the status of any material weaknesses or deficiencies identified in the Fiscal Year 1997 review.

Finally, we reviewed recent Office of Inspector General and GAO audit reports performed at USAID/Philippines to identify potential material weaknesses.

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MAY 2 5 1999

MEMORANDUM

RECEIVED
25 MAY 1999
RIG/MANILA

TO : Mr. Paul Armstrong
RIG/Manila

FROM : Patricia K. Buckles
Mission Director
USAID/Philippines

SUBJECT : Draft Report on the Audit of USAID/Philippines' Implementation of the Federal Managers' Financial Integrity Act (FMFIA), Report No. 5-492-99-00x-P

USAID/Philippines appreciates RIG/Manila's efforts and cooperation in completing the subject audit, and for acknowledging not only the Mission's organized and thorough approach in completing the FY 1998 FMFIA Assessment, but also the Mission's timely and effective implementation of actions necessary to correct the management control deficiencies identified in our FMFIA Reviews.

In general, we find the two recommendations cited in the subject report supportive of the Mission's efforts toward more efficient and effective utilization of limited resources while ensuring appropriate internal controls. Our specific comments and actions taken to close these recommendations are as follows:

Recommendation No. 1: We recommend that USAID/Philippines determine whether a formal and systematic risk assessment would strengthen the efficiency of its FMFIA process.

Comments and Actions Taken:

The Mission has determined that a formal and systematic risk assessment would strengthen the efficiency of its FMFIA process. However, given the Mission's limited resources and the significant workload requirements for this assessment, it will probably take the Mission at least two years to

fully implement it. Our plan, therefore, is to conduct the risk assessment--initially, to cover the 163 management control techniques contained in the M/MPI checklist; and subsequently, to include those management controls that are outside of the M/MPI checklist. From this assessment, a ranking of risks as high, medium, low, or in some cases, not applicable or not significant, will be made, upon which a Management Control Plan (MCP), outlining what risks need to be reviewed, how often and what type of review is to be applied, will be developed, implemented and periodically updated as appropriate.

The MCP will ensure a more efficient and effective utilization of our limited resources since the focus and frequency of the review will now depend on the degree of risks assigned to each of the management control techniques, as opposed to doing a comprehensive testing of all these techniques everytime the annual FMFIA Reviews are conducted. To support the implementation of this plan, a risk assessment training will be provided to the Mission staff. As discussed during the exit conference, we appreciate RIG's willingness to assist the Mission with this training, given its expertise in this area.

Based on the above Mission actions, we request that this recommendation be closed upon issuance of the final audit report.

Recommendation No. 2: We recommend that USAID/Philippines disclose all unresolved major concerns in its future FMFIA certifications.

Comments and Actions Taken:

USAID/Philippines agrees to disclose all unresolved major concerns in its future FMFIA certifications. To implement this recommendation, the Mission's Management Control Review Committee will review each major concern to determine whether each has a potential for being a material weakness. This determination will be based upon the 5 ADS criteria for identifying a material weakness. If a major concern has the potential for being a material weakness, this will then be documented and included in the Mission's FMFIA certification for reporting to the next level of management, which is the Assistant Administrator for the Asia and Near East Bureau.

Based on the above Mission actions, we request that this recommendation be closed upon issuance of the final report.

cc: KSchooler/M/MPI, USAID/W
JGaughran/M/MPI, USAID/W
MLewellen/ANE.ORA, USAID/W