USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

Assistant Inspector General for Audit

MAR 1 1999

MEMORANDUM FOR M/CFO, Michael Smokovich

FROM: A-AIG/A, Paul E. Armstrong

SUBJECT: Reports on USAID's Financial Statements, Internal Controls and Compliance for Fiscal Year 1998, Audit Report No. 0-000-99-001-F

Under the Government Management and Reform Act of 1994, the U.S. Agency for International Development (USAID) is required to prepare consolidated fiscal year end financial statements. The financial statements are required to be audited and submitted to the Office of Management and Budget and the Department of the Treasury by March 1 following fiscal year end. The Office of Inspector General is transmitting its reports on the Agency's fiscal year 1998 consolidated financial statements, internal controls and compliance. The Agency's overview, principal statements and related notes, and supplemental information required under the Act have been included as Appendix I to our reports.

We do not express an opinion on USAID's financial statements because USAID's financial management systems could not produce complete, reliable, timely, and consistent financial information. With respect to USAID's internal controls, USAID's financial management and performance measurement systems could not generate the financial information needed to (1) bring about more effective financial management practices, (2) improve information quality needed in decision-making, and (3) provide assurances that USAID has a low level of risk of fraud, waste, and abuse. Concerning USAID's compliance, we noted several material instances of noncompliance with United States government laws and regulations.

We received and considered the comments provided to the draft report by the Chief Financial Officer. This report contains one recommendation to improve USAID's ability to implement the requirements of the Chief Financial Officers' Act. Based on comments to the draft report, we have accepted the management decision for recommendation implementation. Please forward to me all information on your request to the Office of

Management Planning and Innovation for acceptance of the final management actions related to the recommendations.

I would like to express my sincere appreciation for the courtesies extended by your staffs to the auditors over the past year. The collaborative approach used by our staffs this year, together with the systems improvements you indicate have been made, may ensure a successful audit next year. The Office of Inspector General is looking forward to working with you on the audit of the Fiscal Year 1999 financial statements.

Attachment: a/s

Distribution:

Bureau for Legislative and Public Affairs (LPA)	1
Bureau for Management	1
Bureau for Policy and Program Coordination	1
Bureau for Management, Audit Liaison	1
Bureau for Policy and Program Coordination, Audit Liaison	1
Office of the General Counsel (GC)	1
Office of Management Planning & Innovation (M/MPI)	1
Director, M/FM	3
Director, PPC/CDIE	3
Press Relations Division (LPA/PA/PR)	1
Development Experience Information Division (PPC/CDIE/DI)	1
Office of Legal Counsel and Management, IG/LCM (1 unbound)	12
Deputy Assistant Inspector General for Audit, DAIG/A	2
Other OIG Headquarters and Field Audit Offices	1 each

REPORTS ON USAID'S FINANCIAL STATEMENTS, INTERNAL CONTROLS, AND COMPLIANCE FOR FISCAL YEAR 1998

Report No. 0-000-99-001-F
March 1, 1999

Financial Audit

managers, and other statement users should exercise caution when reading the statements. They should exercise similar caution when relying on financial and performance information derived from USAID's systems because the information may not be reliable. Further, because USAID managers receive less than reliable financial and performance information, there are increased risks that program managers and others cannot measure program performance or the costs for programs, resources might not be adequately safeguarded, reliable financial data might not be reported, and activities might not comply with laws and regulations. We have provided more information regarding these system deficiencies below. Detailed information concerning reportable conditions with the financial statements and other issues developed during this audit can be found in a report[1] to USAID managers on internal controls. The report details the issues mentioned in this report.

Poorly Functioning Systems Cause Unreliable Information

USAID's core financial system, performance measurement system, managerial cost accounting system, and budget system have widespread deficiencies. These systems do not meet federal standards that establish minimum requirements needed to perform effectively. These system deficiencies required USAID to process massive data changes outside normal processes and controls. Further, pervasive computer security deficiencies significantly increase risks that data and assets might not be protected from theft, misuse, alteration or destruction. USAID disclosed many of the systems' deficiencies as material internal control weaknesses in its fiscal year 1998 report to the President under the Federal Managers' Financial Integrity Act (FMFIA). USAID also properly reported deficiencies in these systems to Office of Management and Budget and developed a plan to integrate its financial management systems as required by the Federal Financial Management Improvement Act (FFMIA). (see Pages 7 through 13)

As a result, USAID's systems generate unreliable information and reduce management's effectiveness. These systems' deficiencies have resulted in unreliable or incomplete reports to external parties, including OMB, Congress, and the public. To illustrate, in October 1998, USAID posted unsupported net adjustments of $60 million ($590 million in absolute dollar value) to its general ledger to avoid submitting materially inconsistent financial information to OMB and to the U.S. Treasury on USAID's year end expenditures. Furthermore, USAID's Overview on performance does not accurately report on the results of USAID's performance—instead it reports on the overall accomplishments of the host country and entire donor and recipient community. In addition, USAID's Congressional Presentation, which justifies its budget request, reported incomplete and inaccurate data on host country and other donor financial support of USAID programs and activities. (see Pages 13 through 15)

[1] Audit Report to USAID Managers on USAID Internal Controls for Fiscal Year 1998 (Audit Report Number 0-000-99-002-F which is scheduled for release in March 1999).

EXECUTIVE SUMMARY

The Government Management and Reform Act of 1994 requires U.S. Agency for International Development (USAID) to prepare consolidated financial statements and have them audited for inclusion in the government-wide financial statements. This law and applicable auditing standards require the Office of Inspector General to:

1) express an opinion on the financial statements including performance overview information,

2) report related internal control weaknesses, and

3) report noncompliance with applicable laws and regulations.

Auditor's Opinion on USAID's Fiscal Year 1998 Financial Statements

We could not express an opinion on the consolidated financial statements for the fiscal year ending September 30, 1998, because our audit scope was impaired. This impairment resulted from poorly functioning accounting and financial management systems from which USAID was unable to produce complete, reliable, timely, and consistent financial statements. The amount of substantive testing that would have been required to express an opinion on the presentation of USAID's financial statements would have been prohibitive and unattainable by March 1, 1999—the statutory deadline for submitting the audited financial statements to the Office of Management and Budget (OMB). The deficiencies in USAID's systems create a consequential risk that the financial statements, including the performance overview information, could contain material misstatements. Accordingly, we have not made an opinion on the fairness of the financial statements. (see Pages 3 and 4)

Report on Internal Control Weaknesses

USAID's poorly functioning accounting and financial management systems prevented USAID from generating complete, reliable, timely, and consistent financial and performance information. Because the statements lack such information, policy makers, oversight officials, Unreliable performance information also affects managers' ability to compare actual program results against anticipated results and use such information to make informed decisions, including budget-allocation decisions. For example, reported performance results are not attributed to USAID activities and are not sufficiently supported, objectively verifiable, accurate, and/or validated. (see Pages 15 through 19)

Organization Deficiencies Need Attention

USAID executives have committed to correct management deficiencies and have taken steps to do so. However, fragmented and unclear organizational responsibilities continue to hinder their efforts to correct the deficiencies. In particular, because USAID has not delegated to the Chief Financial Officer (CFO) the responsibility and authority to develop and maintain an integrated financial management system as required by the CFO Act, USAID may repeat costly mistakes by deploying a new system that does not meet federal requirements and does not operate effectively. (see Pages 19 through 25)

USAID's Computers Are Not Year 2000 Compliant

USAID is vulnerable to major disruptions to its programs and operations if it does not adequately complete modifications to its computer systems to allow them to process information in the year 2000. To the extent that developing countries receiving USAID assistance encounter disruptions, USAID's program accomplishments could be at risk. As of the end of fiscal year 1998, USAID had not fully assessed its systems or systems provided to host countries. USAID also lacked detailed schedules and resource estimates and did not expect to meet the government-wide target dates for implementing compliant systems. In addition, USAID has not completed and tested contingency plans to ensure continuity of service in the event of Year 2000-caused disruptions. Due to the scope and complexity of the needed changes and the limited time remaining to correct problems, USAID faces a high risk that business operations and programs. will be disrupted at the start of the new millennium. (see Pages 38 and 39)

Report on Noncompliance with Laws and Regulations

USAID did not comply with provisions of some applicable laws and regulations effecting the financial statements. Consequently, USAID has no assurance that all transactions were executed in accordance with:

1) laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the Principal Statements or Required Supplementary Information, and

2) any other laws, regulations and government-wide policies identified by OMB in Appendix C of its Bulletin **98-08.**

We have provided examples of noncompliance with the specific laws and regulations in the reports attached. (see Pages 27 through 39)

Recommendation No. 1 Because the Chief Financial Officer lacks the authority called for in the CFO Act, we recommend that the Chief Financial Officer collaborate with the Assistant Administrator for Management, Chief Information Officer, and Bureau For Policy and Program Coordination to:

1.1 Determine the specific responsibility, authority, and resources needed to meet the requirements of the Chief Financial Officers Act of 1990, which assigns the Chief Financial Officer responsibility to (1) develop and maintain an integrated accounting and financial management system that meets federal financial system requirements, federal accounting standards, and the U.S. Standard General Ledger at the transaction level; (2) approve and manage financial management system design and enhancement projects; and (3) develop a financial management system that provides for systematic measurement of performance.

1.2 Request by June 30, 1999, that the Administrator approve specific delegations of authority and resources to the Chief Financial Officer. to carry out those Chief Financial Officers Act responsibilities identified in Recommendation 1.1 above.

1.3 Implement policies and procedures to carry out the specific delegations assigned by the Administrator in Recommendation 1.2, above.

Detailed information concerning the financial statements and other issues developed during this audit can be found in a report[2] to USAID managers.

[2] Audit Report to USAID Managers on USAID Internal Controls for Fiscal Year 1998 (Audit Report Number 0-000-99-002-F which is scheduled for release in March 1999).

Table of Contents

Table of Contents

INTRODUCTION

Background

The United States Agency for International Development (USAID) was created in 1961 to advance the United States' foreign policy interests by promoting broad-based sustainable development and providing humanitarian assistance. USAID has an overseas presence in 60 countries, 42 of which have fully operational and formal USAID missions. In fiscal year 1998, USAID had total obligation authority of $6.3 billion, supported by $500 million in operating expenses.[3]

Under the Government Management Reform Act of 1994, USAID is required to submit audited financial statements to the Office of Management and Budget (OMB) and appropriate Congressional Committees. Pursuant. to this Act, USAID has prepared the principal statements: (1) balance sheet, (2) statement of net costs, (3) statement of changes in net. position, (4) statement of budgetary resources, (5) statement of financing, (6) notes to the principal statements, and (7) other accompanying information for the fiscal year 1998 (see Appendix I). Appendix I also includes an overview and supplemental information section, prepared by USAID management, which provides details on USAID's goals, objectives and accomplishments.

Objectives

The Office of Management and Budget's Bulletin No. 98-08 and related guidance establish the minimum audit requirements for federal financial statements. For fiscal year 1998, this Bulletin required us to:

- determine whether USAID's principal financial statements present fairly in all material respects, in conformity with federal accounting standards, the (1)

[3] Per the accompanying "US AID Financial Report Overview."

assets, (2) liabilities and net position: (3) net costs; (4) change in net position; (5) budgetary resources; (6) reconciliation of net costs and budgetary obligations; and if applicable (7) custodial activity in accordance with Office of Management and Budget Bulletins;

- report on USAID's internal control structure related to these financial statements, as well as, to the internal control structure related to the 'performance measures contained in the "USAID's Management Discussions and Analysis" section; and

- report on USAID's compliance with laws and regulations that could have a direct and material effect on the principal statements, and any other applicable laws and regulations.

We were not able to fully implement these objectives because the scope of our work was impaired_ Therefore, our report on the financial statements disclaims an opinion on whether they are presented fairly. This scope impairment resulted from USAID's poorly functioning accounting and financial management systems. This scope impairment prevented us from obtaining sufficient evidential matter. This scope impairment also precluded USAID from preparing complete, reliable, timely and consistent financial information.

The third objective above included' .determining whether US AID's financial management systems comply substantially with federal requirements for financial management systems, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level, as required by Section 803(a) of the Federal Financial Management Improvement Act (FFMIA) of 1996. The scope of our work included those financial management systems that were operational in USAID during fiscal year 1998. To make this determination, we followed the implementation guidance for FFMIA issued by the OMB on September 9, 1997. We reviewed financial management audit reports issued during fiscal year 1993, as well as USAID documents describing financial management system capabilities and deficiencies.

In accordance with the OMB audit requirements for federal financial statements, this combined audit report includes our separate reports on USAID's financial statements, internal control structure, and compliance with applicable laws and regulations.

REPORT ON USAID'S CONSOLIDATED FINANCIAL STATEMENTS

The Government Management and Reform Act of 1994 requires USAID to prepare consolidated financial statements and have them audited for inclusion in the government-wide financial statements. USAID is responsible for the preparation of its statements. This law and applicable auditing standards require, among other things, the Office of Inspector General to express an opinion on the financial statements including performance overview information. An auditor can issue a report on the fmancial statements that provides one of three types of opinions or a conclusion that an opinion cannot be rendered. The three opinions are:

- Unqualified-issued when the auditor believes that the financial statements are presented fairly in all material aspects.
- Qualified-issued when the auditor believes that the financial statements are fairly presented except for a material departure or exception that is explained in the report.
- Adverse-issued when the financial statements are not fairly presented. This also requires that the auditor reveal the reasons for the opinion and the principal effect on the financial statements.

Instead of issuing one of the three above opinions, the auditor may choose not to give an opinion because an audit of sufficient scope could not be conducted due to limitations or condition of the financial records.

We could not express an opinion on USAID's fmancial statements for the fiscal year ended September 30, 1998, because our audit scope was impaired. This impairment resulted from poorly functioning accounting and financial management systems which caused USAID's inability to produce complete, reliable, timely, and consistent financial statements. The amount of substantive testing that would have been required to express an opinion on the presentation of the fmancial statements would have been prohibitive and unattainable by the statutory deadline of March 1, 1999, for submitting the fmancial statements to the Office of Management and Budget. The deficiencies in USAID's accounting and financial management systems create a consequential risk that the financial statements, including the performance overview information, could contain material misstatements. Accordingly, we have not made an opinion on the fairness of the financial statements which were prepared in accordance with the accounting standards and principles as specified by the Office of Management and Budget in its Bulletin 97-01.

The following Report on Internal Control discusses two significant problems--failure to meet minimum federal system standards and computer security deficiencies-with USAID's accounting and financial management systems that impaired the scope of our work.

Office of Inspector General
March 1, 1998

REPORT ON USAID'S INTERNAL CONTROLS

We attempted to audit the accompanying financial statements of USAID as of September 30, 1998. However, our report on these statements disclaims an opinion on whether they are presented fairly because the scope of our work was impaired.

In planning and performing our work to report on these financial statements, we obtained an understanding of the internal control structure. In this regard, we:

- reviewed the design of relevant policies and procedures!
- determined whether they have been placed in operation, and
- assessed control risk.

We gained this understanding of the internal controls to determine our auditing procedures for reporting on the financial statements, not to express an opinion on the internal control structure. Accordingly, we do not express an opinion on this structure.

Nevertheless, we noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions." This report identifies these conditions and provides recommendations for correcting them.

Background on Internal Controls

Under the Accounting and Auditing Act of 1950, the Federal Managers' Financial Integrity Act (FMFIA) of 1982 and implementing policies established by the OMB, USAID's management is responsible for establishing and maintaining effective systems of internal control. To fulfill this 'responsibility, management must make estimates and judgments to

[4] We noted other matters involving the internal control structure and its operation that we will report to the management of USAID in a separate letter.

assess the expected benefits and related costs of internal control policies and procedures. The General Accounting Office has issued Standards for Internal Controls in the Federal Government that executive agencies must follow in establishing and maintaining an effective internal control structure as required by the laws and executive branch policies.

The objectives of an internal control structure, according to the OMB's Bulletin No. 98-08 and 99-08, are to provide management with reasonable—but not absolute-assurance with:

- reliability of financial reporting- transactions are properly recorded, processed, and summarized to permit the preparation of the Principal Statements in accordance with the federal accounting standards, and the safeguarding of assets against loss from authorized acquisition, use, or disposition;

- compliance with applicable laws and regulations-transactions are executed in accordance with: (a) laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the Principal Statements, and (b) any other laws, regulations and government-wide policies identified by OMB in Appendix C of Bulletin 98-08; and

- reliability of performance reporting- transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

Because of inherent limitations in any internal control structure, errors or irregularities may still occur and not be detected. Also, predicting whether the internal controls will be effective in the future is risky because changes in conditions may require additional controls or because the effectiveness of the design and operation of policies and procedures may deteriorate.

Scope of Our Consider&ion of USAID's Internal Controls

We obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation to meet the objectives of an internal control structure noted above. We also assessed control risk

We do not express an opinion on the internal control structure because the purpose of our work was to determine our auditing procedures for reporting. on the financial statements, not to express an opinion on this structure. We assessed control risk and performed limited tests of the internal control structure. In assessing risks, we considered reports that USAID management had issued under the FMFIA and our prior and current audit efforts on financial and internal control matters.

We also do not express an opinion on the performance measures identified in the "Overview of USAID" section of the accompanying financial statements. The expression of such an opinion was also not the purpose of our work. Although the OMB requires certain limited work on this performance information, scope impairments prevented us from determining whether USAID staff recorded proper support for the performance measures to account for and to permit the preparation of reliable and complete reports on program performance.

Even though our work was impaired as discussed above, we noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and the OMB's Bulletin No. 98-08 and 99-08. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control. structure that, in our judgment, could adversely affect USAID management's ability to have reasonable assurance that the control objectives noted above are met.

Some of the reportable conditions are also material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties. Our work would not necessarily disclose all material weaknesses in the internal control structure.

The following section presents our findings and recommendations for those matters that we consider to be reportable conditions and material weaknesses.

Poorly Functioning Systems and Other Internal Control Deficiencies Reduce Information Reliability

USAID's financial management systems, including accounting, performance measurement, managerial cost accounting. and budget systems, have widespread deficiencies. The most significant deficiencies are failure to meet minimum federal system standards and inadequate computer security deficiencies. These deficiencies represent a material internal control weakness because they prevent USAID from generating complete, reliable, timely, and consistent financial and performance information. Other previously reported internal control deficiencies are described in Appendix IV.

USAID reported most of these material weaknesses in its fiscal year 1997 FMFIA Report and has decided to report these material weaknesses in the fiscal year 1998 Accountability Report, which will be issued on or before April 30, 1999. USAID also properly reported the systems' deficiencies to OMB.

Systems Do Not Meet Minimum Standards

USAID's accounting and fmancial'management systems do not meet federal standards that establish minimum requirements for such systems. In particular, the New Management System (NMS) and USAID's legacy systems do not comply with federal financial management systems requirements, applicable federal accounting standards, and the requirement that the U.S. Government Standard General Ledger be used at the transaction level.'

In recent years, the Office of Inspector General (OIG) issued several report? identifying technical and operational problems that prevented the NMS and legacy financial management systems from operating effectively. These reports, as well as USAID's own management assessments, disclosed many financial and management problems caused by ineffective systems. For example, USAID's reliance on multiple non-integrated systems have created several barriers to producing auditable annual financial statements. Because USAID lacks an integrated financial management system, it:

- manually prepares its financial statements using a labor intensive process;
- manually enters similar data into multiple systems, increasing the risk of errors;
- relies on a general ledger that does not include all financial activity; and
- cannot query all financial statements information at the transaction level.

This situation increases the risk that poor policy decisions will be made, less than reliable information will be provided to managers and oversight officials, and scarce resources will be directed at collecting information rather than delivering development assistance services.

---

[5] Because NMS has not operated effectively, USAID relied on a combination of older legacy systems, informal records maintained by individual managers or organizational units, and the new system. As a result, the USAID financial management system consists of non-compliant legacy systems, informal records, and the New Management System.

[6] Audit of the Worldwide Deployment of the New Management System (Audit Report No. A-000-97-004-P, March 31, 1997); Audit of USAID's Efforts to Resolve the Year 2000 Problem (Audit Report No. A-000-97-005-P, July 11, 1997); Audit of USAID's Compliance with Federal Computer Security Requirements (Audit Report No. A-000-97-008-P, September 30.1997); Audit of the Internal Controls for the Operational New Manarement Svstem (Audit Report No. A-000-97-009-P, September 30, 1997); Audit of the Status of USAID's New Management Svstem (Audit Report No. A-000-97-010-P, September 30, 1997); Audit of the New Manarement Svstem Status (Audit Report No. A-000-98-004-P, March 31, 1998); Audit of the Extent to Which US AID's Financial Management Svstem Meets Requirements Identified in the Federal Financial Manarement Improvement Act of 1996 (Audit Report No. A-000-98-003-P, March 2, 1998); and Audit of the Process USAID Used to Prepare its Financial Statements From the General Ledger (Audit Report No. A-000-98-001-F, September 25, 1998).

Other deficiencies also limit USAID management's ability to obtain reliable information. For example, during fiscal year 1998, USAID's financial management systems could not:

- generate reliable financial reports, including required reports to the U.S. Treasury;
- reliably balance subsidiary ledgers to the general ledger;
- integrate planning, budgeting, and accounting functions using a consistent accounting classification structure;
- match Letter of Credit disbursements with obligating documents; and
- provide adequate program performance measurement information.

Computer Security Deficiencies Create Risk Of Data and Asset Loss

Pervasive computer security deficiencies expose USAID to unacceptable risks that resources and data will not be adequately protected from loss, theft, alteration, or destruction. Deficiencies include inadequate general computer security controls over USAID's mainframe legacy systems, the NMS, and mission accounting systems. General computer security controls are a subset of internal controls that include the policies and procedures to ensure that computer processing facilities are protected from the loss, compromise, theft, or destruction of data, assets, and computer resources. Current deficiencies include:

- lack of security programs and plans that guide security efforts;
- weak access controls that allow unauthorized users to access and modify sensitive information;
- weak software development and -maintenance controls that might not prevent implementation of unauthorized programs or modification of existing programs;
- breakdowns in separation of duty requirements that prevent a single individual from initiating, authorizing, and completing a single transaction;
- deficient controls over systems software intended to limit access to computer programs and files; and
- inadequate plans to ensure continuity of services in the event that disasters or other events prevent normal business operations.

We found that NMS access controls were ineffective. The identified weaknesses could allow unauthorized users to inappropriately access or modify NMS data and software without detection. These vulnerabilities resulted from failure to implement available operating system control features and inadequate security practices. We issued a report[7] that disclosed that USAID had not (1) prohibited the use of shared user identifications, (2) implemented adequate monitoring capability, and (3) limited the number of users who have unlimited system access. A more recent report[8] cited deficiencies in all six general control categories.

NMS Design Deficiencies Required Massive Data Changes Outside of Controls

Financial events, such as the commitment, obligation, and disbursement of funds, are recorded in accounting systems as individual transactions. Besides entering transactions to record financial events, authorized users need the ability to enter-and change- non-value information, such as completion dates. A well-designed system will allow authorized users (accountants, contracting officers, and budget analysts) to make necessary entries and ensure that adequate and effective controls and checks are in place to prevent unauthorized entries. An important control is a system's ability to trace all changes to individual users.

Because NMS was prematurely deployed, there have been many problems. These included many erroneous transactions that were created by system software and needed to be corrected. However, authorized users found that they could not execute the transactions needed to correct these or other errors or to complete other tasks. For example, accountants found they could not enter transactions to reverse incorrect entries and reenter the correct entries. When the system would not perform as desired, users requested data administrators from the Office of Information Resource Management to develop "back door" processes to enter the transactions needed to effect the changes. The data administrators had special user privileges that were not available to most NMS users and allowed them to bypass most controls to modify data directly. Existing procedures required that authorized users submit their requests as Data Quality Management Requests (DQMRs), which were approved by a senior USAID manager. Although a certain number of "backdoor" solutions will be required by any complex accounting system, more than 1,472 DQMRs were submitted to the Office of Information Resource Management during fiscal years 1997 and. 1998. We believe that this number is unacceptably high and reflects an environment in which emergencies and nonstandard procedures are perceived as the norm.

---

[7] Memorandum Report on Access Controls over NMS Data and Software (Memorandum Report No. A-000-98-004-S, May 18, 1998)

[8] Audit of General Controls Over USAID Client Server Computer Environment (Audit Report No. A-000-99-005-P, March 1, 1999)

Two data administrators, who are contractors rather than USAID employees, had special access codes that enabled them to make direct changes to systems data, bypassing the accountability controls embedded in the normal processes. For example, although the system recorded the names of authorized users who entered new transactions into the accounting system. data administrators were able to make data changes directly to the general ledger that could not be traced back to them.

We reviewed 1,410 DQMRs submitted to Office of Information Resource Management during fiscal years 1997 and 1998.[9] Most of the DQMRs were submitted to initiate changes to non-financial information. However, 464 DQMRs were submitted to initiate financial transactions. The total amount of these transactions was at least $45 billion.[10] For example, one DQMR resulted in 25 postings totaling $18 billion to record the commitment and obligation of funds related to three disbursements totaling $1.2 billion, which could not be handled through normal NMS procedures at that time. Another DQMR resulted in 1,064 transactions to reverse and re-enter 266 deobligations which system software had caused to be recorded incorrectly. Some DQMRs resulted in very large transactions to record the impact of deobligations of prior year funds and increases in no-year appropriation accounts-a type of adjustment that could not be handled through existing NMS processes.

Although the frequency and materiality of *ad hoc* adjustments caused by design deficiencies is a cause for serious concern, of even greater concern were the potential risks resulting from the ability of data administrators to make changes that were not authorized and documented by DQMRs and for which no audit trails exist. Data administrators had the capability of both creating new transactions and, more importantly, changing correct values in existing transactions and summary tables. Although we found no evidence of any such changes, the fact that such changes could have been made represents a very significant risk area. Because of this risk, we have no assurance that the general ledger, which was subject to such changes, properly reflects the financial activities and the status of USAID.

Security Program Needed

USAID did not implement an adequate system of management controls to support an effective computer security program. USAID has not (1) developed an organizational structure that clearly delegates responsibility and provides appropriate authority, (2) established planning policies needed to provide a foundation for an effective security program, and (3) implemented key management processes to ensure that security requirements are met.

---

[9] In total, 1472 DQMRs were made, but 62 were not available for our review.

[10] Although this figure appears very high, it should be pointed out that this figure is the sum of the absolute value of all changes. In other words, negative and positive changes have not been offset against one another.

A key reason for these general control deficiencies is USAID's lack of an agency-wide computer security program to ensure that effective controls are established and maintained. Responding to prior audit recommendations, USAID reported it's lack of a security program as a material weakness in its fiscal year 1997 Federal Managers' Financial Integrity Act Report and has decided to report the material weakness in the fiscal year 1998 Accountability Report, which is scheduled to be issued on or before April 30, 1999. USAID has also begun taking steps to correct the deficiencies. Specifically, USAID hired a security program manager to develop and implement an action plan and budget to implement an effective computer security program. USAID also entered into an agreement with GSA's Federal Systems Integration and Management Center to assess the risks associated with system security and access controls. However, due to funding limitations, USAID currently estimates that computer security vulnerabilities will not be fully resolved until the year 2003.

Although USAID has made some progress, we recently issued a report[11] that cited continuing organizational deficiencies that hindered implementation of an effective computer security program. In particular, USAID still has not (1) developed an organizational structure that clearly delegates responsibility and provides appropriate authority, and (2) implemented key management processes to ensure that security requirements are met. Resource limitations appear to constrain development of effective processes. In addition to several recommendations to correct deficiencies associated with general controls, this report recommended that responsible US AID managers:

- determine the specific assignments of security roles and responsibility needed to meet the federdl requirements; and
- complete an analysis to determine whether funding has been properly allocated between (1) modernizing financial management systems and (2) correcting security deficiencies.

Questionable Financial and Performance Information

Less than reliable or incomplete financial data is being reported to USAID managers, as well as, to external parties, including OMB, Congress, and the public. To illustrate, USAID submitted financial information[12] to both the OMB and the U.S. Treasury that was inconsistent with its general ledger. Furthermore, USAID's Overview on performance does

[11] Audit of General Controls Over USAID Mainframe Computer Environment (Audit Report No. A-000-99-004-P, March 1, 1999)

[12] This included budgetary infoxmation provided to the Office of Management and Budget and year-end cash balances provided to the U.S. Treasury.

not generally report on USAID performance, instead it reported on the overall accomplishments of the entire donor and recipient community. In addition, USAID Congressional Presentation, which justifies the budget request, reported incomplete and inaccurate data on host country and other donor financial support of USAID programs and activities. These four weaknesses-questionable financial data to oversight authorities, questionable financial data to USAID managers, inability to identify full costs, and inadequate performance measurement system-will be explained in detail below.

Questionable Financial Data Submitted to Federal Agencies Having: Oversight Authoritv

Deficiencies in USAID's general ledger system and inadequate internal controls prevented the Office of Financial Management from preparing accurate, timely, and reliable budget reports[13] for submission to federal agencies which have oversight responsibility. As a result, USAID submitted financial information to the OMB and the U.S. Treasury that was inconsistent with the financial information maintained in its general ledger. In addition, the Office of Financial Management did not submit the first quarter report on budget execution as required by the OMB. Further, these and other quarterly reports submitted were not properly supported by USAID general ledger. USAID utilized a series of internal reports instead of the general ledger-the source that should have been used. USAID officials indicated that the general ledger was not used because of various deficiencies.

'Our review of a sample of the fiscal year 1998 budget reports revealed that the unobligated balances at the beginning of the fiscal year were not consistent with the general ledger balances and year-end cash balances previously reported in fiscal year 1997. This weakness was previously reported in last years' Consolidated Financial Statement audit report.[14] USAID management has not taken corrective actions to ensure that the general ledger adequately supports the reported balances.

Additionally, Office of Financial Management staff did not promptly and adequately reconcile USAID fund balances with information from the U.S. Treasury. According to Treasury officials, properly reconciling the fund balances with Treasury 'accounts is a key internal control procedure to ensure the accuracy of the receipts and disbursements recorded in the agency's accounting records and reported to the U.S. Treasury's Financial Management Services. USAID did not properly reconcile their differences with the U.S. Treasury. Instead, Office of Financial Management personnel established accounts and posted the unreconciled differences into their general ledger. USAID officials informed us that these

---

[13] The Office of Management and Budget's Standard Form 133, Report on Budget Execution, reports budgetary resources, status of budgetary resources, and relation of obligations to outlays.

[14] Report on USAID Financial Statements, Internal Controls, and Compliance for Fiscal Years 1997 and 1996 (Audit Report No. 0-000-98-001-F, March 2, 1998)

differences were posted into the general ledger because the agency felt that theU.S. Treasury's balances were more reliable. This practice permitted USAID to force its fund balance to match U.S. Treasury's fund balance at year end. To date, USAID financial management staff have not undertaken efforts to research and resolve differences, as is required by the U.S. Treasury Financial Manual Part 2, Chapter 3900, Section 3915. As a result, USAID did not properly report differences to the U.S. Treasury on its "Yearend Closing Statement." Because of this practice, fraudulent transactions may have occurred that were not detected by USAID financial managers and a potential for misstatements in USAID financial statement and the Government-wide consolidated financial statements exists. The U.S. Treasury is subsequently reporting this incorrect data to the Congress.

Based on our review, USAID had unreconciled differences totaling over $353 million[15] between its general ledger and financial information obtained from the U.S. Treasury. In addition, USAID had $237.5 million,[16] in unreconciled differences between the overseas missions' general ledger and Treasury's information. Office of Financial Management posted these unreconciled differences into the general ledger to reflect the balances obtained from the U.S. Treasury.

Questionable Financial Data To USAID Managers

USAID does not properly identify, record, and report advances processed through the Letter of Credit system. Approximately $1.7 billion are annually advanced to grantees through the system. Because of Office of Financial Management's policy, these advances are not recorded against the obligation document at the time of the disbursement. Instead, the advances are recorded at the grantee level, without regard to the corresponding grant obligation. As a result, program managers cannot determine fund availability for their projects or identify funds that could be put to better use. To compensate for this deficiency, managers often contact the recipients to obtain the information needed.

Inadequate Performance Measurement Systems

USAID did not have performance measurement systems that allowed it to report accurately or promptly the results of its activities. Specifically, USAID was unable to isolate or attribute the results of its activities from the results of countrywide programs funded by multiple

---

15 This represents the absolute value of. the differences between USAID's records and U.S. Treasury's records. The total net differences which USAID reported in the notes to the financial statements was $60 million.

16 This represents the absolute value of the differences between the overseas missions' general ledgers, the U101 report and the information received from the U.S. Treasury.

parties, including the host country or other donors. Some of USAID difficulty in distinguishing the results of its own activities was caused by its choice of performance indicators, particularly the indicators used to prepare external performance results reports. The Overview on performance section, which accompanied USAID fiscal year 1998 financial statements, is one such external report. Another report is USAID Congressional Presentation. Besides choosing indicators that precluded it from reporting accurate performance data in external reports, USAID reported results data for internal reports that were not objectively verifiable, supported, accurate, complete and/or validated. These issues have been addressed in previous OIG and General Accounting Office reports, as well as through Congressional inquires."

Results Reported in USAID Overview on Performance Cannot Be Attributed to USAID-Funded Activities

The Overview on performance, which accompanies USAID's fiscal year 1998 financial statements did not meet the requirements of OMB Bulletin 97-01, Form and Content of Agency Financial. Statements, that an agency's results should be expressed "...in terms of objective, relevant measures that disclose the extent to which its programs are achieving their intended objectives." Specifically, the Overview on performance credited USAID with results that more properly and correctly should have been attributed to the efforts of multiple parties working to achieve common goals. As a result, readers of the Overview (and other external reports that use the same results data) had little basis for assessing the results of USAID programs or making the cost-benefit analyses needed for budget allocation decisions.

We could not comprehensively review the fiscal year 1998 Overview on performance because USAID management did not give us a copy of its final version until February 2, 1999.[18] Nonetheless, our review of the Overview showed that the same problems we reported last year persist. These included the choice of high-level objectives and indicators that, in turn, led to the reporting of high-level (country-level) results. Such results are difficult, if not impossible, to attribute to USAID activities.

The Overview typically reported trends showing how well regions were performing in various sectors and noted that these results were achieved through the collaborative efforts of USAID, host country partners, non-governmental organizations, international financial institutions, and other donors. In only a few instances did the Overview cite specific countries and in even fewer instances did it describe specific programs. The Overview stated that further details on performance results would be included in USAID's fiscal year 1998 Accountability Report to

[17] See Appendix VI to this Report.

[18] This was significantly later than December 9, 1998, the date stipulated in the audit "engagement letter" agreed to by the USAID Chief Financial Officer and our office.

be issued on or before April 30, 1999. However, it is unlikely that this report will be able to link goals, programs, and results or report more up-to-date results data because, as the Overview stated, USAID performance reporting system "does not adequately link USAID's performance goals with its programs nor does it ensure current data results." To correct this deficiency, USAID reported that it would assess and revise its Strategic Plan, make changes to its Annual Performance Plan and Report, and develop and implement a managerial cost accounting program to attribute costs across various activities and programs." USAID predicted that it would complete these actions by fiscal year 2000. Also, USAID has decided to report this material internal control weakness in its fiscal year 1998 Accountability Report that its performance reporting systems do not yet adequately link performance goals with agency programs, collect timely results data, or require appropriate indicators. In this regard, the Bureau for Policy and Program Coordination noted that these weaknesses impaired USAID ability to obtain, maintain, report, and use reliable and timely performance information for decision making.

USAID Congressional Presentation Also Contains Incomplete and Inaccurate Data

As discussed above, country-level results are frequently the result of activities funded by multiple parties, including USAID. When USAID reports such high-level results as evidence of the success of its activities, a comparison of USAID contributions to those of other donors is relevant and useful to external and internal evaluators.

USAID fiscal year 1999 Congressional Presentation was both inaccurate and incomplete as it pertained to funding provided by host country entities and other donors in support of country-level objectives and reported results. We reviewed 356 Activity Data Sheets included in USAID fiscal year 1999 Congressional Presentation and found that data related to funding provided by other donors and host country entities may have been complete for only 6 activities (2 percent). Data related to at least 350 activities-98 percent-was inaccurate or incomplete. Specifically,

- information on funding provided by other donors and recipients was not reported for 260 activities (73 percent), though the Presentation said that other donors or the host country had participated in the activity, and

- incomplete funding data was reported for 90 activities (25 percent).

Additional problems included the following:

- The Presentation noted that one activity was designed to *"Increase Incomes of the Poor"* and reported that considerable resources were being provided by the European Union, Japan, Germany, Canada, the Swiss and the Dutch. The Presentation did not describe these activities, their cost, or their relationship to the desired change in income. However, documents provided by mission officials showed that these entities provided, or would provide, $1.3 billion in support of this activity.

- The Presentation reported that one activity was designed to 'Reduce *Infant Mortality,* " from 57 per 1,000 births in 199 1 to 39 per 1,000 births in 2001. It noted that by 2001, USAID would have contributed $20.8 million and other partners-the host country and other donors-would have contributed over $100 million. In contrast, documents provided by mission officials showed that the other partners spent about $1.7 billion in support of the objective in just three years, 1995 through 1997.

The lack of reasonably accurate and complete data as to funding provided by others in support of shared country-level objectives (and related country-level indicators) impairs the ability of Congressional and OMB analysts to objectively assess the cost effectiveness of USAID programs and the need for additional funding to accomplish anticipated results.

Internal Performance Reports Also Have Serious Problems

During the past year, we conducted two separate reviews of an internal report prepared annually by each of USAID operating units to report its performance results-the Results Review and Resource Request report (hereafter referred to as R4s). Our first effort was a worldwide audit of R4s conducted at 18 randomly selected Washington operating units or overseas missions." The second was a more limited review conducted at five missions. The first was designed to determine if the results data reported in the R4 was objectively verifiable, supported, accurate, complete and/or validated. The, second was designed to determine if the results of USAID activities had a clear and measurable impact on country-level results reported in the R4.

Based on our worldwide audit, we found problems with 252 of the 302 results reviewed-or 83 percent. Therefore, we are'94 percent confident that, out of a universe of 1,940 results included in the 18 R4s prepared in 1997, the number of results which were not sufficiently supported, objectively verifiable, accurate, complete, and/or validated ranged from 1,580 to 1,658. Examples of these problems included:

- Ninety indicators and reported results were not objectively verifiable. For example, one mission's R4 included the indicator and related unit of measure, *"Percentage of Development and Implementation of a Long-term Self-sufficient*

---

[19] Audit on the Quality of Results Reported in USAID Operating Units' Results Review and Resource Request (R4) Reports Prepared in 1997 (Audit Report No. 9-000-99-006-P scheduled to be issued in March 1999).

Financial Strategy." The R4 reported that the actual result for 1996 was 20 percent. However, this result was not objectively verifiable because the mission had not established a methodology for measuring percentage of implementation.

- Seventy-seven reported results were not sufficiently supported. For example, one mission's R4 included the indicator, *'Length of Time from Opening of a Preliminary investigation to Achieving an Investigative Result." The R4* reported that the time between these two events was 60 days. However, Mission officials did not have supporting documentation for this data.

- Seventy reported results were not sufficiently accurate or complete. For example, one Washington operating unit's R4 included the indicator, *"Primary School Achievement,"* and the unit of measure, *"5th Grade Completion Rate."* 'The R4 reported that the completion rate for 1996 was 64.2 percent. However, documentation provided by USAID officials showed that this was actually the completion rate for 1991. Further, this was the completion rate for children reaching grade five, not completing grade five.

Our second review of R4s was designed to supplement our review of the accuracy of attributed results in USAID fiscal year 1998 Overview on performance. We selected and reviewed performance results information in the R4 reports prepared by five overseas missions.*' Because we were specifically interested in whether claimed results were correctly attributable to USAID activities, we selected 39 indicators which appeared to measure country-level changes.

Our review showed that these five missions could not demonstrate that USAID programs had clearly and measurdbly contributed toward reported changes in 37 of the 39 indicators. Examples included the following:

- One indicator, *"Value of Expenditures per Capita of the Poor," was* selected to measure results 'of the strategic objective, *"Increased Incomes of the Poor."* The reported result for 1994, the baseline year, was $447 and for 1997 was $507. However, Mission officials could not document the causal relationship between USAID activities and the 1997 results.

  It also appeared that USAID played a relatively minor role in affecting this change. According to Mission officials, during 1996 and 1997, USAID spent about $130 million in support of the strategic objective, but the host government had provided $6.9 billion. Other donors had also played a large role, contributing about $2.9 billion over a undetermined period.

---

[20] We reviewed the R4s for the following countries: Ghana, India, Jordan, Ukraine, and Peru.

- Another indicator, *"Increase in Value of Horticultural Exports, "* supported a special strategic objective, *"Increased Investment in Agribusiness by Private Firms. " The* reported 1997 result was $615 million for the indicator which represents national horticultural exports from April 1, 1996 to March 31, 1997— exports that included fresh/processed fruits and vegetables, spices, and floriculture products. However, Mission officials could not provide any documents supporting the extent to which USAID activities had a clear and measurable impact on achieving this result. Furthermore, USAID obligations and expenditures in support of this strategic objective from fiscal years 1995 - 1997 totalled $4.5 million and $6.4 million, respectively. This pales in comparison to more than $2 billion reportedly provided by private investments and other donors since 1992 in support of this strategic objective.

We recognize that share of total funding is only one element in the process of crediting results. However, we believe that it is difficult, if not impossible, to make a convincing argument that USAID activities had a major role in achieving results reported for country-level indicators when its funding constituted only a small share of the total spent by all donors, the host country, and private investors.

Organizational Deficiencies Continue to Hinder Efforts to Implement Systems

USAID executives have committed to correct management deficiencies that have, in the past, prevented successful modernization of USAID financial management system. Although USAID has taken positive steps to correct these systems' deficiencies, significant improvements are not achievable until existing systems are replaced or modernized, an effort that is not scheduled to be completed until 2001. In addition, fragmented and unclear organizational responsibilities continue to hinder USAID efforts to correct the deficiencies. In particular, because USAID executives have not delegated to the CFO the responsibility and authority to develop and maintain an integrated financial management system as required by the CFO Act, USAID may repeat costly mistakes by deploying a new system that does not meet federal requirements and does not operate effectively. We also identified other planning and program management deficiencies in a companion report describing USAID progress implementing a financial management system that meets Federal Financial Management Improvement Act requirements.[21]

---

21 Audit of USAID Progress Implementing a Financial Management System That Meets Federal Financial Management Improvement Act Requirements (Audit Report No. A-000-99-003-P, March 1, 1999).

USAID Managers Need to Strengthen Information Resources Management Practices

OIG audits and USAID management reviews have cited ineffective processes for managing information resources as the primary cause of USAID's difficulty in deploying effective systems: Although USAID has made several attempts to correct these management deficiencies, it has not yet succeeded. The deployment of NMS in October 1996 was the latest attempt to implement an effective system. Although NMS was designed to meet federal accounting and system requirements, it did not do so.

We first reported serious deficiencies in the processes for managing information resources in September 1996, when we reported USAID plans to deploy NMS worldwide involved significant risks because it had not been adequately tested. In March 1997, we reported USAID had adopted a high-risk approach, did not follow accepted system development practices, and deployed NMS worldwide despite severe problems we had previously reported.

USAID now recognizes that effective information resource management processes are essential to implementing systems that meet federal requirements and has begun taking steps to strengthen its processes and organizational control over information technology investments. These steps include appointing a Chief Information Officer (CIO) and establishing an investment review board. Further, in May 1998, USAID hired a systems integration contractor to assist with information technology planning, technical direction, oversight, policy formulation, system acquisition, and management practices. The contractor is expected to help USAID improve its application of disciplined processes as it moves to modernize its financial management systems. In addition, the Office of Financial Management has taken steps towards implementing disciplined practices to modernize the core accounting functions. These include hiring a contractor to assist in its efforts to streamline accounting business processes and implement an effective core financial system. USAID reported the material weakness in its fiscal year 1997 FMFIA Report and has decided to report the material weakness in the fiscal year 1998 Accountability Report, which will be issued on or before April 30, 1999.

Fragmented CFO Responsibilities

Because USAID continues to maintain a fragmented organizational structure and has not assigned its CFO responsibility and authority to manage all financial management systems, current efforts to acquire a single integrated financial management system may be at risk. Reporting to the Administrator, the CFO and the CIO share primary responsibility to implement and maintain a financial management system that meets federal requirements. These officials are responsible for ensuring that (1) agency information systems provide financial and program performance data for agency financial statements; (2) financial and performance data are provided to the financial management system in a reliable, consistent, and timely manner; (3) financial statements support assessments and revisions of mission and administrative processes; and (4) financial statements support measurements of the performance of information technology investments.

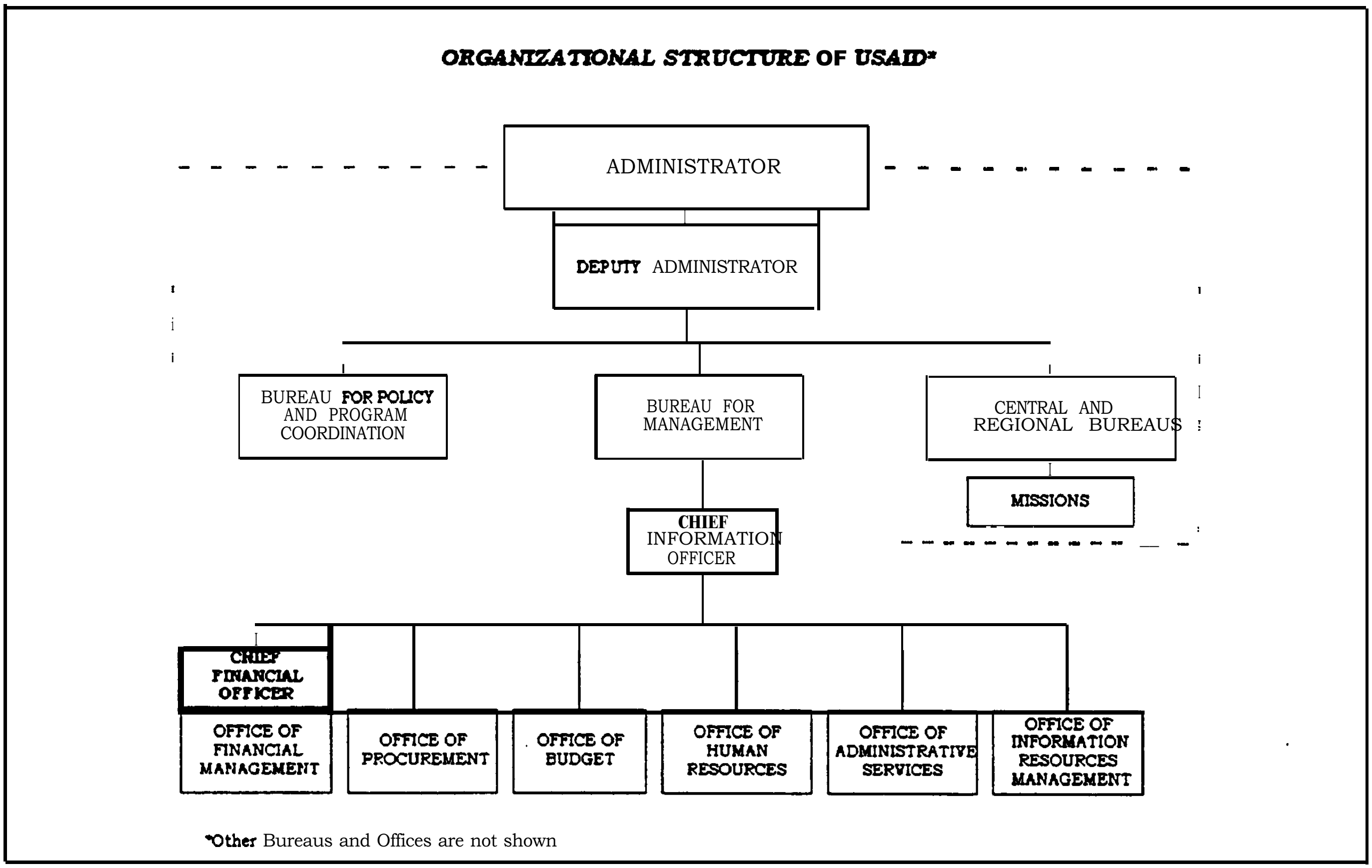
The CFO Act of 1990 (Public Law 101-576) created the CFO position and called for CFOs to report directly to the head of the agency and to be responsible for, among other things;

- overseeing all financial management activities relating to the programs and operations of the agency;

- developing and maintaining an integrated agency accounting and financial management system that complies with all federal requirements for financial management systems; and

- directing, managing, and providing policy guidance and oversight of agency financial management personnel, activities, and operations, including the approval and management of design and enhancement projects for an agency's financial management system.

Although the CFO Act assigned CFO the responsibility for ensuring that financial management systems meet federal requirements and made the CFO's responsible for a broad range of financial management activities, USAID's CFO is only in charge of financial operations and analysis. As illustrated in the organization chart below, the CFO is not responsible for the information systems that support the performance measurement, budget, human resource, or procurement functions. Instead, financial management requirements related to these functions have been dispersed to managers of function-specific offices. That is, USAID's CFO does not have responsibility for the financial portion of systems located in the Office of Procurement, the Office of Budget, the Office of Human Resources or in the Bureau for Policy and Program Coordination. Instead, the directors of these offices are responsible for their own information systems. As such, the CFO lacks the authority to implement an integrated financial management system that meets federal accounting and system requirements and incorporates core financial management, performance measurements, cost accounting, and budget capabilities.



In contrast to the CFO responsibilities at USAID, CFO's at other U.S. Government agencies have much more responsibility. Per OMB's 1998 Federal Financial Management Status Report and Five-Year Plan dated June 1998, USAID's CFO is in charge of the least amount of functions of any U.S. Government Agency CFO. As illustrated in the chart below, USAID's CFO is only in charge of financial operations and analysis whereas CFOs of other agencies are. in addition to financial operations and analysis, responsible for some or all of the following functions: budget formulation and execution, grants management, Government Performance and Results Act, information resources management, personnel, and procurement.

CHIEF FINANCIAL OFFICER RESPONSIBILITIES

Agency	Finance Operations and Analysis	Financial Systems Responsibility	Budget Formulation and/or Execution	Results Act	Procurement	Grants Management	Personnel
USAID	■						
SBA	■	■					
DOE	■	■	■				
DOL	■	■	■				
NASA	■	■	■				
State	■	■	■				
DOD	■	■	■	■			
DOT	■	■	■	■			
EPA	■	■	■	■			
GSA	■	■	■	■			
HUD	■	■	■	■			
NRC	■	■	■	■			
OPM	■	■	■	■			
Education	■	■			■	■	
NSF	■		■		■	■	
USDA	■	■		■		■	
FEMA	■	■	■		■	■	
SSA	■	■	■		■	■	
VA	■	■	■	■	■		
DOJ	■	■	■	■	■		■
Treasury	■	■	■	■	■		■
HHS	■	■	■	■	■	■	■
Commerce	■	■	■	■	■	■	■
DOI	■	■	■	■	■	■	■

Shaded areas indicate the CFO's assigned responsibilities.

As mentioned earlier, the CFO and the CIO share primary responsibility to implement and maintain a fmancial management system that meets federal requirements. The CIO also shares responsibility for ensuring that disciplined processes are followed but has not carried out those responsibilities. The Clinger-Cohen Act of 1996 mandates that Executive agencies implement a process to maximize the value of, assess, and manage risks of information technology investments. The Act establishes the position of Chief Information Officer and, among other things, assigns this officer responsibility to ensure that information technology investments, including fmancial management systems, are managed effectively. The Chief Information Officer is specifically responsible for:

- providing advice and assistance to the agency head and senior managers to ensure 'that information technology is acquired and information resources are managed effectively;
- developing, maintaining, and facilitating implementation of an integrated agency-wide information technology architecture; and
- promoting the effective and efficient design and operation of all major processes of the agency for managing information resources.

A key CIO function is to facilitate implementation of the architecture.[22] This requires the CIO to review planned acquisitions to ensure that they are consistent with the architecture. As pointed out in our report? on USAID's progress implementing the requirements of the Federal Financial Management Improvement Act, the CIO has not met these legislated responsibilities because USAID is proceeding to replace its accounting system before completing an enterprise information technology architecture, preparing a comprehensive acquisition strategy, and developing supporting plans. That report recommended that the CIO complete an information technology architecture and, before approving proposals to acquire any system component, ensure that investments are

1) consistent with the architecture,

2) cost effective,

3) based on a modular acquisition strategy, and

[22] An architecture is a blueprint or high level description of how the systems will interact to accomplish agency mission requirements in a cost effective manner. It focuses on describing the relationships among business functions, work processes, information flows, and technology. It also describes standards to be followed to ensure that systems will interoperate, provide security, and be implemented in a disciplined manner.

[23] Audit of USAID's Progress Implementing; a Financial Management System That Meets Federal Financial Management Improvement Act Requirements (Audit Report No. A-000-99-003-P, March 1, 1999).

4) supported by sufficiently detailed plans.

That report also pointed out that USAID does not use a program management approach to manage its financial management systems' modernization efforts and recommended that the CIO work with the CFO and the Assistant Administrator for Management to establish a strong program management office.

Recommendation

Recommendation No. 1 Because the Chief Financial Officer lacks the authority called for in the CFO Act, we recommend that the Chief Financial Officer collaborate with the Assistant Administrator for Management, Chief Information Officer, and Bureau For Policy and Program Coordination to:

1.1 Determine the specific responsibility, authority, and resources needed to meet the requirements of the Chief Financial Offkers Act of 1990, which assigns the Chief Financial Officer responsibility to (1) develop and maintain an integrated accounting and financial management system that meets federal financial system requirements, federal accounting standards, and the U.S. Standard General Ledger at the transaction level; (2) approve and manage financial management system design and enhancement projects; and (3) develop a financial management system that provides for systematic measurement of performance.

1.2 Request by June 30, 1999, that the Administrator approve specific delegations of authority and resources to the Chief Financial Officer to carry out those Chief Financial Offkers Act responsibilities identified in Recommendation 1.1 above.

1.3 Implement policies and procedures to carry out the specific delegations assigned by the Administrator in Recommendation 1.2, above.

Detailed information concerning the financial statements and other issues developed during this audit can be found in a separate Audit Report[24] to USAID managers.

Office of Inspector General
March 1, 1998

[24] Audit Report to USAID Managers on USAID Internal Controls for Fiscal Year 1998 (Audit Report Number 0-000-99-002-F which is scheduled for release in March 1999).

This page left intentionally blank.

REPORT ON USAID COMPLIANCE

We attempted to audit USAID principal financial statements for the year ended September 30, 1998, but our report on these statements (including the information in the overview section on program performance) disclaims an opinion on whether they are presented fairly because the scope of our work was impaired. USAID management is responsible for compliance with applicable laws and regulations related to these financial statements.

Although we are unable to fully report on USAID compliance with laws and regulations because of scope limitations, instances of potential material noncompliance came to our attention with regards to the requirements of the following:

- Chief Financial Officers Act of 1990,
- Federal Financial Management Improvement Act of 1996,
- Computer Security Act of 1987,
- Budget and Accounting Procedures Act of 1950,
- Federal Credit Reform Act of 1990,
- Foreign Assistance Act of 1968, and
- Federal Managers' Financial Integrity Act of 1982,
- Government Performance and Results Act, and
- Office of Management and Budget Bulletin 97-01.

The following sections discuss instances of potential noncompliance with the above laws and related regulations.

Chief Financial Officers Act of 1990

As indicated in the Report on Internal Controls, USAID has not delegated sufficient responsibilities and authority to the Chief Financial Officer (CFO) to successfully implement an integrated financial management systems required by the Chief Financial Officers Act of 1990 and executive branch policy.

The Chief Financial Officers Act of 1990 (Public Law No. 101-576) requires each federal agency's CFO to, among other things, develop and maintain integrated financial management systems, including financial reporting and internal controls which:

- comply with applicable accounting principles, standards, and requirements, and internal control standards;

- comply with such policies and requirements as may be prescribed by the Director of the Office of Management and Budget (OMB);

- comply with any other requirements applicable to such systems; and

- provide for (1) complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management; (2) the development and reporting of cost information: (3) the integration of accounting and budgeting information; and (4) the systemic measurement of performance.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) requires USAID to implement and maintain a financial management system that complies substantially with (1) federal requirements for an integrated financial management system, (2) applicable federal accounting standards and (3) requirements to post transactions to the U.S. Standard General Ledger at the transaction level.[25] These requirements are detailed in the Office of Management and Budget's Circular No. A-127, Financial Management Systems. Section 7 of this Circular identifies the requirements or characteristics that federal financial management systems should possess. Other policy documents further detail these requirements?

[25] In this section, we report on USAID's compliance with federal requirements for financial management systems rather than its compliance with the Act itself.

[26] Office of Management and Budget's Circulars No. A-130, Management of Federal Information Resources, No. A-134, Financial Accounting Principles and Standards, No. A-11, Preparation and Submission of Budget Estimates, and No. A-34, Instructions on Budget Execution; U.S. Treasury's Treasurv Financial Manual.

The Act also requires that our audit of USAID's financial statements report whether the financial management system complies with those requirements. The following information is summarized from our recent report describing USAID's progress meeting FFMIA requirements (FFMIA progress report).*' Additional details are contained in that report and on pages 19 through 25 of the preceding Report on Internal Controls.

During fiscal year 1998, USAID's financial management systems did not substantially comply with the FFMIA's accounting and system requirements. Although USAID developed a plan to correct these system deficiencies, the plan is not adequate because it is not based on a full information system architecture, an integrated system acquisition strategy, or a detailed listing of planned actions to bring about an agency-wide integrated financial management system. These planning deficiencies occurred because USAID executives have not implemented organizational changes that are needed to successfully acquire complex systems.

Nature' and Extent of Noncompliance

USAID managers have committed to follow disciplined practices to modernize USAID systems and have taken several steps to do so. However, because significant improvements are not achievable until existing systems are replaced or modernized-an effort that is not scheduled to be completed until 2001—USAID has made only limited improvements to its systems during the past year. As a result, during fiscal year 1998, USAID's financial management systems did not yet comply substantially with (1) federal financial management system requirements, (2) applicable federal accounting standards, and (3) requirements that transactions be posted to the U.S. Standard General Ledger at the transaction level as required by FFMIA.

As a result, financial management systems' deficiencies that we first reported during fiscal year 1997 continue to exist? In large part because NMS has not operdted effectively, USAID has had to rely on a combination of outmoded legacy systems, informal and unofficial records maintained by individual managers or organizational units, and NMS--which suffers from technical and operational. problems.

(1) Federal Financial Management System Requirements

In particular, the Joint Financial Management Improvement Program has published several documents describing detailed functional requirements that systems should possess to perform effectively.

[27] Audit of USAID's Progress Implementing a Financial Management System That Meets Federal Financial Management Improvement Act Requirements (Audit Report No. A-000-99-003-P, March 1, 1999).

[28] Audit of the Extent to Which USAID's Financial Management System Meets Requirements Identified in the Federal Financial Management Improvement Act of 1996 (Audit Report No. A-000-98-003-P, March 2, 1998).

USAID did not substantially comply with federal financial management system requirements. These requirements are designed to enable agencies to provide complete, reliable, timely, and consistent information to decision makers and the public. Agencies, including Treasury and OMB, need this information to (1) carry out their fiduciary responsibilities; (2) deter fraud, waste, and abuse; (3) facilitate efficient and effective delivery of programs; and (4) hold agency managers accountable for the way government programs are managed. The Congress needs this information to oversee government operations, and the public, to exercise their citizenship responsibilities. Thus, a key objective of financial management systems is to ensure that reliable financial and program performance data are obtained, maintained, and reported.

During fiscal year 1998, our audits as well as USAID management assessments confirmed the continuing existence of financial management system deficiencies that we reported during fiscal year 1997.[29] As a result, during fiscal year 1998, USAID's financial management systems did not substantially comply with federal financial management system requirements. For example, USAID:

- lacked an agency-wide classification structure, which standardizes data definitions and formats for financial management systems;

- relied on multiple incompatible systems that cannot exchange data and thus, did not have an integrated financial management system;

- had not implemented an effective computer security program; and

- did not have a financial system that met Joint Financial Management Improvement Program requirements to (a) support the Prompt Payment Act, (b) support external reporting needs, and (c) ensure that costs are accumulated and reported with proper matching of periods, segments, and outputs.

(2) Federal Accounting Standards

Contrary to the FFMIA, USAID's financial management systems did not comply with applicable federal accounting standards. Specifically, USAID financial management systems did not comply with the (a) Statements of Federal Financial Accounting Standards No. 1,

---

[29] Audit of the Worldwide Deployment of the New Management System (NMS) (Audit Report No. A-000-97-004-P, March 31, 1997); Audit of USAID's Efforts to Resolve the Year 2000 Problem (Audit Report No. A-000-97-005-P, July 11, 1997); Audit of USAID's Compliance with Federal Computer Security Requirements (Audit Report No. A-000-97-008-P, September 30, 1997); Audit of the Internal Controls for the Operational New Management System (Audit Report No. A-000-97-009-P, September 30, 1997); and Audit of the Status of USAID's New Management System (NMS) (Audit Report No. A-000-97-010-P, September 30, 1997).

Accounting For Selected Assets and Liabilities and (b) Statements of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government.

a. Accounting For Selected Assets and Liabilities

Contrary to Statement of Federal Financial Accounting Standard No. 1, USAID has not implemented an effective accrual methodology to recognize its current liabilities and establish accounts payable for unpaid goods and services. The methodology utilized for estimating the amounts owed was inadequate. Further, USAID did not have a methodology for reducing its advances and recognizing its expenses when goods or services were received, contract terms were met, progress was made under contract or prepaid expenses expired.

USAID established estimates for Accounts Payable and related expenses based solely on unliquidated obligation balances. No additional information was requested or obtained to determine whether the goods or services were actually received. Further, USAID improperly reported both liabilities and assets (Accounts Payable and Advances) against the same unliquidated obligations. As a result, USAID financial statements may not provide management with complete, reliable and consistent information for making well-informed business decisions.

b. Managerial Cost Accounting: Concepts and Standards for the Federal Government

USAID has not implemented Statement of Federal Financial Accounting Standards No. 4. Also, USAID did not comply with the following five fundamental elements of managerial cost accounting:

- Requirement for cost accounting - Each reporting entity should accumulate and report the costs of its activities on a regular basis for management information purposes;

- Responsibility segments - Management of each reporting entity should define and establish responsibility segments;

- Full cost - Reporting entities should report the full costs of outputs in general purpose financial reports;

- Inter-entity costs - Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities; and

- Costing methodology - Cost of resources consumed by responsibility segments should be accumulated by type of resource.

This standard requires federal agencies to be able to provide reliable and timely information on the full cost of their programs, activities, and outputs (by responsible segments). The cost assignments should be performed using one of the following methods listed in order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis. Cost information developed for different purposes should be drawn from a common data source, and output reports should be reconcilable to each other. Currently, USAID is not able to segregate its costs.

(3) Use of U.S. Standard General Ledger at the Transaction Level

USAID did not record Accounts Receivables in accordance with the U.S. Standard General Ledger at the transaction level. USAID did not have an integrated accounting and financial management system which included Accounts Receivable.

USAID relied on data calls[30] to obtain the total amount of outstanding Accounts Receivable because it did not have integrated financial management systems. These data calls provided summary information which was posted to the general ledger at the summary level and was not directly traceable to the transaction level as required. By using data calls to determine outstanding Accounts Receivable, USAID was at risk that the information obtained was not accurate or complete. For instance, USAID's summary of the data calls improperly omitted the Office of Procurement's outstanding Accounts Receivables.

Cause of Noncompliance

Ineffective processes for managing information resources continue to be the primary cause of USAID's difficulties deploying effective information systems, USAID reported deficiencies in its processes for managing information resources as a material weakness in its fiscal year 1997 and planned 1998 reports under the Federal Managers' Financial Integrity Act (FMFIA). Although USAID has taken steps to implement disciplined processes, planning deficiencies continue to threaten USAID's ability to successfully implement an effective financial management system. These deficiencies are further described in our FFMIA progress report.

Organization Responsible for Noncompliance

The Clinger-Cohen Act makes the head of each agency, in consultation with the CFO and Chief Information Officer (CIO), accountable for establishing policies and procedures to ensure that (1) agency information systems provide financial and program performance data for agency financial statements; (2) financial and performance data are provided to financial

[30] "Data calls" is a term used to describe the process of requesting various offices to provide outstanding balances as of year end. The resulting reports are prepared from data contained outside the formal accounting system.

management systems in a reliable, consistent, and timely manner; and (3) financial statements support assessments and revisions of mission and administrative processes, as well as, measurements of the performance of information technology investments. Thus, the CFO and the CIO, reporting to the Administrator, share responsibility for implementing and maintaining effective and efficient financial management systems that meet federal requirements for financial management systems. At USAID, both the CFO and CIO positions are located within the Bureau for Management.

USAID executives have not implemented organizational changes that are needed to successfully acquire complex systems. Organizational deficiencies include the fact that USAID executives have not (1) delegated to the CFO the responsibility and authority to develop and maintain all financial management systems as required by the CFO Act, or (2) established a project management office with sufficient staff, expertise, and authority to ensure that modernization efforts are implemented successfully. Further, USAID has not implemented disciplined processes to acquire systems. Although USAID had not developed an information technology architecture, a modular acquisition strategy, or sufficiently detailed supporting plans; it planned to proceed with the acquisition of a replacement core financial system. These deficiencies are further described in the accompanying report on internal controls and in our FFMIA progress report.

Recommendations

In order to address USAID's organizational and planning deficiencies (and as discussed on page 25 of this report), we recommended that the Chief Financial Officer collaborate with the Assistant Administrator for Management, Chief Information Officer, and the Bureau for Policy and Program Coordination to determine the specific responsibility, authority, and resources needed to meet the requirements of the Chief Financial Officers Act of 1990, which assigns the Chief Financial Officer responsibility to (1) develop and maintain an integrated accounting and financial management system, and (2) approve and manage financial management system design and enhancement projects. In addition, we recommended that the Administrator specifically delegate adequate responsibility, authority, and resources to the Chief Financial Officer to carry out the responsibilities of the Chief Financial Officers Act.

Additional recommendations, which address weaknesses in USAID's remediation plans, were included in our FFMIA status report. That report recommended that before acquiring any financial management system components, USAID should (1) complete an agency-wide information technology target architecture, (2) use the target architecture to define USAID's financial management system portfolio, (3) complete a modular acquisition strategy, and (4) revise its remediation plan and develop sufficiently detailed supporting plans. The report also recommends that USAID establish a strong program management office with the responsibility, authority, and resources to apply disciplined practices to implement financial management system improvements.

Computer Security Act of 1987

USAID has not implemented an effective computer security program as required by the Computer Security Act of 1987 (Public Law No. 100-235). This law requires federal agencies to protect information by (1) identifying sensitive systems, (2) developing and implementing security plans for sensitive systems, and (3) establishing a training program to increase security awareness and knowledge of accepted security practices. The OMB Circular No. A-130 contains executive branch policy implementing this law.

In September 1997, we reported[31] that management deficiencies had prevented USAID from implementing an effective computer security program as required by the Computer Security Act. These deficiencies exposed USAID to high risks that resources would not be adequately protected from fraud or misuse. The deficiencies occurred because USAID did not implement an adequate system of management controls to support an effective computer security program. USAID had not (1) developed an organizational structure that clearly delegated responsibility and provided appropriate authority, (2) established planning policies to provide a foundation for an 'effective security program, and (3) implemented key management processes to ensure that security requirements were met.

During fiscal year 1998, USAID took several steps to correct these organizational, planning, and process weaknesses, including appointing a computer security program manager and preparing a security program master plan. However, budget constraints have delayed the expected correction date from 2000 to 2003. USAID has decided to report this material internal control weakness in its fiscal year 1998 Accountability Report, which will be issued on or before April 30, 1999.

During fiscal year 1998, we conducted a series of audits of USAID general computer security controls.[32] The audits found that general controls over the mainframe, client server (which hosts the NMS), and Mission computer systems were not effective. Specifically, deficiencies were identified in (1) entity-wide security program and management, (2) access controls, (3) application software development and change processes, (4) segregation of computer system duties, (5) system software change controls, and (6) continuity of services controls. A primary reason for ineffective general controls was the lack of an agency-wide security program that included clear security responsibilities and agency-wide security processes.

---

[31] Audit of USAID Compliance with Federal Computer Security Requirements (Audit Report No. A-000-97-008-P, September 30, 1997).

[32] Audit of USAID/Peru's General Controls Over the Mission Accounting and Control System (Audit Report No. A-527-99-001-P, December 30, 1998); Audit of Access and System's Software Security Controls Over the Missions Accounting and Control System (Audit Report No. A-000-99-002-P, December 31, 1998); Audit of General Controls Over USAID Mainframe Computer Environment(A-000-99-004-P, March 1, 1999); Audit of General Controls Over USAID Client Server Environment (A-000-99-005-P, March 1, 1999); Memorandum Report on Access Controls Over NMS Data and Software (A-000-98-004-S, May 18, 1998)

Budget and Accounting Procedures Act of 1950

As shown in our report on internal controls, USAID (1) has not maintained an adequate system of internal and accounting control as required by the Budget and Accounting Procedures Act of 1950 and (2) has not always provided the U.S. Treasury all requested information on USAID financial operations.

The Budget and Accounting Procedures Act of 1950 (Chapter 946, 64 Stat. 832) requires each federal agency to maintain a system of accounting and internal control that provides:

- full disclosure of the financial results of agency activities;
- adequate financial information needed for agency management purposes;
- effective control over and accountability for all funds, property and other assets for which the agency is responsible;
- reliable accounting results to serve as the basis for the preparation and support of agency budget requests, for controlling the execution of its budget, and for providing financial information required by OMB; and
- suitable integration of the accounting of the agency with the accounting of the U.S. Treasury in connection with the central accounting and reporting responsibilities imposed on the Secretary of the Treasury.

Federal Credit Reform Act of 1990

USAID did not fully comply with the Federal Credit Reform Act of 1990 (Public Law 101-558). This Act states that "Direct Loans disbursed and outstanding are recognized as assets at the present value of their estimated cash inflows." USAID did not efficiently value its assets because it did not fully account for direct loans that were uncollectible. Therefore, related assets were overstated by about $449 million. Additionally, USAID did not fully account for the effects of rescheduled direct loans on its financial statements. USAID needs to re-evaluate its direct loan uncollectible accounts and ensure that rescheduled loans are adequately included and accounted for on the financial statements. Additionally, USAID needs to make the necessary adjustments to its direct loan accounts after a revaluation of the uncollectible accounts is made.

Foreign Assistance Act, Amended in 1968

As discussed in our report on internal controls, USAID has not implemented an effective performance measurement system which would allow USAID to meet the requirements of Section 62 1A of the Foreign Assistance Act, as amended in 1968 (Public Law No. 90-554).

This Section states that foreign assistance funds could be utilized more effectively by the application of a management system that will include the following: (1) the definition of objectives for U.S. foreign assistance, (2) the development of quantitative indicators of progress toward those objectives, (3) the adoption of methods for comparing actual results of programs and projects with those anticipated when they were undertaken, and (4) provides information to USAID and Congress that relates funding to the objectives and results in order to assist in the evaluation of program performance.

Federal Managers' Financial Integrity Act of 1982

Contrary to federal law and the executive branch's implementing policies, USAID has not (1) promptly resolved all audit recommendations within the prescribed time frames, (2) established adequate internal controls for measuring and reporting on program performance, and (3) taken timely action to correct findings and recommendations from prior audits related to problems in measuring and reporting on program performance. Further, USAID has not taken action to correct the material weaknesses that the OIG identified previously. These weaknesses prevented USAID from providing complete, reliable, timely, and consistent information on USAID activities.

OMB Circular No. A- 123. which provides standards for implementing the FMFIA of 1982 requires agencies to develop and implement management controls to ensure that (1) programs achieve their intended results; (2) resources are' used consistent with agency mission; (3) laws and regulations are followed; and (4) reliable and timely information is obtained, maintained, reported, and used for decision making. The Circular also requires that the head of each agency submit annually to the President and the Congress (1) a statement of whether the agency's controls provide reasonable assurance that they are achieving their intended objectives and (2) a report on material weaknesses in the agency's controls.

The OMB Circular No. A-50 contains another implementing policy of the executive branch. This policy requires prompt resolution and corrective actions on audit recommendations. The Circular says that resolution shall be made within a maximum of six months after issuance of a final report and corrective action should proceed as rapidly as possible.

Pursuant to the FMFIA and the implementing policies of the executive branch, USAID has decided to report nine material internal control weaknesses in its fiscal year 1998 Accountability Report scheduled to be issued on or before April 30, 1999.

During the course of our review we identified an internal control weakness that we feel should have been considered as a material internal control weakness and reported in its fiscal year 1998 Accountability Report. Specifically, USAID does not properly identify, record, and report advances processed through the Letter of Credit system. Approximately $1.7 billion are annually advanced to grantees through the system. Because of Office of Financial Management's policy, these advances are not recorded against the obligation document at the time of the disbursement. Instead, the advances are recorded at the grantee level, without regard to the corresponding grant obligation. As a result, USAID cannot properly report the status of its appropriations at year end. Additional details regarding this issue will be reported in the audit report to USAID Managers on its internal controls.[33]

Government Performance and Results Act

As discussed in our report on internal controls, USAID does not have an effective system to consistently and reliably measure and report achievements that are attributable to USAID-funded activities. As a result, USAID reports country-level results in their Annual Performance Report with little assurance that USAID activities had a clear and measurable impact toward achieving the reported results.

Part of the problem is due to deficiencies in the preparation of USAID's Strategic Plan and Annual Performance Plan which are required under the Government Performance and Results Act of 1993 (the Results Act).

For example, the Results Act requires that no later than September 30, 1997, the head of each agency shall submit to the Director of the OMB and to the Congress a Strategic Plan for program activities. Such a plan shall contain among other things-general goals and objectives, including outcome—related goals and objectives, for the major functions and operations of the agency.

USAID submitted its strategic plan to the Congress in September 1997. In January 1998, GAO issued a report on its review of 24 federal agencies' strategic plans, including USAID's. GAO commented that, even though USAID had made progress in their strategic plan, USAID still needed to make improvements. In particular, USAID goals and objectives were improperly targeted at results which USAID could not reasonably influence.

In addition, the Results Act requires agencies to prepare an annual performance plan covering each program activity set forth in its budget. Such plans will establish performance goals; performance indicators which are to be used in measuring or assessing the relevant outputs, service levels, and outcomes of each program activity; and describes a measure to be used to

---

[33] Audit Report to USAID Managers on USAID Internal Controls for Fiscal Year 1998 (Audit Report Number 0-000-99-002-F which is scheduled for release in March 1999).

verify and validate measured values. USAID submitted its annual performance plan for fiscal year 1999 to the Congress in February 1998. However, GAO reported in June 1998 that USAID's annual performance plan provided only a partial picture of its intended performance.

, These problems were also discussed in OIG audit reports on the status of USAID's implementation of the Results Act?

Office of Management and Budget Bulletin 97-01

USAID's Office of Financial Management did not prepare its Statement of Net Cost in accordance with the OMB Bulletin 97-01, Form and Content. Specifically, the Office of Financial Management did not develop responsibility segments, accumulate the costs and report the full cost assigned to each responsibility segment as required by OMB.

USAID's Computers Are Not Year 2000 Compliant

USAID is also vulnerable to major disruptions to its programs and operations if it does not adequately complete repairs to its computer systems to allow them to process data in the year 2000. In addition, to the extent that developing countries, which are the beneficiaries of USAID development assistance activities, encounter disruptions, USAID program accomplishments could be put at risk. As of the end of fiscal year 1998, USAID had not fully assessed its systems or the systems it provided to host countries. USAID also lacked detailed schedules and resource estimates and did not expect to meet government-wide target dates to implement compliant systems. In addition, USAID has not completed and tested contingency plans to ensure that it will be able to operate in the event of year 2000 caused disruptions. Due to the scope and complexity of the needed changes and the limited time remaining to correct problems, USAID faces a high risk that business operations and programs will be disrupted at the start of the new millennium.

Office of Inspector General'
March 1, 1998

[34] Audit of USAID Status in Implementing the Government Performance and Results Act of 1993 (Audit Report No. 9-000-98-003-P, September 3, 1998) and Audit of the Status of USAID's Implementation of the Government Performance and Results Act of 1993 (Audit Report No. 9-000-98-005-P, September 30, 1998).

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

USAID

Consolidated Financial Statements for Fiscal Year 1998

UNAUDITED

This page left intentionally blank.

TABLE OF CONTENTS

UNAUDITED

This page left intentionally blank.

OVERVIEW OF USAID

Background

The United States Agency for International Development (USAID) was created in 1961 to advance U.S. foreign policy interests by promoting broad-based, sustainable development and by providing humanitarian assistance for natural and man-made disasters. USAID typically works in countries committed to achieving sustainable development, but which lack the technical skills or resources necessary to implement policies and programs that will accomplish this result. In these countries, USAID emphasizes one or more of the Agency's six strategic goals depending upon a country's specific needs and the activities of other donors. USAID also works in countries which have made major commitments to cooperating with the United States in achieving complementary goals, particularly, the establishment and maintenance of regional peace. In these countries USAID typically enhances the country's capacity to continue to collaborate with the United States on goals of mutual interest.

Mission

USAID's mission is to contribute to U.S. national interests by supporting the people of developing and transitional countries in their efforts to achieve enduring economic and social progress and to participate more fully in resolving the problems of their countries and the world. USAID pursues its mission through partnerships with the people and governments of assisted countries, U.S. businesses, non-governmental organizations, academic institutions, other U.S. government agencies and international assistance agencies. In cooperation with its many partners, USAID identifies the needs of a country, assesses the country's commitment to sustainable progress, and develops country specific plans to address the country's needs or to enhance its contribution to the resolution of regional or global problems.

Organizational Structure

USAID is based in Washington, D.C. with a Headquaters staff consisting of the Office of the Administrator, nine bureaus and four independent offices. The Agency implements development assistance activities in: Africa (AFR); Asia and the Near East (ANE); Latin America and the Caribbean (LAC); and Europe and the New Independent States of the former Soviet Union (ENI). There are 69 field based missions implementing development programs and three regional services offices. In addition, USAID provides coordination with other donor nations in five countries.

PROGRAM PERFORMANCE

The Agency for International Development promotes sustainable development in six goal areas:

1. achieving broad-based economic grow&
2. building sustainable democracies;
3. human capacity built through education and training;
4. stabilizing world population and protecting human health;
5. managing the environment for long-term sustainability; and,
6. saving lives, reducing suffering, and reinforcing development.

Many Agency activities relate to **two** or more goals. For example, promoting community management of natural resources **often** enhances democracy by allowing citizens to exercise more control over their livelihood and destiny. Increasing economic opportunity for the poor typically enhances their sense of participatory democracy and the potential for good, local government. Likewise, **USAID** has found that as people become more educated, birth rates and child mortality drop, and nutrition improves. When girls are able to get a basic education, they raise healthier children. Improving education also encourages rule of law and helps develop an active and open civil society. **USAID** is increasingly planning activities to benefit **from** such natural synergies.

In all its activities the Agency collaborates closely with host country partners, non-governmental organizations, international financial institutions, and other donors. These partnerships are essential to **USAID's work**; they both increase program effectiveness and promote sustainability.

The remainder of this section provides a summary of the results within each goal area. Further detail on performance results will be provided in **USAID's** Management Accountability Report which will be available at the end of March, 1999.

1. Achieving Broad-Based Economic Growth

In May 1996, **USAID** and development communities adopted the challenge of reducing the proportion of people living in extreme poverty by half Eighty-five percent of the world's poor subsist in low-income developing countries and regions where poverty is widespread. Development programs have been working to provide the poor with life improving opportunities.

In 1997, the Agency had 145 programs supporting broad-based **economic growth** and agricultural development in 76 operating units (countries, regional **offices,** and central bureaus). These programs represent 29 percent of all **USAID** programs and 84 percent of all operating units. Of these programs, 67 were in developing countries, and 68 were in countries making the transition **from** communism. Another 10 were globally oriented.

UNAUDITED

Indicators and Results

Annual Growth Rates in real per capita income above 1 percent achieved.
Growth performance for 1994-97 improved substantially in all regions, compared with the 1992-96 base period. About two thirds of **USAID** recipient countries achieved the performance goal of per capita income growth higher than 1 percent, compared with about 45 percent in the base period. By region, the proportion of countries with such growth ranged **from** 50 percent (and rising) for Europe and the new independent states to 100 percent for Asia and the Near East.

Average annual growth in agriculture at least as high as population growth achieved in low-income countries.
The vast majority of low-income countries achieved agricultural growth at least as rapid as their population growth. Performance in sub-Saharan Africa improved dramatically. Overall, 25 out of 29 **USAID** recipients (86 percent) achieved this performance goal for 1994-96, compared with about 35 percent for the 1990-95 baseline period. This is primarily because of improved agricultural performance, and secondarily gradually declining rates of population growth.

Proportion of the population in poverty reduced by 25 percent in 10 years.
The goal of reducing the proportion of the population in poverty is among the goals of the Development Assistance Committee of the Organization for Economic Cooperation and Development, to which the United States participates. Overall, incomes have been expanding in line with the performance goal in 57 percent of **USAID** recipient countries, including low-income Asia, which accounts for the bulk of the global poverty.

Increased openness and greater reliance on private markets.
The Heritage Foundation compiles annual scores for economic freedom, which seek to measure the degree to which the policy and institutional setting supports well-functioning private markets that reward individual initiative. Overall, economic **freedom** has improved in 68 percent of **USAID-recipient** countries, remained unchanged for about 10 percent, and declined in 22 percent. Economic **freedom** has improved in at least 60 percent of the countries in each region.

2. Building Sustainable Democracies

USAID emphasizes four broad areas under its democracy and governance strategic **framework**:

- Rule of law and human rights;
- Credible and competitive political processes;
- A politically active civil society; and
- Transparent and accountable government institutions.

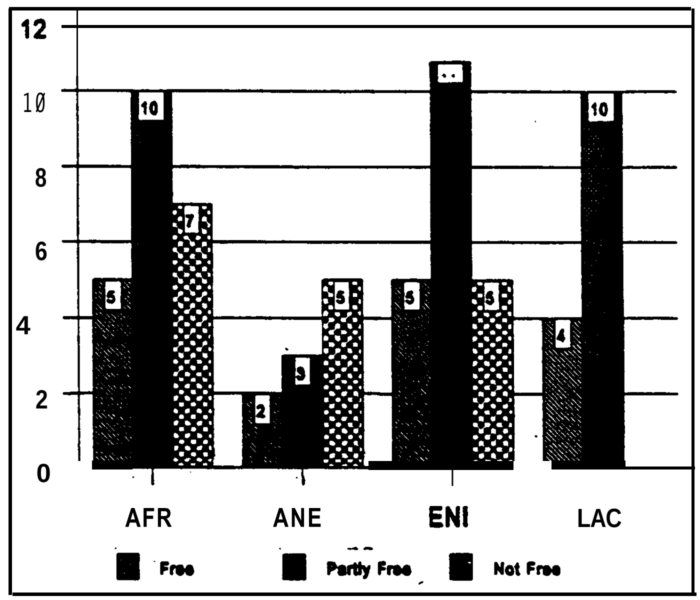
In **1997, 85** percent of **USAID's** country and regional programs provided assistance to democracy and governance.

UNAUDITED

Indicators and Results

The primary measure of democratic status is the country score of the Freedom House survey. While Freedom House scores do not provide a direct measure of USAID's democracy and governance assistance, they do provide important information on country development trends.

Figure 1



On average, according to Freedom House, the democratic status of USAID-assisted countries improved in 1997. Four countries moved up on the overall Freedom House scale; none declined. The best performance was in the LAC region, where Honduras and El Salvador improved from "partly free" to "free." In Europe and the new independent states, Azerbaijan moved from "not free" to "partly free." In Africa, Liberia changed from "not free" to "partly free." The overall classification did not change for any countries in the ANE region. Figure 1 compares the Freedom House ratings of countries receiving USAID democracy assistance. With the exception of the ANE region, countries categorized as "partly free" predominate. This finding indicates that many countries have undergone only a partial transition to democracy. In such incomplete transitions, often the executive branch continues to monopolize power, the judiciary is weak, local government lacks capacity, and the democratic culture necessary for broadened citizen participation is in an early stage of development.

3. Human Capacity Development

Education is crucial to growing up in the modem world. Without a decent education, children become adults with limited opportunities. In poor countries, improved education leads to faster and more sustainable economic and social development and contributes to the emergence of strong democratic institutions. The goal encompasses Agency objectives in basic and higher education.

USAID places special emphasis on expanding and improving primary education for the under-served population, especially for girls and women. USAID also seeks to provide literacy programs for adults and out-of -school children. In 1997, USAID allocated most of its human capacity development funding to basic education. The Agency provided

$127.9 million for basic education in three regions-Africa, Latin America and the Caribbean, and Asia and the Near East. Of that, $122.8 million (96 percent) went to basic education for children. The remaining $5.1 million supported adult literacy programs.

Indicators and Results

Full primary enrollment by 2015 achieved.
The United States is committed to the target of full primary'enrollment by 2015. A country is considered "on track" if its net primary school enrollment ratio is increasing at a rate fast enough to reach full enrollment by 2015, *if that rate is sustained.*

Among the nine countries in Africa with USAID programs contributing to basic education in 1997, five-Benin, Ethiopia, Mali, Namibia, and South A&a-reported the necessary data. Of the five, Namibia and South Africa are on track toward full primary enrollment by 20 15. A sixth country, Malawi, reported full primary enrollment in 1996. The three countries that did not report the necessary data were Ethiopia, Ghana, and Uganda.

Data problems were even more severe in the Asia and Near East region. Of five countries with basic education objectives-Cambodia, Egypt, India, Morocco, and Nepal-only Morocco reported sufficient data, showing Morocco to be on track toward full enrollment by 2015. Cambodia reported full primary enrollment in 1996.

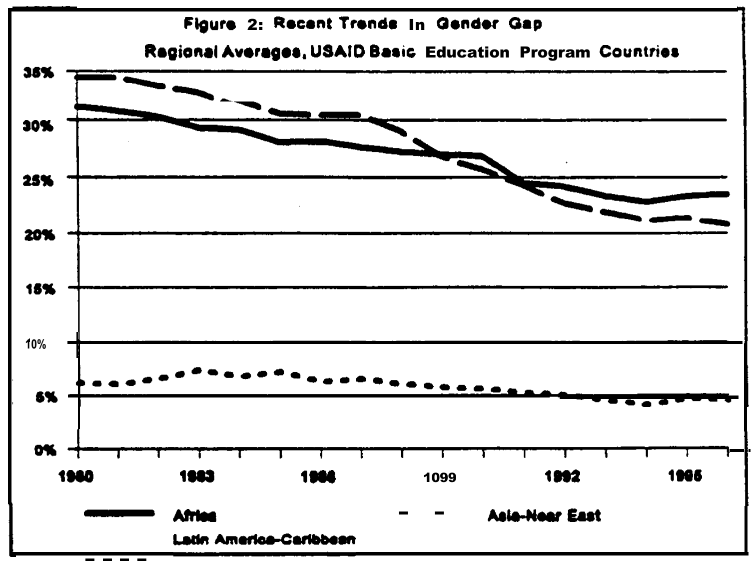
In Latin America and the Caribbean, USAID supported basic education programs in 10 countries in 1997, of which five, Brazil, Dominican Republic, El Salvador, Nicaragua, and Peru-reported the data necessary to calculate primary enrollment growth over the past decade. The first three were increasing net enrollments fast enough to reach full enrollment by 20 15. Nicaragua fell just short of the required growth rate. By contrast, Peru's net primary enrollment rate has fallen over the past decade, although there is some evidence of recovery since 1993.

Many countries in Europe and the new independent states do not report net enrollment rates. Among those that do, most have high rates of primary enrollment, though in some countries these have slipped in recent years. USAID does not provide direct support for basic education in this region.

Gender gap in primary enrollments reduced.
USAID supports eliminating the difference, for all practical purposes, between boys' and girls' enrollment rates at the primary level. To track progress toward this goal, USAID calculates a gender gap measure for each USAID-assisted country based on its gender equity ratio, the ratio of girls' to boys' *gross* primary enrollment ratios. Gender gaps for individual countries are' averaged across each region.

Figure 2 shows recent trends in the average gender gap among the countries that supported basic education programs in 1997. Although the regional averages conceal much country-level detail, they show a gradual narrowing of the gender gap in all three regions. Despite progress, however, the gender gap remains large in much of **Africa** and in many countries in Asia and the Near East. Among the nine **USAID** basic education countries in the **Africa** region, the average gender gap declined markedly from **28.1** percent in 1986 to **23.5** percent in 1996.

The five **USAID** basic education countries in Asia and the Near East region also achieved a dramatic reduction in the primary school gender gap over the past decade. Despite this impressive progress, each of these countries still has a long way to go to reach gender equality.



Progress has been slower in Cambodia and Egypt, though the gender gaps have been smaller there than in other countries in the region.

With the exception of Guatemala, gender gaps in primary enrollment rates are quite small among the nine countries with basic education objectives in Latin America and the Caribbean.

Enhanced responsiveness in higher education partnerships.

USAID fosters partnerships between institutions of higher education in the United States and overseas in an effort to enhance the contributions of host-country colleges and universities to development.

In Egypt, **USAID-fostered** partnerships helped Egyptian universities improve their research capacity. In South Africa, **USAID** provided grants to strengthen 15 historically disadvantaged institutions. **USAID** provided support to 9 institutions in Albania, Hungary, **Latvia,** Lithuania, Poland, and Slovakia to create or expand programs in management training and market economics education, and to 11 institutions in Russia and the Ukraine to **strengthen** educational programs in areas such as economic **restructuring,** health, and the environment.

In addition, **USAID's** Center for Human Capacity Development has supported the University Development Linkages Project since 1992. The program is designed to enhance long-term, sustainable collaboration between U.S. and developing country colleges and universities so that higher education institutions in developing countries can more effectively meet the development needs of their societies, and so that U.S. colleges and universities can increase the international dimension of their programs by attracting more foreign students or making the curriculum global in perspective. In 1997, the linkages program supported the formation of 41 partnerships, including **4** historically black colleges and universities in the United States. The highlights section provides more information on some of the results of these programs.

Performance indicators for **USAID's** higher education objective are under development.

4. Stabilizing World **Population** and Protecting Human Health

Population, health, and nutrition have been major **USAID** programs since the Agency was established. The Agency recognizes that population growth and population pressures both cause and affect ecological, economic, political, and social transformations. **USAID's** efforts to stabilize the world's population growth and combat poor health and nutrition affect many areas.

USAID has also taken on the challenges of reducing maternal mortality, reducing the impact of the HIV/AIDS pandemic, and reducing the threat of infectious diseases that pose serious public health risks. These areas are of vital importance to families in the United States, as well as to families in developing countries, because the world is becoming a much smaller community.

Indicators and Results

In its strategic plan, **USAID** established performance goals for each major area of population, health, and nutrition. By the year 2007, **USAID** along with other partners, is expected to achieve the following:

- a 20 percent reduction in average fertility rates
- a 25 percent reduction in average mortality rates for infants and children under 5
- a reduction in the proportion of underweight children under 3

The following three indicators have been proposed but, for technical reasons, have not been made operational yet. See Ml description in the 2000 Annual Performance Plan.

- a 10 percent reduction in the maternal mortality ratio
- a slowing of the rate of new HIV infections
- a reduction in deaths caused by infectious diseases (excluding **HIV/AIDS)**

Total Fertility Rate Reduced by 20 Percent: Figure 3 shows the progress made in achieving this goal through FY97.

Figure 3
Regional Total **Fertility Rates (number of children per woman)**

Year	AFR	ANE	EM	LAC
1992	6.1	3.6	2.1	3.5
19%	5.8	3.3	1.8	2.9
1997	5.7	3.2	1.7	2.9

. **Source: US Census Bureau. Weighted averages for USAID-assisted countries.**

Under-5 Mortality Bate Decreased by 25 Percent: **USAID's** goal of reducing under-5 mortality rates by 25 percent by 2007 contributes to achieving goals articulated at the World Summit for Children in 1990. **USAID** and other donors have done significant work in child survival programming and, as evidenced by Figure 4, have made progress in meeting this goal.

Figure 4
Regional Under-5 Mortality Rates (per 1,000 live births)

Year	AFR	ANE	ENI	LAC
1992	178.2	112.3	49.0	60.5
19%	164.6	97.0'	47.8	53.3
1997	162.4	93.7	47.3	51.5

Source: U.S. Census Bureau. Weighted averages for USAID-assisted countries.

5. Managing the Environment

USAID's environmental goal-protecting the world's environment for long-term sustainability-has long been considered **USAID's** silent goal. Environmental changes often go by unnoticed until a crisis erupts. Rapid population growth, industrialization, and urbanization all increase the demands made of the earth. The effects are alarming. Productive crop lands disappear, deserts enlarge, rich oceans are overfished, large inland lakes are polluted or drained. Wetlands are lost to urban sprawl and agricultural expansion. Essential ecosystems like tropical forests and coral reefs are **often** destroyed or severely damaged for short-term economic gain.

USAID is laying the groundwork now for interventions with its **1998-2002** Climate Change Initiative. The initiative will help ensure a substantial U.S. government financial commitment during this **period.USAID** is concentrating on those countries and regions that contribute most to net global greenhouse, i.e., Brazil, Central **Africa,** Central America, Central Asia, India, Indonesia, Mexico, Philippines, Poland, Russia, South **Africa,** and Ukraine.

In FY97, the Agency helped prevent or lessen environmental damage in more than 60 countries worldwide--compared with 52 countries the previous year. New environmental programs in Africa and Latin American and the Caribbean accounted for most of these. The Agency increased efforts to slow global climate change, improve natural resource

UNAUDITED

management, and improve energy services. These changes reflect, in part, the Agency's increased attention to transborder issues, such as global warming. USAID only decreased slightly its distribution of urban and biodiversity programs.

Indicators and Results

National environmental management strategies
A government's commitment to a cleaner environment and to better management of natural resources is crucial to sustainable development, but commitment and management are difficult to measure and interpret. The strength of environmental policies in any country reflects the priority its government assigns to environmental degradation. Many countries have completed national environmental action plans or similar environmental strategies in the past decade. Of USAID-assisted countries, 83 percent have completed them in sub-Saharan Africa, 71 percent in the Asia-Near East region, 53 percent in Latin America and the Caribbean and 48 percent in Central and Eastern Europe and the new independent states. Another 10 percent of USAID-assisted countries are preparing action plans. Still more are updating existing ones. USAID is well on its way to achieving the *Shaping the 21st Century goal* by 2005.

National protected areas and biodiversity conservation
Biodiversity is essential to environmental and economic sustainability. The main approach most countries have taken to conserve biodiversity is to establish systems of national 'parks, wildlife refuges, forest reserves, marine sanctuaries, and other formally protected areas. More than 900 million hectares of the earth's surface are officially designated as protected, an area nearly equal in size to the continental United States. Some experts recommend setting aside 10 percent to 15 percent of lands as protected areas. As of 1994, the most recent data available, sub-Saharan Africa has 6.8 percent (78.2 million hectares) of its area protected, Asia-Near East and North Africa have 6.1 percent (46.4 million hectares), Central and Eastern Europe and the new independent states have 4 percent (82.8 million hectares), and Latin America and the Caribbean (LAC) have 9.3 percent (73.5 million hectares). Each of these protected areas is at least 1,000 hectares and includes national parks, natural monuments, nature reserves or wildlife sanctuaries, protected landscapes and seascapes, and scientific reserves with limited public access.

Carbon dioxide emissions
Trends are not encouraging. Global energy use has risen nearly 70 percent since 1971 and will continue to increase over the next several decades. As energy use rises, there is a concomitant increase in greenhouse gas emissions. Fossil fuels supply roughly 90 percent of the world's commercial energy and account for more than 80 percent of carbon dioxide released into the atmosphere. Developing countries' commercial energy consumption will contribute approximately 40 percent of the world's carbon dioxide (CO_2) output by 20 10. Much of this will come from China and south Asia, which depend heavily on coal. Unfortunately, market conditions favor reliance on cheap fossil fuels. Actions are needed to increase energy efficiency; replace fossil fuels with cleaner,fuels; and develop and adopt renewable energy technologies.

Urban population and access to safe drinking water and sanitation services
Two of the main global indicators the Agency uses to measure progress toward sustainable urbanization are access to safe drinking water and access to sanitation services. In USAID-assisted countries, 63 percent of the urban population has access to safe water in sub-Saharan Africa, 67 percent has access in Asia-Near East and North Africa, and 80 percent in Latin America and the Caribbean. Few countries in Eastern Europe and the former Soviet Union report on access to safe water, so regional data are not available. Of USAID-assisted countries, 60 percent of the urban population has access to sanitation services in sub-Saharan Africa, 60 percent has access in Asia-Near East and North Africa, and 71 percent in Latin America and the Caribbean.

Energy efficiency and production from renewable sources
In 1997 USAID helped form a partnership between Columbia Gas and the Russian Utility Penzagaz to develop an automated customer information and payment system. Columbia helped Penzagaz establish a direct payment center, avoiding costly bank transaction fees. This resulted in a savings worth more than $61 million for Penzagaz.

Annual change of total forest area and natural resource management
This is just one indicator the Agency considers in its approach to sustainable natural resource management. From 1980 through 1995, the developing world lost nearly 200 million hectares of forests. The greatest threats are from roads, mining, accidental fires, unchecked logging, slash-and-bum agriculture, and land conversion to cattle ranching and cash crops.

6. Providing Humanitarian Assistance

Humanitarian assistance is an act of national conscience and an investment in the future. It is a response to U.S. values and ideals as it saves lives, reduces suffering, and protects health. USAID's humanitarian assistance goal is to save lives, reduce suffering associated with natural or man-made disasters, and reestablish conditions necessary for political or economic development.

USAID provides humanitarian assistance in three broad categories-natural disasters, man-made disasters, and complex emergencies. Natural disasters are caused by physical hazards such as drought, earthquake, fire, flood, and pest and disease outbreak. Man-made disasters are caused by human error in design, implementation, operation, or management, such as a building collapse or industrial accident. Complex emergencies may include natural disasters such as droughts, but are frequently caused or complicated by civil strife. They are manifested in armed conflict, death, displaced populations, hunger, and injury.

In all its humanitarian assistance endeavors, USAID works closely with other donors, international organizations, PVOs, and other U.S. agencies. Its partnerships with other groups enable USAID to leverage and share resources. All results given below represent the cumulative effects of USAID and other donor resources and activities.

Indicators and Results

In 1997, 20 countries and regional and central USAID offices had strategic objectives supporting one or more of the humanitarian assistance objectives-prevention, relief, or the most active, transition. Fifteen Missions and offices had objectives to assist with the transition process. Nine countries and offices pursued objectives in support of relief and another nine each supported prevention.

Measuring the impact of humanitarian assistance programs is challenging. First,. it is difficult to distinguish between various causes and effects. Second, USAID's country and regional programs operate at different levels and have different objectives, making an assessment of overall Agency performance difficult. Although saving lives is the primary aim of most emergency programs, preserving and promoting livelihoods is becoming equally important to achieving effective economic and political transitions.

USAID, with multilateral and bilateral donors, is beginning to pilot-test and implement information systems that will be used in emergency situations to monitor Agency capacity for saving lives and reducing suffering. In a preliminary effort to measure results of USAID efforts, the Agency selected the followingindicators:

- crude mortality rate in selected emergency situations
- levels of acute malnutrition stable at, or declining to, acceptable levels in emergencies
- number of people displaced by open conflict by region
- changes in the number and classification of designated "postconflict transition" countries

Since humanitarian assistance operates in fluid, complex situations, these indicators will be initially applied on a pilot basis to determine whether data collection is feasible. Reporting on these indicators requires working with other donors and agencies to develop systems that collect and report these indicators regularly.
In 1997, USAID reached more than 11.5 million people with emergency food aid through Title II P.L. 480 programs, implemented primarily by U.S. PVOs and the World Food Program in 28 countries in Africa, Asia, and Europe. The program provided 781,360 metric tons of Title II emergency food aid valued at $404.1 million.

The World Refugee Survey 1998 estimates there were 13.6 million refugees and asylum seekers in 1997. USAID provided emergency food aid to more than 10 million or 76 percent of them. (Data were not available for some programs.) Much of this assistance was provided through the World Food Program.

USAID's Office of Foreign Disaster Assistance (OFDA) provides emergency assistance primarily in health, sanitation, shelter, and water. In 1997, the office spent $140 million to help more than 18 million victims of 48 officially declared disasters in 46 countries. Of these, 13 were complex emergencies, 27 were natural disasters, and 8 were man-made emergencies.

In addition to the figures shown in the Figure 5, in 1997 the Bureau for Europe and the New Independent States (ENI) supported more than 8.4 million of the most vulnerable populations in Central and Eastern Europe and the new independent states, at a cost of more than $79.1 million. All the countries in this region were undergoing economic, political, and social transition. Several are also in conflict-Armenia, Azerbaijan, Bosnia-Herzegovina, Georgia, and Tajikistan.

Figure 5
FY 1997 Number of People Assisted by Bureau for Humanitarian Response Emergency Program, by Region*

Region	OFDA (% affected reached)	Food For Peace (% targeted reached)
Africa	15,606,000 (59%)	4,890,000 (61%)
Asia and Near East	1,470,000 (13%)	3,718,000 (83%)
Europe and the new independent states	1,539,000 (68%)	2,982,000 (95%)
Latin America and the Caribbean	143,000 (61%)	**
Total	18,766	11,590,000

*Office of Transition Initiatives programs (not included in table) include media activities that reach entire country populations. and demining activities that benefit refugees, returnees, merchants, and farmers who begin to use land and roads made safe. Determining the number of direct beneficiaries is difficult.
**There were no emergencies in this region in 1997 that required emergency food aid
Note: There may be emergencies where different USAID programs reach the same beneficiaries.

MANAGEMENT CONTROLS

USAID has undertaken comprehensive management reforms to improve accountability and to make the Agency more efficient and results-oriented Although the reform process continues, USAID has dramatically changed the way it does business and its approach to the delivery of foreign assistance.

USAID's management controls have been reengineered over the past few years to support management reforms and improve the integrity of its operations. For example, USAID was reorganized to reduce overlap, unnecessary layering, and to facilitate empowerment of Agency staff Operation procedures were adopted for USAID programs which were based on result achievement, improved assistance delivery, and better customer service. In addition, an automated directives system was implemented to provide USAID staff

UNAUDITED

access to policies, procedures and supplemental information needed to effectively implement Agency programs and manage administrative operations.

USAID is also well underway in rationalizing and upgrading its management controls in the area of financial management.

In fiscal year 1997, USAID deployed a new management information system worldwide to improve accountability and provide more timely information for decision making. The New Management System (NMS) encompasses all of the core business systems-- accounting, procurement, budget, and program operations. After a series of technical difficulties, selected modules of NMS were suspended in field missions, while continuing operations in Washington. USAID changed the approach to the development of NMS to correct the technical difficulties, and management control deficiencies identified by USAID staff and the Office of the Inspector General.

USAID's Office of Financial Management subscribes to the recommendations of the Vice-President's National Presidents Review and the vision statement prepared by the CFO council and has created its own vision and strategic plan to move USAID to the forefront of a new era of responsive, effective, collaborative, customer-oriented financial management. To make this vision a reality, USAID embarked on an ambitious undertaking to replace thirteen disparate financial management systems and applications with a single integrated financial and information management system.

The objectives of USAID's single integrated financial management system are to:

- Capture accounting transactions when and where they occur,
- Reduce the creation and flow of paper, and
- Generate information, not just data.

USAID's goal is an integrated financial management system linking the mixed financial systems for budgeting, procurement, program operations, human resources and property management. This will enable USAID to capture accounting transactions when and where they occur, eliminating redundant data entry and greatly simplifying the reconciliation processes.

The problem with current USAID legacy financial systems is their lack of integration. The estimated level of redundancy among these systems is forty-five percent. Thus, lack of data integrity coupled with redundant system maintenance is a major problem which needs immediate corrective action. Like many other federal agencies, most of USAID's legacy accounting systems are outdated, expensive to maintain, non-integrated, and produce data that is inconsistent with data contained within other support systems. Problems with the legacy systems include the following:

- USAID uses numerous headquarters and overseas financial management systems, subsystems, and "cuff record" systems that require the input of redundant and inadequately controlled data.

- USAID's core financial systems are not integrated. As an example, obligation and disbursementtransactions which take place in the field are first recorded in the Mission Accounting and Control System (MACS), electronically transmitted to Washington, summarized, and then manually re-entered in summary form in Washington.

In the fiscal year (FY) 1997 Federal Managers Financial Integrity Act (FMFIA) report; USAID identified material weaknesses in control systems and procedures. These included weaknesses in the following areas:

- financial management systems and procedures;
- security and reporting capabilities of NMS;
- information resources management processes; and
- the computer security program.

Although progress has been made, the weaknesses were not fully corrected during FY 1998. Two additional weaknesses were identified in FY 1998 relating to USAID's program performance reporting and the Year 2000 (Y2K) problem.

The following is a brief description of each material weakness, corrective action, and planned corrective dates.

Financial Management Systems and Procedures

Non-Conformance of USAID's Financial Management System

USAID's financial management systems do not filly comply with federal financial management system requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Agency management and the Office of the Inspector General have identified internal control and security deficiencies and other vulnerabilities. The system also does not meet important financial management systems requirements, such as the capability of producing all required financial reports and other management information at an acceptable level of timeliness and accuracy.

The lack of an effective, integrated financial management system has been identified as a material weakness since 1988. Several efforts have been made to resolve the deficiencies, including the development of the Agency-Wide Accounting and Control System (AWACS), a component of the NMS. This new system did not meet the Agency's expectations. AWACS does not comply with important financial management system requirements. A three-pronged strategy is being implemented to improve the accounting system. The strategy combines the use of a commercial-off-the-shelf core accounting system with cross servicing and out-sourcing of some operational areas. A business process improvement analysis was completed during fiscal year 1998 which helped to define functional requirements for the accounting system. Detailed evaluation criteria for a new system will be in place by February 1999. USAID plans to implement the new accounting system in USAID/Washington in FY 2000, followed by implementation in field missions in FY 2001.

Additional controls and an integrated general ledger system are needed to effectively manage the direct loan program. A credit review board has been established to direct the policy, planning and implementation of the Agency's portfolio of loans and loan guarantees. To strengthen the management of the loan program, servicing of loan accounts will be out sourced to Riggs National Bank in 1999. In addition, the credit program general ledger will be migrated to the new accounting system in FY 2001.

Financial Management Procedures

USAID's financial management policies and procedures have not been fully updated and incorporated into the automated directives system. Therefore, policy guidance and regulations are not readily available to USAID staff from a complete and easily accessible source. USAID expects to continue to take appropriate steps to correct this Weakness.

Security and Reporting Capabilities of NMS

System Security and Access Controls

In October 1996, USAID implemented a portfolio of systems under an initiative entitled the New Management System (NMS). The initiative was to provide the Agency with an integrated suite of applications to perform the required business functions associated with the USAID mission, to support the reporting and tracking requirements of the Agency, and to bring the Agency into full compliance with U.S. government standards and reporting requirements. The NMS was designed to meet USAID's system needs in support of the extensive management reform efforts to transform the Agency into a results-oriented organization. Following the implementation of the NMS worldwide, legacy and feeder systems were to be maintained, replaced or absorbed, as the situation warranted, and, as applicable, their data migrated into the NMS.

One year after deploying the NMS applications, Agency management determined that a variety of vulnerabilities, deficiencies, and concerns existed with regard to the system as implemented. NMS's current design creates a risk for unauthorized access to Privacy Act information and the system does not generate an adequate audit trail when data is changed. NMS does not contain a comprehensive integrated computer security and access control plan which clearly defines internal control objectives. An assessment of risks and deficiencies associated with NMS has been completed and a contractor hired to implement a comprehensive security program. Security enhancements for NMS are being implemented and are scheduled for completion by fiscal year 2001.

Svstem Reporting and Resource Management Canabilities

NMS reporting and resource management capabilities are also identified as a material weakness, USAID's ability to maximize management efficiency was impaired by the lack of accurate and timely NMS generated reports. The financial management component of NMS does not always produce reliable obligation and expenditure information, resulting in "cuff' records being used. Using a cuff record system increases the risk of over or under obligating Agency resources. Data transfer from the Agency's legacy financial systems to NMS was substantially difficult and caused reports to be unreliable and payments delinquent. Although many useful reports have been generated from NMS, more improvement is needed. Long-term strategy to correct this vulnerability is planned in conjunction with the implementation of the new core accounting system.

Information Resources Management Processes

Organizational and management deficiencies exist in the Agency's information resources management practices. During fiscal year 1998, USAID began implementation of a new information technology management strategy which will improve compliance with the Clinger-Cohen Act. The new approach identifies and incorporates industry-wide best-practices and lessons learned to improve management discipline. USAID has established a Capital Investment Review Board (CIRB) for Information Technology (IT) to provide broad management oversight for investments. The CIRB will oversee the development, refinement and documentation for the Agency's IT portfolio; the completion of an Agency IT architecture for Y2K; and the initiation of long-term technical architecture planning to guide preparation, evaluation, and selection of USAID technology investments by the end of FY 2000.

Computer Security Program

USAID's information system security program does not currently meet the requirements of the Computer Security Act and Office of Management and Budget guidance. In January 1998, USAID hired a senior information professional to serve as the Agency's Information System Security Officer. In consultation with the Office of the Inspector General, an information security program plan has been developed and is being implemented. A risk analysis software tool has been procured and the internal networks have been secured from hackers. Steps are now being taken to incorporate security requirements into every major system and information technology initiative. USAID expects to complete the objectives of the agency-wide information system security plan by fiscal year 2003.

Program Performance Reporting

USAID's performance reporting does not adequately link the Agency's performance goals with its programs nor does it ensure current data results. To correct this deficiency USAID has issued updated guidance on performance monitoring and evaluation, improved the documentation and program performance review process, and reviewed the use of GPRA reporting. Planned corrective actions include:

- assessing and revising the Agency's Strategic Plan;
- making corresponding changes to the Annual Performance Plan and the Annual Performance Report; and,
- developing and implementing a managerial cost accounting program to attribute costs across various activities and programs.

By October 1999, USAID will have assessed how operating units are evaluating programs and using the information in decision making and to assess and report performance. USAID expects to correct this weakness by fiscal year 2000.

Year 2000 Problem

The Agency's Office of Information Resources Management has implemented a comprehensive Y2K compliance review of the Agency's systems, hardware and software. An assessment has not been completed of the implications of Y2K for overseas offices nor have necessary corrective actions been completed to assure compliance of all mission critical systems with Y2K guidance. In addition to the mission critical systems, USAID is affected by the information technology applications which are part of the assistance provided to countries and institutions, as well as systems and equipment run by others, particularly those in the countries where USAID works.

USAID has devoted substantial resources to assessing, repairing, testing and implementing systems and applications that may be affected by the Y2K problem. An assessment of mission critical systems and a renovation plan was completed in July 1998. In addition, a schedule has been established for making mission critical systems Y2K compliant. USAID believes that the necessary modifications, implementation and validation of all mission critical systems can be completed by September 1999.

USAID has initiated a contingency planning exercise to cover its most critical operational systems, focusing initially on the financial accounting systems.

ANALYSIS OF FINANCIAL, STATEMENTS

FY 1998 marks the first year that agencies are required to produce financial statements in accordance with the Statement of Federal Financial Accounting Standards Number 2, Entity and Display. Due to the significant differences in reporting requirements between FY 1997 and FY 1998, USAID has decided not to present comparative statements. Comparative statements are not required by the Office of Management and Budget, (OMB) until reporting periods beginning after September 30, 1999.

During FY 1998, net position decreased by $7.413 million. This decrease is primarily due to a change in the presentation of Resources Payable to Treasury for Credit Loan

Programs. $6.212 million in Resources Payable to Treasury was reclassified from net position to other intragovernmental liabilities.

In FY 1997, in consultation with OMB, these amounts were classified as invested capital (a component of net position) for financial statement reporting purposes. This decision was based on OMB Circular 94-O 1, which included pre-credit reform loans financed by appropriations in its definition of invested capital. In addition, the reclassification of Resources Payable to Treasury as an equity account eliminated a discrepancy between the Statement of Operations and the Statement of Changes in Net Position. This discrepancy occurred when income and expense were closed to Resources Payable to Treasury, as required by the Credit Reform Act.

During FY 1998, invested capital was removed from the U.S. Standard General Ledger. Additionally, in the new Entity and Display statements, the closing of income and expenses to Resources Payable to Treasury is recognized as a decrease in Unexpended Appropriations on the Statement of Changes in Net Position, thereby eliminating any discrepancies between the statements. By reclassifying Resources Payable to Treasury as a liability, rather than as a component of net position, consistency between the financial statements is maintained and the payable is properly reflected as a liability.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The financial statements have been prepared to report the financial position and results of operations of USAID, pursuant to the requirements of 31 U.S.C. 3515(b).

While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

U.S. AGENCY FOR **INTERNATIONAL** DEVELOPMENT
CONSOLIDATED BALANCE SHEET
As **of September 30, 1998**
(In millions)

ASSETS		
Entity Assets:		
Intragovernmental		
Fund Balance with Treasury (Note 2)		**9,735**
Accounts receivable, net (Note 3)		503
Advances and prepayments (Note 4)		' 38
Governmental		
Accounts receivable (Note 3)		2
Advances and prepayments (Note 4)		1,036
Credit program receivables (Note 5)		6,581
Cash and other monetary assets (Note 6)		172
Operating materials and supplies (Note 7)		27
Property plant and equipment, net (Note 8)		28
Total **Assets**	**$**	18.122

***The** accompanying notes are an integral part of these financial statements.*

UNAUDITED

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED BALANCE SHEET
As of September 30, 1998
(In **millions)**

LIABILITIES		
Liabilities Covered by Budgetary Resources		
Intragovernmental liabilities		
Accounts payable (Note 9)	$	210
Debt (Note 10)		308
Other intragovernmental liabilities (Note 11)		6,222
Governmental liabilities		
Accounts payable (Note 9)		1,488
Liabilities for loan guarantees (Note 5)		595
Other governmental liabilities (Note 11)		196
Total liabilities covered by budgetary resources		9,019
Liabilities Not Covered by Budgetary Resources		
Governmental liabilities		
Liabilities for loan guarantees (Note 5)		348
Accrued unfunded annual leave and separation pay (Note 12)		27
Accrued unfunded Workers Compensation Benefits (Note 13)		42
Total liabilities not covered by budgetary resources		417
Total Liabilities	$	9.436
NET POSITION		
Unexpended appropriations		8,723
Cumulative results of operations		(37)
Total net position		8.686
Total Liabilities and Net Position	$	18,122

The accompanying notes are an integral part of these financial statements.

UNAUDITED

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF NET COST
For the year ended September 30, 1998
(In millions)

Achieving Broad-Based Economic Growth		
Intragovernmental	S	70
With the public		4.240
Total		4.310
Less earned revenues		(117)
Net program costs		4.193
Building Sustainable Democracies		
Intragovernmental		47
With the public		325
Total		372
Less earned revenues		-
Net program costs		372
Human Capacity Built Through Education and Training		
Intragovernmental		6
With the public		660
Total		666
Less earned revenues		(1)
Net program costs		665
Stabilizing World Population and Protecting Human Health		
Intragovernmental		81
With the public		1.087
Total		1.168
Less earned revenues		(1)
Net program costs		1.167
Managing the Environment for Long-Term Sustainability		
Intragovernmental		75
With the public		366
Total		441
Less earned revenues		(31)
Net program costs		410
Saving Lives, Reducing Suffering, and Reinforcing Development		
Intragovernmental		62
With the public		341
Total		403
Less earned revenues		(29)
Net program costs		374
Less earned revenues not attributed to programs		(3)
Net Cost of Operations	$	7.178

Tk accompanying notes are an integral part of these financial statements

UNAUDITED

U.S AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Year Ended September 30, 1998
(In millions)

Net Cost of Operations	$	(7,178)
Financing Sources (other than exchange revenues)		
Appropriations Used		6,389
Taxes (and other non-exchange revenues)		7
Donations (non-exchange revenue)		50
Imputed Financing		14
Other Financing Sources		181
Net Results of Operations		(537)
Prior Period Adjustments (Note 15)		(80)
Net Change in Cumulative Results of Operations		(617)
Increase (Decrease) in Unexpended Appropriations		(6,796)
Change in Net Position		(7,413)
Net Position-Beginning of Period		16,099
Net Position-End of Period	$	8,686

The accmpanying notes are an **integral** *part of these statements*

UNAUDITED

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF BUDGETARY RESOURCES
For the Year Ended September 30, 1998
(In millions)

Budgetary Resources:		
Budget authority	$	6,368
Unobligated balances - beginning of period		1,841
Spending authority from offsetting collections		1,523
Adjustments		(1,130)
Total budgetary resources	$	8.602
Status of Budgetary Resources:		
Obligations incurred	$	6,805
Unobligated balances - available		895
Unobligated balances - not available		902
Total, status of budgetary resources	$	8.602
Outlays:		
Obligations incurred	$	6,805
Less: spending authority from offsetting collections and adjustments		(1,701)
Obligated balance, net - beginning of period		8,365
Obligated balance transferred, net		
Less: obligated balance, net - end of period		8,441
Total outlays	$	5,028

The accompanying notes are an integral *part of these statements*

UNAUDITED

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
CONSOLIDATED STATEMENT OF FINANCING
For the Year Ended September 30, 1998
(In millions)

Obligations and Nonbudgetary Resources		
Obligations incurred	$	6,631
Less: Spending authority for offsetting collections and adjustments		1,325
Donations not in the budget		50
Fiicing Imputed for Cost Subsidies		14
Exchange revenue not in the budget		(749)
Non-exchange revenue not in the budget		2
Total obligations as adjusted, and nonbudgetary resources		7,273
Resources That Do Not Fund Net Cost of Operations		
Change in amount of goods, services, and benefits ordered but not yet received or provided		(84)
Costs capitalized on the balance sheet		(700)
Financing sources that fund costs of prior periods		(53)
Other		(146)
Total resources that do not fund net cost of operations		(983)
Costs That Do Not Require Resources		
Depreciation and amortization		6
Revaluation of assets aud liabilities		2
other		704
Total costs that do not require resources		712
Financing Sources Yet to be Provided		176
Net Cost of Operations	$	7,178

The accompanying notes are an integral part of these statements

UNAUDITED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

These financial statements report USAID's the financial position and results of operations. They have been prepared using USAID's books and records in accordance with Agency accounting policies, the most significant of which are summarized in this note. The statements are presented in accordance with the applicable form and content requirements of the Office of Management and Budget (OMB) Bulletin 97-O 1, Form and Content of Agency Financial Statements, and the Government Management Reform Act of 1994.

USAID accounting policies follow an "other comprehensive basis of account" as agreed to, and published by the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Comptroller General. These policies are based on the following, on the following hierarchy.

1. Accounting standards and principles, known as Statements of Federal Financial Accounting Standards (SFFAS), recommended by the Federal Accounting Standards Advisory Board (FASAB) and approved and issued by the above named offkials.

2. Interpretations related to the SFFASs issued by OMB.

3. Form and content requirements in OMB Bulletin 97-01.

4. Accounting standards contained in USAID's accounting policy manuals and handbooks.

5. Accounting principles published by authoritative standard-setting bodies (such as the Financial Accounting Standards Board (FASB)) and other authoritative sources (1) when no guidance is available from the other sources listed and (2) when the use of such accounting standard makes these financial statements more meaningful.

B. Reporting Entity

Established in 1961 by President John F. Kennedy, USAJD is the independent U.S. Government agency that provides economic development and humanitarian assistance to advance United States economic and political interests overseas.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Programs

The financial statements reflect the various program activities, shown by appropriation in the financial statements, which include such programs as the Economic Support Fund, Development Assistance, Assistance for the New Independent States of the Former Soviet Union, Development Fund for Africa, Special Assistance Initiatives, International Disaster Assistance, International Organizations and Programs, and Direct and Guaranteed Loan Programs. This classification is consistent with the Budget of the United States.

Economic Support Fund

Programs funded through this account provide economic assistance to select countries in support of efforts to promote stability and U.S. security interests in strategic regions of the world.

Development Assistance

This program provides economic resources to developing countries with the aim of bringing the benefits of development to the poor. The program promotes broad-based, self-sustaining economic growth and supports initiatives intended to stabilize population growth, protect the environment and foster increased democratic participation in developing countries. The program is concentrated in those areas in which the United States has special expertise and which promise the greatest opportunity for the poor to better their lives.

Assistance for the New Independent States of the Former Soviet Union

This account provides funds for a program of assistance to the independent states that emerged from the former Soviet Union. These funds support U.S. foreign policy goals of consolidating improved U.S. security; building a lasting partnership with the New Independent States; and providing access to each other's markets, resources, and expertise.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Development Fund for Africa

The Development Fund for Africa account provides development assistance to sub-Saharan African countries. This account is designed to enhance USAID's effectiveness in meeting Africa's development requirements. These resources finance both project and non-project assistance to address shared development programs and policy objectives in reform-oriented African countries. These funds also support initiatives intended to promote economic growth, stabilize population growth, protect the environment and foster increased democratic participation.

Special Assistance Initiatives

This program provides funds to support special assistance activities. The majority of funding for this program in fiscal year 1997 was for democratic and economic restructuring in Central and Eastern European countries consistent with the objectives of the Support for East European Democracy (SEED) Act. All SEED Act programs support one or *more of the following strategic objectives: promoting broad-based economic growth with an emphasis on privatization, legal and regulatory reform and support for the emerging private sector; encouraging democratic reforms; and improving the quality of life including protecting the environment and providing humanitarian assistance.

International Disaster Assistance

Funds for the International Disaster Assistance Program provide relief, rehabilitation, and reconstruction assistance to foreign countries struck by disasters such as famines, floods, hurricanes and earthquakes; support assistance in disaster preparedness, prevention and mitigation, as well as the longer term recovery efforts managed by the Office of Transition Initiatives.

Child Survival and Disease

This program provides economic resources to developing countries to support programs to improve infant and child nutrition with the aim of reducing infant and child mortality rates; to reduce HIV transmission and the impact of the HIV/AIDS pandemic in developing countries; to reduce the threat of infectious diseases of major public health importance such as polio, and malaria; and to expand access to quality basic education for girls and women.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- Continued

International Organizations and Programs

The United States makes assessed payments and contributes to voluntary funds of over twenty-five international organizations and programs involved in a wide range of sustainable development, humanitarian, and scientific activities.

Direct and Guaranteed Loans:

Direct Loan

These loans are authorized under Foreign Assistance Acts, various predecessor agency programs, and other foreign assistance legislation. Direct Loans are issued in both U.S. dollars and the currency of the borrower. Foreign currency loans made "with maintenance of value" place the risk of currency devaluation on the borrower, and are recorded in equivalent U.S. dollars. Loans made "without maintenance of value" place the risk of devaluation on the U.S. Government, and are recorded in the foreign currency of the borrower.

Urban and Environmental

The Urban and Environmental (UE) program, formerly the Housing Guarantee Program, extends guaranties to U.S. private investors who make loans to developing countries to assist them in formulating and executing sound housing and community development policies that meet the needs of lower income groups.

Micro and Small Enterprise Development

The Micro and Small Enterprise Development (MSED) Program supports private sector activities in developing countries by providing direct loans and loan guarantees to support local micro and small enterprises.

Israeli Loan Guarantee

Congress enacted the Israeli Loan Guarantee Program in Section 226 of the Foreign Assistance Act to support the costs for immigrants resettling to Israel from the former Soviet Union, Ethiopia, and other countries. Under this program, the U.S. Government will guarantee the repayment of up to $10 billion in loans from commercial sources, to be borrowed in $2 billion annual increments. Guarantees are made by USAID on behalf of the U.S. Government, with funding responsibility and basic administrative functions resting with USAID.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- Continued

Ukraine Loan Guarantee

The Ukraine Export Credit Insurance Program was established with the support of the Export-Import Bank of the U.S. to assist Ukrainian importers of American goods. The program commenced operations in Fiscal Year 1996 and is expected to expire in Fiscal Year 1998. Guarantees in the portfolio have maturities of six to eighteen months.

Fund Types

The accompanying consolidated financial statements for USAID include the accounts of all funds under USAID's control. The agency maintains 26 general funds, 1 special fund, 11 revolving funds, 4 trust funds, and 4 deposit funds.

General and Special funds are used to record financial transaction under Congressional appropriations or other authorization to spend general revenue.

Revolving funds are established by law to finance a continuing cycle of operations, with receipts derived from such operations usually available in their entirety for use by the fund without further action by Congress.

Trust funds are credited with receipts generated by the terms of the trust agreement or statute. At the point of collection, these receipts are unavailable, depending upon statutory requirements, or available immediately.

Deposit funds are established for (1) amount received for which USAID is acting as a fiscal agent or custodian, (2) unidentified remittances, (3) monies withheld from payments for goods or services received, and (4) monies held waiting distribution on the basis of legal determination

Trust Funds

The Foreign Currency Trust Funds were established to maintain foreign currencies owned by participating governments, which the Agency holds in trust. These funds are used to pay for program and operating expense of USAID-related activities in a foreign country. Funds may be withdrawn only by mutual agreement between the participating government and the United States. If the bilateral agreement is terminated , all remaining funds revert to the participating government.

The U.S. Dollar Advances from Foreign Governments Trust Fund was established to maintain advances of U.S. dollars from foreign governments and/or international

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

organizations to facilitate the purposes of the Foreign Assistance Act of 1961. USAID acts in a fiduciary capacity in carrying out specific activities and programs in accordance with bilateral agreements with foreign countries. The Agency draws from the Foreign Governments Trust Fund balances to pay for related expenses.

The Gifts and Donations Trust Fund was established to maintain money, funds, property, and services of any kind made available by gift, device, bequest, and grant.

The Foreign Service National Separation Pay Trust Fund was established to fund and account for separation payments for eligible foreign service national employees who voluntarily terminate employment. It is applicable only in those countries that, because of local compensation plans, accrue a lump-sum voluntary-separation benefit based upon years of service and rate of pay.

The unexpended balance in trust funds at year end is recorded in the financial statements. Further, to the extent that the income from the trust funds is used towards USAID expenses, the income is recorded as “other income” in the financial statements.

Social Progress Trust and Enterprise Development Funds

Though not recorded in the financial statement, USAID has established several unique loan and enterprise funds to support economic growth in accordance with the authorizing legislation. The major funds include the Latin American Social Progress Trust Fund administered by the Inter-American Development Bank, Enterprise Funds in Central and Eastern Europe and the former Soviet Union, authorized under the Support for East European Democracy and Freedom Support Acts, and the South African Enterprise Fund.

USAID does not take an active role in managing these funds beyond authorizing their transfer for the U.S. Government. There has been no financial control over these institutions since they were established. However, if the funds are terminated or liquidated, these funds should be returned to the U.S. Government. The government has an equity interest in these funds but they are not measurable and accordingly are not recorded in the financial statements.

C. Basis of Accounting

The accompanying financial statements have been prepared on an accrual basis. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints on, and controls of: the use of federal finds.

NOTE **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

D. Budgets and Budgetary Accounting

The components of USAID's budgetary resources include current budgetary authority (that is, appropriations and borrowing authority) and unobligated balances remaining from multi-year and no-year budget authority received in prior years. Budget authority is the authorization provided by law to enter into financial obligations that result in immediate or future outlays of federal funds. Budgetary resources also include reimbursement and other income (that is, spending authority from offsetting collections credited to an appropriation of fund account) and adjustments (that is, recoveries of prior year obligations).

Pursuant to Public Law 101-S 10, unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but

not new obligations, until that account is canceled. When accounts are canceled five years after they expire, amounts are not available for obligations or expenditure for any purpose and are returned to Treasury.

Pursuant to Section 511 of USAID's Appropriations Act for fiscal years 1994 through 1998, or Section 5 17 for USAID's Appropriations Act for fiscal years 1987 through 1993, funds appropriated for certain purposes under the Foreign Assistance Act of 196 1, as amended, shall remain available until expended if such funds are initially obligated within their period of availability.

E. Revenues and Other Financing Sources

USAID receives the majority of its funding through congressional appropriations -- annual, multi-year, and no-year appropriations -- that may be used within statutory limits. Appropriations are recognized as revenues at the time the related program or administrative expenses are incurred. Appropriations expended for capitalized property and equipment are not recognized as expenses. In addition to funds warranted directly to USAID, the agency also receives allocation transfers from the Commodity Credit Corporation and the Department of State.

Additional financing sources for USAID's various credit programs and trust funds include amounts obtained through collection of guaranty fees, interest income on rescheduled loans, penalty interest on delinquent balances, permanent indefinite borrowing authority from U.S. Treasury, proceeds from the sale of overseas real property acquired by USAID, and advances from foreign governments and international organizations.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenues are recognized as financing sources to the extent that they were payable to USAID from other agencies, other governments and the public in exchange for goods and services rendered to others.

F. Fund Balances with the U.S. Treasury.

Cash receipts and disbursements are processed by the U.S. Treasury. The balances with Treasury are primarily appropriated funds that are available to pay current liabilities and finance authorized purchase commitments, but they also include revolving, deposit, and trust funds.

. G. Foreign Currency

The Direct Loan Program has foreign currency funds which are used to disburse loans in certain countries. Those balances are reported at the U.S. dollar equivalents using the exchange rates prescribed by the U.S. Treasury. A gain or loss on translation is recognized for the change in valuation of foreign currencies at year-end.

H. Accounts Receivable

Accounts receivable consist of amounts due mainly from foreign governments but also from other Federal agencies and private organizations. USAID regards amounts due from other Federal agencies as 100 percent collectible. The Agency establishes an allowance for uncollectible accounts receivable for non-loan or revenue generating sources that have not been collected for a period of over one year.

L Credit Program Receivable

Loans are accounted for as receivables after funds have been disbursed. For loans obligated before October 1, 1991 (the pre-credit reform period), loan principal, interest, and penalties receivable are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on a method prescribed by OMB that takes into account country risk and projected cash flows.

For loans obligated on or after October 1,199 1, the loans receivable are reduced by an allowance equal to the present value of the subsidy costs (due to the interest rate differential between the loans and Treasury borrowing, the estimated delinquencies and defaults net of recoveries, the offset from fees, and other estimated cash flows) associated with these loans. This allowance is re-estimated when necessary and changes reflected in the operating statement.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Loans are made in both U.S. dollars and foreign currencies. Loans extended in foreign currencies can be with or without "Maintenance of Value" (MOV). Those with MOV place the currency exchange risk upon the borrowing government; those without MOV place the risk on USAID. Foreign currency exchange gain or loss is recognized on those loans extended without MOV place the risk on USAID. Foreign currency exchange gain or loss is recognized on those loans extended without MOV, and reflected in the net credit programs receivables balance.

Credit program receivables also include origination and annual fees on outstanding guarantees, interest on rescheduled loans and late charges. Claims receivables (subrogated and rescheduled) 'are due from foreign governments as a result of defaults for guaranteed loans. Receivables are stated net of an allowance for uncollectible accounts, determined using a country-specific identification methodology.

While estimates of uncollectible loans and interest are made using methods prescribed by OMB, the final determination as to whether a loan is collectible is also affected by actions of other U.S. Government agencies.

J. Advances and Prepayments

Funds disbursed in advance of incurred expenditures are recorded as advances. Most advances consist of funds disbursed under letters of credit to contractors and grantees. The advances are liquidated and recorded as expenses upon receipt of reports of expenditures from the recipients.

K. Operating Materials and Supplies

USAID has operating materials and supplies held for use that consist mainly of computer paper and other expendable office supplies not in the hands of the user. USAID also has materials and supplies in reserve for foreign disaster assistance stored at strategic sites around the world. These consist of tents, vehicles, and water purification units. The Agency also has birth control supplies stored at several sites.

USAID's office supplies are deemed items held for use because they are tangible personal property to be consumed in normal operations. Agency supplies held in reserve for future use are not readily available in the market, or there is more than a remote chance that the supplies will be needed, but not in the normal course of operations. Their valuation is based on cost and they are not considered "held for sale". USAID has no supplies categorizable as excess, obsolete, and unserviceable operating materials and supplies.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

L. Property, Plant and Equipment

USAID capitalizes all property, plant and equipment that have an acquisition cost of $25,000 or greater and a useful life of two years or more. Acquisitions that do not meet these criteria are recorded as operating expenses. Assets are capitalized at historical cost and depreciated using the straight-line method. Real property is depreciated over 20 years, nonexpendable personal property is depreciated over 3 to 5 years, and capital leases are depreciated according to the terms of the lease. The Agency operates land, buildings, and equipment that are provided by the General Services Administration. Rent for this property is expensed. Internally developed and contractor developed software is not capitalized because it is for internal Agency use only.

M. Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by USAID as the result of transactions or events that have already occurred. However, no liability can be paid by the Agency without an appropriation or borrowing authority. Liabilities for which an appropriation has not been enacted are therefore classified as liabilities not covered by budgetary resources (unfunded liabilities), and there is no certainty that the appropriations will be enacted. Also, USAID non-contract liabilities can be abrogated by the U.S. Government, acting in its sovereign capacity.

N. Liabilities for Loan Guarantees

The Credit Reform Act (CRA) of 1990, which became effective on October 1, 1991, has significantly changed the manner in which USAID's loan programs finance their activities. The main purpose of CRA was to more accurately measure the cost of Federal credit programs and to place the cost of such programs on a basis equivalent to other Federal spending. Consequently, commencing in fiscal 1992, the loan program's funding for activities changed so that activities are funded through direct appropriation provided for that year only, rather than through cumulative appropriations granted in prior years and accumulated under the Revolving Fund.

For USAID's loan guarantee programs, when guarantee commitments are made, the program records a guarantee reserve in the program account and this reserve is based on the present value of the estimated net cash outflows to be paid by the Program as a result of the loan guarantees, except for administrative cost, less the net present value of all revenues to be generated from those guarantees. When the loans are disbursed, the Program transfers from the program account to the financing account the amount of the

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

subsidy cost related to those loans: The amount of the subsidy cost transferred, for a given loan, is proportionate to the amount of the total loan disbursed.

For loan guarantees made before the CRA, liabilities for loan guarantees for pre-1992 loans represent unfunded liabilities. For financial statement purpose the unfunded amounts are shown separate from the post-1991 liabilities. The amount of unfunded liabilities also represents a future funding requirement to USAID. The liability is calculated using a reserve methodology that is similar to OMB prescribed method for post-1991 loan guarantees.

0. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent that current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of leave are expensed as taken.

P. Retirement Plans

USAID employees are covered by one of four retirement plans. There are two Civil Service plans, Civil Service Retirement System (CSRS) 'and Federal Employees Retirement System (FERS), and two foreign service plans, Foreign Service Retirement and Disability System (FSRDS) and the Foreign Services Pension System (FSPS). The Agency contributes approximately 7.5 percent of an employees gross salary for CSRS and FSRDS, and approximately 24 percent of an employees gross salary for FERS and FSPS.

Employees may elect to participate in the Thrift Savings Plan (TSP). Under this plan, FERS and FSPS employees may elect to have up to 10 percent, but not to exceed $10,000, of gross earnings withheld from their salaries and receive matching contributions from a minimum of one percent to a maximum of 5 percent. CSRS and FSRDS employees may elect to have up to 5 percent of gross earnings withheld from their salaries, but do not receive matching contributions.

USAID funds a portion of employee post employment benefits (PEB) and makes necessary payroll withholdings. It has no liability for future payments, nor is it responsible for reporting the assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees for these programs. Reporting of such amount is the responsibility of the Office of Personnel Management and the Federal Retirement Thrift Investment Board. Current year operating expenses are charged for the fill amount of

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES **- Continued**

employer PEB costs with the unfunded portion being charged to Other Revenue **Sources-** Imputed Financing in accordance with **SFFAS #7**.

Foreign Service National and Third County Nationals at overseas posts who were hired prior to January 1, 1984 may be covered under CSRS. Employees hired **after** that date are covered under a variety of local governmental plans in compliance with host country laws and regulations. In a limited number of cases where no plans are regulated by the host country or where such plans are inadequate, the employees are covered by a privately managed pension plan to conform to prevailing practices by employers.

The Foreign **Service** National Separation Pay Trust Fund (FSNSPTF) was established in 1991 by public law 102-138 to finance separation payments for eligible individuals, primarily Foreign Service Nationals employed by **USAID**. The FSNSPTF finances separation liabilities to employees who resign, retire, or lose their jobs due to a **reduction-**in-force; and is applicable only in those countries that, due to local law, require a lump sum voluntary payment based on years of service.

Q. Net Position

Net position is the residual difference between assets and liabilities. It **is** composed of unexpended appropriations and cumulative results of operations.

- Unexpended appropriations are appropriations not yet expended, including undelivered orders.

- Cumulative results of operations are also part of net position. This account reflects the net difference between (1) expenses and losses and (2) financing sources, including appropriations, revenues and gains, since the inception of the activity.

NOTE 2. FUND BALANCES WITH TREASURY (In Thousands)

Entity and Non-Entity Fund Balances with Treasury as of September 30, 1998 consisted of the following:

Funds Balances	Entity Assets	Non-Entity Assets	Total
Appropriated Funds	$8,833,710	-	$8,833,710
Trust Funds	12,674	-	12,674
Revolving Funds	891,658	-	891,658
Other Funds	(3,124)	-	(3,124)
Total	$9,734,918	-	$9,734,918

On September 30, 1998 there was a cash reconciliation difference of $60.1 million between USAID and the Department of Treasury's Fund Balances. For FY 1998 reporting purposes, USAID adjusted its fund balance downward by this difference to equal the Department of Treasury's fund balance. This was a change from previous years, when USAID reported the fund balance per their records. By adjusting USAID's fund balance to equal Treasury's fund balance, there will be consistency between various published reports. Also, based on past experience, the Department of Treasury's balances were more accurate and the differences were usually cleared when USAID processed the required disbursements.

The $60.1 million cash reconciliation difference was posted to separate Fund Balance sub-accounts and the cash differences remain identified as such. USAID intends to perform a reconciliation of the amounts in these accounts and to make adjustments accordingly.

NOTE 3. ACCOUNTS RECEIVABLE, NET (In Thousands)

The primary components of USAID's accounts receivable as of September 30, 1998 were as follows:

	Receivable Gross	Allowance Accounts	Receivable Net
Entity			
Intragovernmental			
Appropriation Reimbursements from Federal Agencies	$208	-	$208
Accounts Receivable from Federal Agencies	1,040	-	1,040
Disbursing Authority Receivable from USDA	501,299	-	501,299
Total Intragovernmental	502,547	-	502,547
Governmental			
Accounts Receivable	11,201	9,543	1,658
Total Governmental	11,201	9,543	1,658
Total Entity	513,748	9,543	504,205
Non-Entity	-	-	-
Total Receivables	$5 13,748	$9,543	$504,205

Reconciliation of Uncollectible Amounts (Allowance Accounts)

Beginning Balance	$10,379
Additions	1,136
Reductions	**(1,972)**
Ending Balance	**$9,543**

Entity Intragovernmental accounts receivable consist of amounts due from other U.S. Government agencies. No allowance has been established for the intragovernmental accounts receivable, which are considered to be **100** percent collectible. Disbursing Authority Receivable from USDA consists of obligational authority from the U.S. Department of Agriculture's Commodity Credit Corporation. The authority is for payment of transportation costs incurred by USAID associated with the shipment of P.L. 480, Title II and III commodities; Farmer-to-Farmer Technical Assistance Programs; and for assistance to private voluntary organizations, cooperatives, and international organizations. Collections against this receivable are realized when USATD requests a transfer of funds from USDA to cover incurred expenses.

UNAUDITED

NOTE 3. ACCOUNTS RECEIVABLE, NET (In Thousands) - Continued

Entity Governmental accounts receivable consist of amounts managed by missions or USAID/Washington. These receivables consist of non-program related receivables such as: overdue advances, erroneous payments, audit tindings, and any interest related to these types of receivables. A 100 percent allowance for uncollectible amounts is estimated for governmental accounts receivable which are more that one year past due. Accounts receivable from missions are collected and recorded to the respective appropriation.

NOTE 4. ADVANCES AND PREPAYMENTS (In Thousands)

Advances and Prepayments as of September 30, 1998 consisted of the following:

Intragovernmental	
Advances to Federal Agencies	$37,965
Total	$37,965
Governmental	
Advances to Contractors/ Grantees	$887,584
Travel Advances	4,182
Advances to Host Country Governments and Institutions	141,149
Prepayments	2,253
Advances, Other	694
Total	$1,035,862

Advances to Host Country Governments and Institutions represents amounts advanced by USAID missions to host country governments and other in-country organizations, such as educational institutions and voluntary organizations. Other Advances consists primarily of amounts advanced for living quarters and home service.

NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES **FOR LOAN GUARANTEES (In Thousands)**

USAID operates the following loan and/or loan guarantee programs:

- Direct Loan Program (Direct Loan)
- Urban and Environmental Program (UE)
- Micro and Small Enterprise Development Program (MSED)
- Ukraine Export Insurance Credit Program (Ukraine)
- Israeli Loan Guarantee Program (Israeli Loan)

Direct Loan obligations or loan guarantee commitments made prior to FY 1992, and the resulting direct loans or loan guarantees, are reported net of allowance for estimated uncollectible loans or estimated losses.

Direct Loan obligations or loan guarantee commitments made afer FY 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act. The Act provides that the present value of the subsidy costs (i.e. interest rate differentials, interest subsidies, estimated delinquencies and defaults, fee offsets and other cash flows) associated with direct loans and loan guarantees be recognized as a cost in the year in which the direct or guaranteed loan is disbursed.

An analysis of loans receivable, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy costs associated with the loans and loan guarantees are provided in the following sections.

The following net loan receivable amounts are not the same as the proceeds that USAID would expect to receive from selling its loans. Actual proceeds may be higher or lower depending on the borrower and the status of the loan.

Direct Loans Obligated Prior to FY 1992:.

Loan Programs	Loans Receivables Gross	Interest Receivable	Allowance For Loan Losses	Value of Assets Related to Direct Loans
Direct Loans	$11,566,448	$442,62 1	$5,856,377	$6,152,692
MSED	4,298	22	3,294	1,026
Total	$11670,746	5442,643	$5,859,671	$6,153,718

UNAUDITED

NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR **LOAN GUARANTEES (In Thousands) - Continued**

Direct Loans Obligated After FY 1991:

Loan Programs	Loans Receivables Gross	Interest Receivable	Allowance for Subsidy Cost	Value of Assets Related to Direct Loans
Direct Loans	$283,355	-	3142,144	$141,211
MSED	1,968	$28	173	1,823
Total	$285,323	$28	5142,317	$143,034

Defaulted Guaranteed Loans from Pre-1992 Guarantees:

Loan Guarantee Programs	Defaulted Guaranteed Loan Receivable. Gross	Interest Receivable	Allowance For Loan Losses	Defaulted Guaranteed Loan Receivable. Net
UE	5505,579	$20,210	$240,959	$284,830
Total	3505,579	$20,210	$240,959	$284,830

Defaulted Guaranteed Loans from Post-1991 Guarantees

There were no defaults on Post-1991 Guarantees for FY 1998.

Guaranteed Loans Outstanding:

Loan Programs	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
UE	$2,241,671	$2,241,671
MSED	30,598	15,299
Ukraine Export	141,236	141,236
Israel	9,226,200	9,226,200
Total	$11,639,705	$11,624,406

Loan Guarantees Outstanding are not presented on the face of the financial statement but instead are used to calculate the liability for loan guarantees presented below.

UNAUDITED

NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES (In Thousands) - Continued

Liability for Loan Guarantees (Estimated Future Default Claims, pre 1992)

Loan Programs	Liability for Losses on Pre 1992 Guarantees, Estimate Future Default Claims	Liabilities for Loan Guarantees for Post-91 Guarantees Present Value	Total Liabilities For Loan Guarantees
UE	$347,709	$49,889	$397,598
MSED	-	1,965	1,965
Ukraine Export		28,135	28,135
Israel	-	515,076	515,076
Total	3347,709	5595,065	$942,774

Subsidy Expenses for Post-1991 Direct Loans

1 Current Year's Direct Loans

There have been no new loans disbursed in the past two years.

2 Direct Loan Modification and Reestimates

There have been no modifications and reestimates.

Subsidy Expenses for Post-1991 Loan Guarantees:

1 Current Year's Loan Guarantees

Loan Programs	Defaults	Fees	Interest Supplement	Total
UE	$11,784	34,119	-	$7,665
MSED	0	0	-	-
Ukraine Export	0	0		-
Israel	63,534	63,534	-	-
Total	$75,318	567,653	-	37,665

2 Loan Guarantee Modifications and Reestimates

There have been no modifications and reestimates.

UNAUDITED

NOTE 5. CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTEES (In Thousands)

3 Total Loan Guarantee Subsidy Expenses

Loan Programs	Defaults	Fees	Interest Supplement	Total
UE	$11,784	$4,119	-	$7,665
MSED	0	0	-	-
Ukraine Export	0'	0	-	
Israel	63,534	63,534		-
Total	575,318	$67,652,9 14		57,665

Administrative Expenses

Loan Programs

Direct Loans	-
UE	$6,506
MSED	855
Ukraine Export	65
Total	57,426

UNAUDITED

NOTE 6. CASH AND OTHER MONETARY ASSETS (In Thousands)

Cash and Other Monetary Assets as of September 30, 1998 are as follows:

Entity Cash and Other Monetary Assets	
Undeposited Collections	1
HGP and Micro and Small Enterprise Fund Other Cash	40
Foreign Currencies	172,144
Total Entity Cash and Other Monetary Assets	$172,185
Non-Entity Cash and Other Monetary Assets	-
Total Cash and Other Monetary Assets	$172,185

USAID has imprest funds in various overseas locations. These funds are provided by the Department of State overseas U.S. Disbursing Officers to which USAID is liable for any shortages. USAID's portion of the Department of State imprest funds provided to USAID is $2.4 million. These imprest funds are not included in USAID's Balance Sheet. Foreign Currencies included $ 172 million related to Foreign Currency Trust Funds.

NOTE 7. OPERATING MATERIALS AND SUPPLIES (In Thousands)

Operating Supplies and Materials as of September 30, 1998 are as follows:

Items Held for Use	
Office Supplies	$5,625
Items Held in Reserve for Future Use	
Disaster assistance materials and supplies	4,112
Birth control supplies	17,289
Total	$27,026

Operating Materials and Supplies are composed of office supplies held for use, disaster assistance materials and supplies, and birth control supplies held in reserve for future use. They are valued at historical cost and considered not held for sale.

UNAUDITED

NOTE 8. PROPERTY, PLANT AND EQUIPMENT, NET (In Thousands)

The components of PP&E at September 30, 1998 were:

Classes of Fixed Assets	Useful Life	cost	Accumulated Depreciation	Net Book Value
Equipment	3 to 5 years	$28,820	$21,498	$7,322
Structures, Facilities, & Leasehold Improvements	20 years	27,749	11,435	16,3 14
Land	NIA	3,706	N/A	3,706
Assets Under Capital Lease		136	136	-
Construction in Progress	N/A	778	N/A	778
Total		$61,189	$33,069	$28,120

USAID PP&E includes assets located in Washington, D.C. offices and overseas field missions. USAID capitalizes PP&E when the original acquisition cost is $25,000 or greater and it has a useful life of two or more years. USAID uses the straight-line method of depreciation.

- Equipment consists primarily of electric generators, ADP hardware, vehicles and copiers located at the overseas field missions.
- Structures and Facilities include USAID owned office buildings and residences at foreign missions, including the land on which these structures reside. These structures are used and maintained by the field missions. USAID does not separately report the cost of the building and the land on which the building resides.
- Land consists of property owned by USAID in foreign countries. Usually the land is purchased with the intention of constructing an office building at the site.
- The capitalized leases are four bungalows in Kenya that USAID has exercised its lease purchase options on that are in litigation.
- Construction in Progress consists primarily of new facilities.

NOTE 8. PROPERTY, PLANT AND EQUIPMENT, NET (In Thousands) - Continued

In addition to its capitalized leases, the building in which USAID operates is leased by the General Services Administration (GSA). USAID is charged rent intended to approximate commercial rental rates. The lease is for 20 years. However, USAID and

GSA are currently involved in negotiations to extend the lease term to 30 years. Lease payments for FY 1998 amounted to $26.1 million. GSA is requesting a 10% increase for FY 1999.

NOTE 9. ACCOUNTS PAYABLE (In Thousands)

The Accounts Payable covered by budgetary resources as of September 30, 1998 consisted of the following:

Intragovernmental,	
Accounts Payable	$209,674
Disbursements in Transit	1 2 5
Total **Intragovernmental**	209,799
Governmental	
Accounts Payable	1,487,020
Disbursements in Transit	1,133
Total Govemmental	1,488,153
Total Accounts Payable	$ 1,697,952

Intragovernmental Accounts Payable are those payable to other federal agencies and consist mainly of unliquidated obligation balances related to interagency agreements between USAID and other federal agencies.

Governmental Accounts Payable represent liabilities to other non-governmental entities.

UNAUDITED

NOTE 10. DEBT (In Thousands)

USAID Intragovernmental debt as of September 30, 1998 consisted of the following borrowings from Treasury for post-1991 loan programs:

	Beginning Balance	Net Borrowing	Ending Balance
Urban & Environmental	$85,000	$(13,000)	$72,000
Direct Loan	234,158	76	234,234
MSED	2,099	(222)	1,877
Total Debt	$321,257	($13,146)	$308,111

UNAUDITED

NOTE 11. OTHER LIABILITIES (In Thousands)

At September 30, 1998, Other Liabilities consisted of the following:

Intragovernmental	
Due to U.S. Treasury	$6,200,695
OPAC Suspense	8,016
Deposit and Clearing Accounts	(3,151)
Due to Treasury	102
Other	16,783
Total Intragovernmental	6,222,445
Governmental	
Accrued Funded Payroll/Benefits	9,861
unamortized Origination Fees	2,094
Foreign Currency Trust Fund	170,927
Trust Fund Balances	12,674
Total Governmental	195,556
Total. Other Liabilities	**$6,418,001**

Intragovernmental Liabilities represent amounts due to other federal agencies. Other Governmental Liabilities are liabilities to non-federal entities.

UNAUDITED

NOTE 12. ACCRUED UNFUNDED ANNUAL LEAVE AND SEPARATION PAY (In Thousands)

Accrued unfunded benefits for annual leave and separation pay as of September 30, 1998 are:

Liabilities Not Covered by Budgetary Resources

Governmental

Accrued Annual Leave	**$26,557**
FSN Separation Pay Liability	1,086
Total Accrued Unfunded Annual Leave and Separation Pay	**$27,643**

NOTE 13. ACCRUED UNFUNDED WORKERS' COMPENSATION BENEFITS (In Thousands)

The provision for workers' compensation benefits payable, as of September 30, 1998, are as follows:

Liabilities Not Covered by Budgetary Resources

Governmental	
Accrued Unfunded Workers' Compensation	$6,764
Future Workers' Compensation Benefits	35,005
Total Accrued Unfunded Workers Compensation Benefits	$41,769

The Federal Employees Compensation Act (FECA) program is administered by the U.S. Department of Labor (DOL) and provides income and medical cost protection to covered Federal civilian employees who have been injured on the job or have incurred a work-related occupational disease. Compensation is given to beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. DOL initially pays valid FECA claims for all Federal government agencies and seeks reimbursement two fiscal years later from the Federal agencies employing the claimants.

USAID's total FECA liability is $41.7 million as of September 30, 1998 and comprises of unpaid FECA billings for $6.7 million and estimated future FECA costs of $35 million. Estimated future FECA costs are determined by the Department of Labor. This liability is determined using a paid losses extrapolation method calculated over a 37 year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value. The interest rate assumptions used for discounting were 5.60% in year 1 and thereafter.

UNAUDITED

NOTE 14. INTEREST AND PENALTIES, NON-FEDERAL (In Thousands)

Interest and Penalties, Non-Federal as of September 30, 1998 consisted of the following:

Interest and Penalties, Non-Federal

Interest Income	$710,138
Income.- Penalties	6,601
Total	716,739
Less: Transfers to Treasury	572,224
Total Interest and Penalties, Non-Federal	**$144,515**

UNAUDITED

NOTE 15. ADJUSTMENTS (In Thousands)

Prior Period Adjustments as of September 30, 1998 consisted of the following:

Equipment	$17,891
Structures, Facilities & Leasehold Improvements	10,072
Credit Program Equipment	1,977
Fund Balance with Treasury	50,032
	$79,972

FY 1998 is the first year USAID is depreciating its property, plant, and equipment in accordance with Statement of Federal Financial Accounting Standard (SFFAS) Number 6, *Accounting for Property, Plant, and Equipment*. By implementing this standard, prior period adjustments of $27.9 million were recorded to properly value PP&E.

Also during FY 1998, the Credit Program increased its capitalization threshold for PP&E to $25,000 to be consistent with USAID's capitalization threshold. A prior period adjustment of $1.9 million was recorded to expense property that did not meet the $25,000 threshold.

Additionally, in FY 1998, USAID adjusted its Fund Balance to equal Treasury's Fund Balance. However, a portion of this adjustment related to FY 1997 and was classified as a prior period adjustment.

NOTE 16. TOTAL COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION (In Thousands)

Total Cost and Earned Revenue by Budget Functional Classification, as of September 30, 1998 are as follows:

Function Classification	Total Cost	Earned Revenue	Net Cost
International Affairs - 150	$7,358,806	$181,807	$7,176,999
Income Security - 600	948	-	948
Total	$7,359,754	$181,807	$7,177,947

UNAUDITED

NOTE 17. DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES AND THE BUDGET OF THE UNITED STATES GOVERNMENT (In Thousands)

Differences exist between the information presented on the Statement of Budgetary Resources and the amounts described as "actual" in the Budget of the U.S. Government. These differences occur because funds are appropriated to USAID and then allocated out to other agencies. In those cases, the related funds are not included in the Agency's Statement of Budgetary Resources but are included in its part of the U.S. Budget. But sometimes funds that are appropriated to other agencies are then allocated to USAID. In those cases, related funds are included in the Agency's Statement of Budgetary Resources but are not included in its portion of the Budget.

The amounts related to other agency activity as of September 30, 1998 are as follows:

	Allocated to Other Agencies	Allocated From Other Agencies
Budgetary Resources		
Budget Authority	362,7 14	427,797
Unobligated Balance	11,661	175
Spending Authority From Offsetting Collections	4	
Adjustments	604	7,004
Total Budgetary Resources	374,983	434,976
Status of Budgetary Resources		
obligations Incurred	352,696	415,752
Unobligated Balances Available	18,994	19,224
Unobligated Balances Not Available	3,293	-
Total Status of Budgetary Resources	374,983	434,976
Obligated Balance, Net - Beginning of Period	146,688	466,013
Obligated Balance Transferred, Net	-	-
Obligated Balance, Net - End of Period	119,256	540,137
Outlays	370,905	334,624

UNAUDITED

NOTE 18. CONTINGENCIES

USAID is involved in certain claims, suits and complaints that have been filed or are pending. These matters are in the ordinary course of the Agencies operations and are not expected to have a material adverse effect on the Agency's financial position.

USAID is involved in ten contract appeals that are currently before the Armed Service Board of Contract Appeals that total more than $20 million. It is reasonably possible that there will be damages assessed against USAID in these cases. Should there be any judgement in favor of a contractor, USAID also could be liable for indeterminable attorney's fees and Contract Disputes Act (CDA) interest.

There are seven cases against USAID pending before the U.S. Court of Federal Claims that total approximately $3 million. It is reasonably possible that there will be damages assessed against USAID in these cases. Should there be any judgement in favor of a contractor, USAID also could be liable for attorney's fees and CDA interest. It is not possible at this time to estimate what those amounts might be.

USAID is involved in eight cases' that 'are pending appellate decision or waiting initial stage processing and/or hearing before the Equal Employment Opportunity Commission. All eight cases involve a reasonable possibility of loss for the Agency for an estimated amount totaling $1.1 million.

USAID is also involved in five cases that are pending before the Foreign Service Grievance Board involving cognizable claims under Chapter 11 of the Foreign Service Act of 1980, as amended. They involve probable likelihood of financial loss to USAID in excess of $1 million less indeterminable offsets under the Backpay Act.

In addition, there are three appeals pending before the Merit Systems Protection Board involving reasonably possibility of loss to USAID in the amount of $450,000 less indeterminable offsets.

The building in which USAID operates is leased by the General Services Administration (GSA). USAID is charged rent intended to approximate commercial rental rates. The lease is for 20 years. However, USAID and GSA are currently involved in negotiations to extend the lease term to 30 years. Lease payments for FY 1998 amounted to $26.1 million. GSA is requesting a 10% increase for FY 1999.

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
STATEMENT OF SUPPLEMENTAL INFORMATION BY MAJOR APPROPRIATION
For the Period Ending September 30, 1998
(In millions)

	Program Fund						Operating Fund			
	1010	1021	1035	1037	1093	1095	1000	4336	Other	Consolidated Total
Budgetary Resources:										
Budget authority	419	1,170	1 Q	2,381	563	550	479	425	101	6,368
Unobligated balances - beginning of period	154	288	38	282	228	37	34		790	1,841
Spending authority from offsetting collections	-	2				-	7		1.514	1,523
Adjustments	20	- 28	1	41	19		12	7	(1,256)	(1,130)
Total budgetary resources	593	1,467	229	2,704	810	587	532	432	1,248	8,602
Status of Budgetary Resources:										
Obligations incurred	459	1,345	221	2,456	606	529	511	413	265	6,805
Unobligated balances - available	134	121	8	247	204	58	20	19	84	895
Unobligated balances - not available	-	1	-	1	-	-	1	-	899	902
Total, status of budgetary resources	593	1,467	229	2,704	810	587	532	432	1,248	8,602
Outlays:										
Obligations incurred	459	1,345	221	2,456	606	529	511	413	265	6,805
Less: spending authority from offsetting collections and adjustments	(19)	(28)	(1)	(41)	(19)	-	(19)	(7)	(1,567)	(1,701)
Obligated balance, net - beginning of period	622	1,696	238	2,837	886	456	212	466	848	8,365
Obligated balance transferred, net	-	-	-	-	-	-	-	-	-	-
Less: obligated balance, net - end of period	623	1,566	309	2,831	860	836	206	538	573	8,441
Total outlays	439	1,448	149	2,421	615	150	498	334	(1,027)	5,028

MAJOR FUNDS

Program Fund

1010 Special Assistance Initiatives
1021 Development Assistance
1035 International Disaster Assistance
1037 Economic Support Fund
1093 Assistance for the N.I.S. Of The Former Soviet Union
109s Child Survival and Disease Programs Funds

Operating Fund

1000 Operating Expenses of USAID
4336 Commodity Credit Corporation (from U.S. Dept. of Agriculture)

OTHER FUNDS

Credit Program Funds

Operating Funds

0113 Salaries & Expenses - Diplomatic Security
0535 Acquisition & Maintenance Of Building Abroad
1007 Operating Expenses of USAID Inspector General
1036 Foreign Service Retirement and Disability Fund

OTHER FUNDS (con't)

Program Funds

100s International Organizations and Programs
1012 Sahel Development Program
1013 American Schools and Hospitals Abroad
1014 Africa Development Assistance
1023 Food and Nutrition Development Assistance
1024 Population and Planning & Health Dev. Asst.
1025 Education and Human Resources, Dev. Asst.
1038 Central American Reconciliation Assistance
1040 Sub-Saharan Africa Disaster Assistance
1075 Anti-Terrorism Demining
1500 Demobilization and Transition Fund

Trust Funds

8342 Foreign Natl. Employees Separation Liability Fund
8502 Tech. Assist. - U.S. Dollars Advance from Foreign
8824 Gifts and Donations

Revolving Funds

4175 Property Management Fund
4590 Acquisition of Property, Revolving Fund

The accompanying notes are an integral part of these statements

UNAUDITED

This page left intentionally blank.

USAID MANAGEMENT COMMENTS

USAID
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

February 19, 1999

MEMORANDUM

TO: AIG/A (Acting), Paul E. Armstrong

FROM: M/CFO, Michael Smokovich

SUBJECT: Draft Audit Report on USAID's Consolidated Financial Statements, Internal Controls, and Compliance for Fiscal Year 1998

This memorandum provides the Agency's formal response to the audit of USAID's financial statements, internal controls, and compliance for Fiscal Year 1998.

The implementation of the New Management System (NMS) and specifically the AID Worldwide Accounting and Control System (AWACS) were expected to resolve the issues of a non-integrated system and non-compliance with the Joint Financial Management Improvement Program (JFMIP) system requirements. That effort is ongoing.

We continue to recognize the core accounting system as a material weakness under the Federal Managers' Financial Integrity Act of 1982. Because our current systems are not integrated, we rely on legacy systems in conjunction with compensating controls and manual systems to produce the best possible financial information. The dedicated efforts of the financial management staff both in Washington and overseas, along with the compensating controls, have enabled us to produce what we believe are reasonably accurate financial statements.

We appreciate the collaborative and constructive manner in which this audit was conducted. We look forward to working even more closely with the OIG organization on next year's statements with the objective of enabling you to express an opinion, relying on our legacy systems (automated and manual) and our compensating controls.

Improvements Made During FY 1998

We made significant advances during FY 1998 in improving the quality and timeliness of the Agency's financial reports. Many of the data problems caused by the implementation of the new accounting system have been corrected over the past year. Other Improvements include the automation of accruals in USAID/Washington and the automation of the closing of revenues, expenses, and required budgetary accounts. Data retrieval capabilities of NMS were also improved. As a result of these improvements, the year-end closing process occurred a month earlier than last year. Additionally, external reports at year-end were more accurately and efficiently prepared than in past years,

The year-end reports were primarily prepared from the NMS general ledger. Except for some unique items, all reports were prepared in accordance with Department of Treasury and OMB 97-01 crosswalks to the various line items of the required reports. Consistent information among the various reports was reported.

As a result of the improvements in retrieving information from NMS, analysis of various account balances was also possible. Xeconciliatrons and account analyses of accccnt balances were performed to further improve the quality of the data in the general ledger. These included:

- reconciling the general ledger to U101 subsidiary ledgers;
- reconciling the general ledger to NMS advance accounts;
- reconciling the generel ledger to Department of Treasury warrants and SF-1151 non-expenditure transfers as recorded by Treasury;
- reconciling cash on a monthly basis by Agency Location Code; and,
- reconciling the general ledger to the FY 1998 Current Year Obligations reported in NMS detail records.

To further improve the accuracy of anounfs in the general ledger, an adjustment to Fund Balance with Treasury totaling $60 million was posted at year-end. As a result of this adjustment, Fund Balance per the financial statements agrees to Fund Balance per Treasury. We plan to review and resolve this identified difference.

FY 1998 was the first year agencies were require5 to prepare financial statements in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 2, Entity and Display. It was the first year agencies were required to depreciate property, plant, and equipment. Despite these significant changes in reporting requirements, we submitted FY 1998 draft year-end financial statements and footnotes to the GIG on December 7, 1996, almost two months earlier than the previous year. We also provided the OIG with the final year-end financial statements and footnotes on the date originally agreed to with the OIG.

USAID successfully implemented OMB Bulletin No. 97-01, Formats and Instructions -for-the Forn and Content of Agency Financial Statements. Earlier this year, OMB anticipated that most agencies would have difficulty preparing the Statement of Financing and stated that a difference of 15% or less between Net Cost of Operations per the Statement of Financing and Net Cost of Operations per the Statement of Net Cost would be acceptable. USAID reported only a .07% difference between the two statements.

The Office of Financial Management (FM) also ensured that the Statement of Budgetary Resources was reconcile5 to the SF-133s. All identified differences were researched and resolved. Additionally, the Statement of Net Cost was prepared in accordance with SFFAS No. 4, Managerial Cost-Accounting Concepts and Standards far the Federal Government. The statement reflects the full cost of outputs allocated on a reasonable and consistent basis among USAID programs.

The process of compiling the statements was also streamlined this year. Workpapers supporting preparation of the financial statements decreased from 22 'binders fcr FY 1997 to only four binders for FY 1998.

In addition to submitting the financial statements to the OIG in a timely manner, all external year-end reports were submitted within the required due dates. USAID met the year-end reporting deadlines despite the fact that due dates were tightened in FY 1998. The FMS 2108 Year-End Closing Statement and the SF 133 Reports on Budget Execution deadlines were moved up to November 10 as compared to November 16 for FY 1997 reporting. The transmission of preliminary FACTS Adjusted Trial Balance (ATB) and Footnctes to Treasury was due February 1 as compared to February 15 in FY 1997. FM is on schedule to meet the March 3 deadline for the CFO verification that the FACTS ATB and Footnctes is consistent in all material respects with the Agency's financial statements,

Information Technology Accomplishments and Futnre Plans

USAID has committed to develop an information technology architecture containing all components identified in OMB's guidance at a level of detail to ensure that USAID's financial management system investments are consistent with the architecture, integrate work processes and technology to achieve the Agency's strategic goals, and conform to standards for information exchange and resource sharing. It is just one of many components to USAID's efforts to correct its deficiencies and come into compliance with Government-wide policies and regulations. USAID initiated the Financial Management Systems Project to replace the core accounting system (AWACS) with the alternative recommended by the FEDSIM IV&V study, a commercial off-the-shelf (COTS) package. This project, supported by a team from a major consulting firm and led by a manager with extensive credentials in financial management systems, has achieved significant milestones and remains ongoing. Milestones achieved include:

- Completion of a market survey of commercially available Federal financial management systems. Vendors offering JFMIP compliant core financial management systems, all on the GSA FMSS schedule, presented demonstrations of their systems to a bread-based group of Agency representatives.

- Completion of a comprehensive "gap analysis" of current systems and the JFMIP functional requirements for a core financial management system.

- Completion of an "Organization Transformation Plan" and a "Change Management Study" to guide FM in transiticning to a new system.

- Completion of an analysis of Agency "as is" business process flows and descriptions, the application of industry and government "best practices" and business process reengineering, resulting in a set of "to be" process flows and descriptions. A comprehensive list of Agency requirements, including interface requirements, was documented and presented to FM staff and senior management, and over a three-day period to all Agency offices and Bureaus. The resulting documentation presents an analysis and listing of all core accounting functional requirements the Agency must acquire in a core financial management system. This documentation will form the core component of a solicitation document.

An in-depth "Aiternatives Analysis" drafr is nearing completion. This document will present to USAID manaaement a risk-adjusted cost benefit analysis of the alternatives (COTS, cross-servicing, and/or outsourcing) available to correct the Agency's financial management system deficiencies. The document will also serve to support a request for approval and funding from the Capital Investment Review Board.

In conjunction with the Financial Management Systems Prcject, we initiated a Managerial Cost Accounting Prcject to analyze Agency cost accounting requirements. It is led by the Bureau of Policy and Program Coordination. Team members represent the Central and Regional Bureaus. This companion project accomplishments to date include:

- Development of the methodology and configuration for a managerial cost accounting component of a COTS financial management system. The structure of cost pools and cost distributions is undergoing final analysis following pilot programs at a field Mission and Central Bureau office.

- Development of an accounting classification code structure (ACS) is nearing completion and is to be used in the configuration of a COTS core accounting system.

Additional Comments

. Attachment A provides our response to the recommendations in the draft audit report. Attachment B provides addition.21 comments regarding the financial statements, as well as USAID's compliance with applicable laws and regulations and other issues .

ATTACHMENT A

MANAGEMENT RESPONSE TO RECOMMENDATIONS

Recommendation No. 1.1: Determine the specific responsibiiity, authority, and resources needed tc meet the requirements of the Chief Financial Officers Act cf 1993, which assigns the Chief Financial Officer responsibility to (1) develop and maintain an integrated accounting and financial management system that meets federal financial system requirements, federal accounting standards, and the U.S. Standard General Ledger at the transaction level; and (2) approve and manage financial management system design and enhancement projects.

Recommendation No. 1.2: Request by June 33, 1999, that the Administrator approve specific delegations of authority and resources to the Chief Financial Officer to carry out those Chief Financial Officers Act responsibilities idenrified in Recommendation i.1 above.

Recommendation No. 1.3: Implement policies and procedures tc carry out the specific delegations assigned by the Administrator In Recommendation 1.2, above.

We agree with all three parts of this recommendation and will rake steps to clarify the CFO's responsibilities.

ATTACHMENT B

ADDITIONAL COMMENTS

Overview on Performance

On page 14 of the report it is stated thaf because the final version of the overview was not received until February 2, 1999 the OIG was not able to conduct a comprehensive review. While the February 2 date is correct for delivery of the final version of the overview, USAID delivered to the OIG a more extensive version of the overview on January 5, 1999, as agreed with OIG staff several months earlier. The more extensive version contained all the information included in rhe final version.

Inadeauate Performance Measurement Systems

The report indicates that USAID's performance indicators precluded it from reporting accurate performance data and that results information is not objectively verifiable, supported, accurate, complete and/or validated.

USAID has been very aggressive in working to comply with the GPRA mandate. Based on the experience we have gained, we believe it is appropriate to simplify our measurement process so that policy officials will understand and accept which measures cap. be quantified readily and which cannot. We agree that where we establish measures that rely on quantitative data, the data must be readily available and routinely verifiable. Measures that are not effective and economical to maintain and to review should be discontinued as is provided for in the OMB requirements. PPC and the CFO staff will work on this issue together. We invite the OIG staff to work with us on our GPRA efforts on a continuing basis.

Questionable Financial Data

The draft audit report states that USAID made "unsupported" adjustments to the general ledger related to the Fund Balance with Treasury. The entry was in fact supported by an analysis of the differences between Treasury's balances and USAID's balances at the appropriation level and disclosed in Note 2 to the financial statements. We recognize that further action is required to resolve these differences and that this problem has existed for too long, but we believe that the entry was appropriate since Treasury will be using its Fund Balance amount for the consolidated governmentwide financial statements, and not USAID's balance as stated in the draft report. In addition, other agencies have made similar adjustments to bring their fund balances into agreement with Treasury's balances.

Debt Collection and Improvement Act of 1996

The report states that there is a material non-compliance issue with the Debt Collection and Improvement Act of 1996 (DCIA). We agree that further improvements need to be made in the management of the Agency's Accounts Receivable. However, given that the Accounts Receivable as reported on the Consolidated Balance Sheet only total $2 million, we do not believe the weaknesses result in a material non-compliance issue. Further, the requirement to transfer debt over 180 days to Treasury does not include debt owed in foreign currency or debt owed by host governments, which constitutes most of USAID's Accounts Receivable.

Federal Credit Reform Act of 1990

The report states incorrectly that the Agency is not in compliance with the Federal Credit Reform Act of 1990 (FRCA), and that the credit program assets are overstated by $449 million. However, as the auditor was informed by an official at the U.S. Office of Management and Budget, USAID is to calculate its credit program asset value using the model approved by OMB and USAID is nos at liberty to go beyond the model as suggested by the auditor. Accordingly, the balances are reasonably stated in the financial statements.

Antideficiency Act

The report indicates that USAID potentially violated the Antideficiency Act because of the methodology used for making letter of credit (LOC) advances. We do not agree that the method used to advance funds to recipient organizations would create a violation of the Act and therefore believe this section should be removed from the report. If actual violations of the Act were identified by either the Agency fund control procedures or OIG audits, appropriate action would be taken.

Other Issues

We understand that matters related tc LOC advances, accrued expenditures, and credit program receivables will be discussed in more detail in the Management Report tc the USAID's Financial Statements, Internal Controls, and Compliance for Fiscal Year 1998, to be issued March 31, 1999. However, we believe that it is important for this report, to recognize the significant improvements USAID has made in all three of these areas.

- We have entered into a cross-servicing agreement with the Department of Health and Human 'Services for LOC advance and liquidation voucher processing. This new arrangement when fully implemented this fiscal year will enable USAID to more effectively manage its LOC advances and promptly liquidate advances. In addition, we intend to work with the OIG to see if the new core accounting system to be implemented in FY 2000 can be configured to address the significant internal control concerns.

- Regarding accrued expenditures, late in FY 1998 FM introduced an accrual capability to the NMS. This new capability permits the establishment of delivery schedules for services and goods. The schedules may be modified by program managers to reflect actual delivery. This information is used by NMS to calculate the accrued expenditure based on physical completion. While further refinement is needed, this process together with the accrual process in place at field accounting locations is a major step forward for the Agency.

- The Agency has entered into a contract with a major bank to provide credit-servicing functions for the Agency's credit' portfolios. This contract includes the introduction of a modern loan servicing system to be operated by the Bank with data transferred into the Agency's general ledger. This outsourcing constitutes a major improvement in the Agency credit management system and will allow the old credit program legacy systems to be discontinued.

USAID's Computers Are Not Year 2000 Compliant

While it is true as stated on page 36 that as of September 1998, USAID had not "fully assessed its systems", progress since that time means that USAID decidedly does nor face a "high risk" that its operations and programs will be disrupted due to the Y2K issues.

> USAID's focus on Y2K issues began in mid-1998 with two independent reviews aimed at examining the rhen-current NMS and outlining alternatives for future direction. This was followed quickly in the late summer of 1998 with the establishment of a prime contract through the GSA/FEDSIM contracting vehicle. With the award came immediate attention and high priority being placed on meeting the Agency's Y2K vulnerabilities. By mid-February 1999, several of the Mission Critical systems had been renovated with one having passed through the validation phase. While the latest estimates reflect that full implementation of all Mission Critical systems will miss the OMB target date of March 31, 1999, all are scheduled to be implemented by mid-May 1999, with the exception of the NMS. The NMS is scheduled to be implemented in July. Tracking of status is being accomplished via an Earned Value approach brought into USAID via the prime contractor.

FM completed phase 1 of a Contingency Plan for the financial Mission Critical systems in December 1998. Phase 2 is scheduled for completion by June 1999. In late January, attention shifted to contingency planning for our overseas locations. Specifically these activities focused on working with several other foreign affairs agencies to collectively establish a telecommunications network capable of providing continuity of service to our remote field locations. In addition, USAID has also been working with the State Department in an effort to ensure that their Contingency Planning Guidance for USG overseas posts takes into account USAID concerns. This guidance will be issued next month with USAID's Missions developing their Contingency Plans in concert with the Embassies.

Management Decisions and Final Actions of Recommendations

Several of the recommendations listed in Appendix V of the draft audit report as pending a management decision or final action already had a management decision or final action and were discussed with your staff. We appreciate the continued cooperation to have the Appendix reflect the ongoing work to obtain management decisions and final actions on all outstanding recommendations.

OIG EVALUATION OF USAID MANAGEMENT COMMENTS

USAID's management agreed with all three parts of the recommendation made in this report. In agreeing with the recommendation, USAID management officials said that steps would be taken to clarify the CFO's responsibilities. USAID's management has also provided information regarding improvements made during fiscal year 1998 and additional comments in response to the recommendation in the draft audit report.

In our evaluation, we are providing clarification regarding the improvements made during fiscal year 1993. We are also providing our evaluation of USAID's Overview of Performance, Information Technology Accomplishments and Future Plans, and Year 2000 Compliance.

Clarification Regarding the Improvements Made During Fiscal Year 1998

We agree that USAID has made some improvements in the preparation of the fiscal year financial statements. However, we did not draw a conclusion as to the fairness of the statements' presentation in relationship to the requirements of Office of Management and Budget (OMB) Bulletin 97-01. We continue to believe that there are significant problems in at least three areas:

Automating accrual calculations at year end,
Reconciling USAID's fund balance with the U.S. Treasury, and
Implementing OMB Bulletin 97-01.

Automating Accrual Calculations at Year End

In their response, USAID financial management officials said that improvements were made in this area. While USAID has taken advantage of the system's capacity to compute the accruals for USAID/Washington, we believe that the methodology is not compliant with the Statements for Federal Financial Accounting Standard No. 1, "Accounting for Selected Assets and Liabilities." as we reported in our Compliance Report.

Specifically, USAID's methodology computes accruals on a straight-line basis using the scheduled completion date as the end date for the project. According to USAID financial managers, the scheduled completion dates in the New Management System are questionable. However, USAID/Washington did not assess the continuing need for the unliquidated obligations at the end of fiscal years 1997 and 1998. Because unliquidated obligations are a key component of the USAID accrual calculation methodology, we questioned whether USAID should be accruing liabilities against these obligations. Details about this issue will be discussed in our audit report on internal controls to be issued in March 1999.

Reconciling USAID's Fund Balance with the U.S. Treasury

GAO reported that reconciliation of the fund balance with the U.S. Treasury is a major problem at 10 of the 22 agencies covered by the Chief Financial Officers Act of 1990. GAO concluded that the reconciliation problems could affect the government's ability to effectively monitor the execution of the budget. Also, the lack of effective reconciliations of disbursements contributes to the overall inability of the federal government to accurately measure the full cost of its programs and increases the risk of fraud, waste, and mismanagement.

In their response, USAID financial management officials said that improvements in data quality occurred because a number of account reconciliations and analyses were being completed.

We agree that USAID has made some improvements in reconciling cash on a monthly basis during fiscal year 1998. The monthly reconciliation process is a fundamental accounting practice. For example, federal agencies and U.S. Treasury use it as the key internal control to ensure that receipts and disbursements are in agreement. The reconciliation process is a two-part process. The first part is identifying the differences between the accounts and the second part is promptly researching and resolving the differences. We noted that USAID accomplished the first part regularly, but did not successfully accomplish the second part of the reconciliation.

After identifying the differences, which amounted to a net difference of $60 million ($590 million in absolute dollar value). USAID simply adjusted its books without conducting the required research to determine whether the U.S. Treasury-reported account balances were correct.

According to the GAO's Standards for Internal Controls in the Federal Government, documentation of transactions should be complete and accurate. The documentation should facilitate tracing the transaction through its complete cycle--before it occurs, through processing, and after it is completed. In our opinion, these adjustments did not meet the GAO's internal control standard.

Implementing OMB Bulletin No. 97-01

We feel that USAID made a good initial effort to implement the major requirements of the OMB Bulletin No. 97-01, "Format and Instructions for the Form and Content of Agency Financial Statements." However, the performance was not completely successful., We noted the following problems.

Statement of Budgetary Resources

We agree that USAID ensured that the Statement of Budgetary Resources was reconciled to its Report on Budget Execution (SF-133). However. like the fund balance reconciliation process noted above, USAID financial managers made adjusting entries to force a balance between the Statement and the Report.

We do not believe that there was adequate support to document the adjustments made to eliminate the difference between the Statement and the Report on Budgetary Execution.

Statement of Net Cost

The Statement of Net Cost was not prepared in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards." For the fiscal year 1998 Statement of Net Cost, USAID did not develop responsibility segments

According to the SFFAS No. 4, the Statement of Net Cost should provide program managers with relevant and reliable information relating costs to outputs and activities that permits program managers to respond to inquiries about the costs they manage. In addition, the Statement of Net Cost is intended to assist the federal agency to ensure consistency'between costs reported in general purpose financial reports and costs reported by program managers.

Because reporting responsibility segments were not developed and used, USAID program managers cannot compare their program costs with the Statement of Net Cost, the objectives of SFFAS No. 4 have not been met.

Other Minor Noncompliance Instances with OMB Bulletin No. 97-01

Based on our recent review on final financial statements and footnotes that were received on February 26, 1999, we noted a number of other minor problems including inadequate disclosures and inconsistent information within the financial statements. USAID statements did not fully disclose the required items for the Balance Sheet, Statement of Net Cost, the Statement of Budgetary Resources, and the Statement of Financing. For example, USAID did not disclose obligated and unobligated information in the Note for fund balance with the U.S. Treasury and unexpended appropriation information in the Note for Unexpended

Appropriations. Additionally, the Statement of Budgetary Resources and the Statement of Financing and the Supplemental Information contain inconsistent information among their data lines. We also noted that a number of items in the financial statements were not properly captioned or published.

Information Technology Accomplishments and Future Plans

USAID's comments also describe improvements made to financial management systems during fiscal year 1998. USAID cited projects to implement a replacement core financial system and a managerial accounting system. The comments describe accomplishments related to these two projects and state that an alternative analysis was nearing completion. That document is intended to provide a risk adjusted cost benefit analysis of the alternatives available to correct the agency's financial management system deficiencies. The document will support a request for approval and funding from the Capital Investment 'Review Board.

Although we agree that USAID has taken positive steps to add discipline to its efforts to implement the core financial system, this report and our companion Federal Financial Management Improvement Act (FFMIA) status report pointed out that USAID's approach is flawed. This report points out that, although the CFO and CIO share responsibility to implement an effective financial management system. the CFO has not been delegated adequate responsibility and authority to do so and the CIO has not enforced the use of disciplined processes.

The FFMIA status report pointed out that USAID had made only limited progress correcting system deficiencies during fiscal year 1998 and that planning and organizational deficiencies threaten its efforts to successfully modernize its systems. In particular, USAID's plan to acquire the core financial system is premature because it has not yet:

(1) completed an agency-wide information architecture that provides a blue-print of how all the related systems will work together to meet financial management needs;

(2) developed a modular acquisition strategy to reduce integration risks and lead to an integrated financial management system; and

(3) prepared the supporting plans describing the remedies, resources, and interim milestones needed to correct the deficiencies.

These deficiencies create a substantial risk of delays, cost increases, and system performance shortfalls and are an indication that USAID is repeating past mistakes that led to premature deployment of the New Management System-a system that does not operate effectively.

That report also found that the lack of a strong program management office or function contributes to these planning deficiencies.

By. continuing to highlight its plans to replace the core financial system as progress, USAID is risking an approach that may succeed. For example, although USAID's comments state that its alternatives/investment analysis will provide a risk adjusted cost benefit analysis of the alternatives available to correct the agency's financial management system deficiencies, the analysis being developed is limited to the core financial management system. As a result, it will not consider other financial and mixed financial systems such as budget, procurement, human resources, and property management.

Overview on Performance

In its response, USAID provided comments on its planned actions to implement the Government Performance and Results Act. The OIG will continue to work with USAID in its efforts to implement this law.

USAID took issue with the OIG's statement that we could not comprehensively review the fiscal year 1998 Overview on Performance (Overview) section because USAID management did not give us a copy of its final version until February 2, 1999 (containing 18 pages). They contended that the earlier more extensive January 5th version (containing 55 pages) provided to the OIG contained all the information that was included in the final version. In effect, USAID was implying that we had time to effectively review the Overview prior to February 2nd.

We agree that we received the first version of the Overview on January 5th. However, within one week of this receipt, we notified USAID management that the Overview contained some obvious, omissions (e.g. blank spaces, missing appendices and charts). We were told that these omissions would be corrected. However, this correction did not take place until we received the final version of the Overview on February 2, 1999. At the exit conference on February 10th, there were some USAID officials who believed that the January 5th version was in fact the final version.

Although we did perform some audit work on the initial version of the Overview, 'it was not practical or efficient for us to perform a comprehensive review of the Overview until we had the final version. Otherwise, we would be in a position of reviewing something that was not in the final version, or more importantly, reviewing USAID facts and conclusions, that changed between the first and final versions-which is what actually happened. To extensively review what USAID and the OIG knew to be a draft (first version), we believe is not an efficient and effective use of our time.

The OIG performed enough audit work over the last year on USAID's performance measurement system so that we were in a position to relate that work to specific issues discussed in the Overview. However, we were not in a position to confirm all of USAID's facts and conclusions as stated in the Overview. We made our own assessment based on sufficient, independent, and competent audit work-as required by professional standards. Because of the short lead time between receipt of the Overview on February 2nd, the issuance of our draft report on February 8th, and the legislatively mandated issuance of our final report by March lst, we maintain that we could not comprehensively review the fiscal year 1998 Overview Report on Performance.

USAID's Computers Are Not Year 2000 Compliant

Regarding our conclusion that USAID faces a high risk that its business operations and programs will be disrupted at the start of the new millennium, USAID agreed that, as of September 1998, it had not fully assessed its computer systems. However, USAID stated that progress since that time means that it does not face a high risk of disruptions. USAID recognized that it got a late start addressing the problem but cited a May 1998 contract that focused attention on the problem. According to the comments, by May 1998 several critical systems had been renovated and one validated as being able to process year 2000 dates. USAID conceded that its systems will not be compliant in time to meet OMB's schedule, but noted that all systems are scheduled to be compliant by July 1999. Regarding contingency planning, USAID stated that it has made progress developing a contingency plan for financial systems, which it expects to complete in June 1999. USAID also stated that it is working with the Department of State to develop contingency plans for overseas missions.

We agree that USAID has strengthened its approach to address Year 2000 vulnerabilities, but we also continue to believe that USAID faces a high risk of disruptions. The contractor has added discipline to management efforts by developing realistic schedules and closely tracking progress. However, as stated in our report, due to the scope and complexity of the changes needed, and the limited time remaining, USAID faces high risks. In fact, USAID's latest quarterly progress report to OMB, dated February 12, 1999, pointed out that additional problems were discovered when validating which mission critical systems could process dates involving the year 2000 and beyond. The three systems that were farthest along in the correction process all encountered schedule delays, which means that none of USAID's systems will be implemented by the OMB scheduled due date of March 1999. The Assistant Administrator for Management stated that the unanticipated delay in completing implementation of the three mission critical systems is of grave concern.

Regarding contingency planning, USAID operates in Washington and at over 70 overseas missions located in developing countries around the world. This worldwide operating environment increases risks to USAID's operations and employees. The risk is compounded because many developing countries, where USAID operates, are expected to encounter disruptions in basic functions including power, telecommunications, water, and transportation. We believe USAID will not be in a position to have confidence that its operations will not be disrupted until it completes and tests contingency plans that address both its business operations and its ability to safeguard its overseas staff.

Other OIG Comments

Debt Collection and Improvement Act'of 1996

USAID financial management officials agreed further improvements are needed to better manage the account receivables but they stated that the issue was not material. We considered USAID management comments and agree with their position. The final report did not include this issue.

Federal Credit Reform Act of 1990

USAID management said that it believed that. the balances for its loan receivables are reasonably stated. USAID management also stated that it had calculated its credit program asset value using the model provided by the OMB. In a discussion with OMB, we were informed that USAID could not deviate from the OMB model. even if the model conflicted with the requirements of the federal accounting standards. While we do not agree with the OMB position, USAID financial managers acted in accordance with guidance provided to them.

We intend to pursue this issue with OMB and GAO during the fiscal year 1999 audit.

Antideficiencv Act

USAID management did not agree that the method used to advance funds to recipient organizations would create a violation of the Antideficiency Act. We considered USAID management comments and agree with their position. The final report does not include this issue.

Management Decisions and Final Action of Recommendations

USAID management said that several of the recommendations listed in Appendix V of the draft audit report as pending management decision or final action. We have discussed these issues with USAID management and made the adjustments to the final report, as needed.

This page left intentionally blank.

PREVIOUSLY IDENTIFIED MATERIAL INTERNAL CONTROL WEAKNESSES

This appendix discusses the previously identified material control weaknesses that.still exist.

USAID's Primary Accounting System

USAID's primary accounting system did not (1) meet the Federal financial management system requirements, (2) comply with applicable Federal accounting standards, and (3) implement the United States Standard General Ledger at the transaction level.

Integrated Financial Management System

USAID lacked an integrated financial management system. USAID commenced operation of the New Management System in October 1996. However, 'due to serious problems, USAID/Missions were instructed to discontinue using the New Management System and go back to using the Mission Accounting and Controls System. In addition to these systems, USAID used many lesser systems, such as the Loan Accounting Information System, General Ledger Accounting and Reporting System, Letter of Credit Support System, and various informal records. These systems required data re-entry, supplementary accounting records, and lengthy and burdensome reconciliation processes without sufficient discipline, effective internal controls, and reliable information. As a result, USAID had insufficient assurance that the financial information reported was complete, reliable, timely, and consistent.

Data Reconciliation

USAID did not always perform data reconciliation's in a timely manner. This occurred, in part, because USAID had not developed and implemented an integrated accounting and financial management system.

Suspense Appropriation 72F3875

For fiscal year 1997, USAID had an unidentified balance of over $29 million in suspense appropriation 72F3875. USAID did not properly identify and post the transactions to the correct appropriation. Instead, the transactions were posted directly to suspense appropriation 72F3875. Thus, USAID avoided the receipt of a Statement of Difference from the Department of Treasury, which is required to be reconciled on a monthly basis. Treasury Financial Manual, Part 2, Chapter 3900, states that Agencies should:

> 1) Verify the amounts of transactions and transaction codes to ensure that each transaction is correct, 2) Adjust any differences in the agencies records and 3) Notify the United States Treasury of any processing discrepancies.

As a result , USAID can not provide financial statements that are complete, reliable, timely, and consistent.

Differences in the General Ledger and the Letter of Credit Support System

USAID had an unreconciled difference of approximately $46 million between the general ledger and the Letter of Credit Support System. This occurred because USAID had not taken action to identify and correct prior year differences. As a result. USAID's Advances and Prepayment balance may be misstated in the financial statements.

Advices of Charge

Because of the lack of adequate reconciliations, outstanding Advice of Charge expenditures of over $238 million as of September 30, 1997. were not properly applied against an appropriate obligation. This amount represents a 345 percent increase from the September 30, 1996 balance of $69 million. As a result, no means exist to readily determine whether these expenditures were made for goods or services received by USAID until the advices of charge are cleared.

Fund Balance with Treasury

USAID has material unreconciled differences of over $1.94 billion in the Fund Balance with Treasury account. USAID did not properly research and reconcile differences identified between its general ledger balances and the Department of Treasury's balances throughout the fiscal year. In an attempt to ensure that the balances 'maintained in USAID's general ledger agreed with balances maintained by the Department of Treasury, USAID improperly adjusted the differences into Account No. 4801, Undelivered Orders, thereby overstating USAID's obligations. Department of Treasury Bulletin No. 97-06 states that agencies should verify their records each month against the transactions recorded by the Department of Treasury, as shown on the Department's monthly reports.' This bulletin further states that if agencies do not perform the monthly reviews, errors may be discovered during budget preparations and year-end certifications. As a result, USAID's Fund Balance with Treasury is potentially misstated.

<u>Use of United States Standard General Ledger at the Transaction Level</u>

USAID did not record Accounts Receivables in accordance with the United States Standard General Ledger at the transaction level. USAID did not have an integrated accounting and financial management system, which included Accounts Receivable.

USAID relied on data calls[2] to obtain the total amounts of outstanding Accounts Receivable because USAID did not have an integrated accounting and financial management system. These data calls were posted to the General Ledger at the summary level as opposed to the transaction level as required. By using data calls to determine outstanding Accounts Receivable, USAID was at risk that the'information obtained is not complete. For instance, USAID's summarization of these data calls improperly omitted the Office of Procurement's outstanding Accounts Receivables.

<u>Manually Processed Journal Vouchers</u>

USAID continued to have a high number of manually processed journal vouchers. USAID did not' establish and implement procedures to ensure continual supervision of these journal vouchers to ensure that adjusting entries are correct. As of September 3, 1998,[3] 27 percent of the 301 manually processed journal vouchers were recorded to correct previously posted data. Seventy-one percent of the 301 manually processed journal vouchers did not have supervisory approval.

---

[1] These forms are Financial Management Services Form 6653, "Undisbursed Appropriation Account Ledger," and Financial Management Services Form 6655, "Receipt Account Ledger.,"

[2] Data calls is a term used to describe the process of requesting various offices to provide outstanding balances as of year end.

[3] Note that although September 30, 1997, ended the fiscal year, journal vouchers continued to be posted through January 1998.

Debt Collection Acts of 1982 and 1996

USAID did not implement policies and procedures to ensure. compliance with the requirements of the Debt Collection Acts of 1982 and 1996. Specifically, USAID did not (1) always provide debtor with "due process rights" when demanding payment on outstanding debts, (2) always automatically refer delinquent debts in excess of 180 days to the United States Treasury for the recovery of agency debts, (3) did not provide information regarding the issuance or guarantee of credit to consumer credit reporting agencies.

Reconciliations of Budget Clearing Accounts

USAID/Washington had not reconciled balances in its budget clearing accounts as of September 30, 1997. These balances had not been cleared because USAID's Office of Financial Management, had not established and implemented written procedures for reconciling and clearing outstanding differences within the budget clearing accounts. Treasury Financial Manual Bulletin No.97-06, Volume 1, requires Federal agencies to clear out all budget clearing accounts at year-end.[4] Further, all amounts contained in budget clearing accounts must be transferred to the proper account on the September 1997, Statement of Transactions submission. As a result of the untimely reconciliation's, the appropriation balances for fiscal year 1997 are potentially misstated by over $29 million.' In addition, uncleared differences distort the budget results of the United States Government in government-wide financial statements and could affect USAID's appropriation requests. Furthermore, the ability to discover possible loss, fraud, or irregularities is limited if the discrepancies are not reconciled and cleared.

Direct Loan Program

The above reconciliation problem continues to exist because the two systems used to record and report loan activity are not integrated. In addition, adequate reconciliation's are not performed to ensure the accuracy and consistency of the data in both systems.

---

[4] When differences exist between the amounts an agency reports and the amounts recorded by the Department of Treasury, the Department of Treasury sends a statement-Financial Management Services Form 6652, Statement of Differences-to the agency on the disbursement and deposit transactions. If the agency does not reconcile the differences within six months of the accomplished date, as reported on this statement, the Department of Treasury automat&y charges the difference to the budget clearing accounts.

[5] As of September 30, 1997, USAID/Washington had the following balances in its budget clearing accounts: (1) Account 72F3879 (Disbursements) - $150.00; (2) Account 72F3878 (Deposits) - $43,725.00; and (3) Account 72F3875 (Agency Suspense Account) - $29,846,161.

Differences between the two system arise when financial data is processed in one system and not in the other system. Differences also arise when financial data is manually entered in the systems without proper supporting documentation.

Reviews of Obligated and Unobligated Balances

USAID/Washington did not review obligated and unobligated balances as part of certifying the account balances of appropriations in fiscal year 1997. The Office of Financial Management did not establish procedures for conducting this review in Washington to ensure the validity of recorded obligations in the new core accounting system. As a result, USAID potentially over-obligated its appropriations. Further, the Office of Financial Management did not have a reasonable basis to certify that the obligations were proper and that the amount of unobligated balances or expenditures incurred were proper.

The Supplemental Appropriations Act of 1955 (Title 31 of the United States Code, Section 1501) provides that no amount shall be recorded as an obligation unless it meets specified criteria. Further statements of obligations furnished to the Congress or to any of its committees shall include only amounts representing valid obligations. Title 31 of the United States Code, Section 1108(c) requires that agency heads support their appropriations request with a certification of the obligated balances. Treasury Financial Manual, Section 2-1000, "Regulations Governing Reporting of Information Relating to Year-End Status and Closing of Appropriation and Fund Accounts" states:

> The primary responsibility for reviewing the status of its accounts rests with the agency managing the appropriation or fund. Each agency, in order to properly certify obligated and unobligated balances...must verify its own accounts at least once a year. Accordingly, agency management should be aware that they are certifying that obligations are proper and that the amount of obligations or expenditures incurred is proper.

USAID/Washington did not review the obligated and unobligated balances as part of certifying the account balances of appropriations for fiscal year 1997. Prior to fiscal year 1997, the Office of Financial Management was responsible for recording all obligations and deobligations into the accounting system. However, the deployment of the New Management System required USAID management to re-engineer its processes for recording obligations and deobligations. Consequently, the Office of Procurement and other U&AID/Washington offices were assigned the responsibility of recording obligations and deobligations in the new accounting system. Because of this change, the Office of Financial Management did not have the required documentation to conduct the reviews of fiscal year 1997 obligations and deobligations to ensure that the appropriations balances were valid. Therefore, the Office of Financial Management needed to perforrn the role collaboratively with other USAID/Washington offices that recorded obligations and deobligations.

Office of Financial Management officials informed us that the lack of this review caused problems during the preparation of the year-end Closing Statement. Further, they said that this material weakness should be addressed by USAID's Management Control Review Committee.

In November 1997, the Office of Financial Management made the following certifications regarding the obligation balances for fiscal year ending September 30, 1997:

> . ..in each appropriation account of the agency reflect proper existing obligations and that the expenditures from the account since the preceding review were supported by a proper obligation of funds and otherwise meet the criteria of 31 U.S.C. 1501 (A).

Since USAID/Washington did not review the obligated and unobligated balances for fiscal year 1997, the Office of Financial Management did not have a reasonable basis on which to certify that the obligations were proper and that the amount of unobligated balances or expenditures incurred were proper. Further, USAID/Washington did not review the obligations and unobligated balances for fiscal year 1998.

Letter of Credit Disbursements

USAID's financial management staff does not properly match disbursements with the obligating documents at the time of the transactions. USAID's procedures for making disbursements also do not require recipient organizations to identify the appropriate obligation. As a result, USAID management did not have sufficient assurance that all disbursements made-about $1.69 billion in fiscal year 1997—were authorized, propelr and correct, and that all disbursements were accurately recorded and reported.

Title 7, Appendix III, Chapter 6 (Disbursements), of the General Accounting Office's Policy and Procedures Manual for Guidance of Federal Agencies, dated May 1993, states:

> The disbursements shall be supported by basic payment documents, in the form of hard copy or machine readable source records, including purchase orders, contracts, receiving reports, invoices, bills, statements of accounts, etc., showing sufficient information to adequately account for the disbursements. The

> documentation should link all supporting records and enable audit of the transactions and settlement with the certifying or disbursing officers as required by law.

Further, the General Accounting Office's, Standards for Internal Controls In the Federal Government, dated 1983, requires that transactions be promptly recorded and classified.-

USAID staff made disbursements to recipients at the organization level based on funds availability, and may have made disbursements for obligations that had not been recorded. We identified 13 Letter of Credit Financial Status Reports totaling $3.4 million that were not registered in the accounting system because the obligation had not been recorded. Because the accounting system does not facilitate tracing disbursements through liquidation, it is unclear whether the obligations had been exceeded.

Office of Financial Management officials said that the Letter of Credit Support System does not allow drawdown requests to be approved for more than the available balance in the Letter of Credit. They further said that the requirement to link the disbursement to the obligating document "was all new information".

Without linking the document, however, nothing prevents a drawdown from exceeding the obligation at the grant level. According to a representative of the General Accounting Office, this problem with Letters of Credit is a government-wide problem that is currently under review by the CFO Council. As a result, USAID management did not have reasonable assurance that all disbursements were authorized, proper, and correct, and that all disbursements were accurately recorded and reported.

Letter of Credit Financial Status Reports

USAID's account balances for governmental advances and prepayments may be-materially overstated, and the balances for operating expenses may be materially understated. These unreliable balances occurred because the Office of Financial Management did not track all Letter of Credit Financial Status Reports to ensure that they are recorded. As a result, USAID management does not have reasonable assurance that the financial statements are complete, reliable, and consistent.

The Cash Management and Payments Division identified a universe of 86 Letter of Credit Financial Status Reports totaling over $26 million that had not been recorded! However, we determined that at least 530 reports, totaling over $264 million,' also had not been fully recorded. All of these reports required an adjustment to prevent the line items for governmental advances and prepayments from being overstated and operating expenses from being understated. According to officials in the Office of Financial Management, the adjustments were made subsequent to our review. However, because of the uncertainties about the completeness of the universe made available to us, we are not sure of the absolute impact on the financial statements.

The Cash Management and Payments Division could not readily identify the unrecorded reports because it needed to implement a formal tracking system. Office of Financial Management officials said that the recording of the reports was delayed because USAID management decided in March 1997 to use the New Management System for Letter of Credit Agreements. However, the data processed for the first half of the year could not be recorded in the new system. As a result, the Letter of Credit team spent the second half of the year manually posting the data processed during the first half of the fiscal year and current transactions.

USAID management has taken corrective action to implement an informal tracking system as a temporary solution until the Letter of Credit Support System can be replaced with a system that provides tracking capability.

Accrued Expenditures for Advances and Prepavments

USAID's account balances for advances and prepayments may be materially overstated and the related expenditures may be materially understated by at least $68 million because the Office of Financial Management did not properly accrue expenditures in accordance with applicable Federal accounting principles.

---

[6] The recording of these reports by financial management staff is done in three stages. The first stage is report registration, which has no accounting impact. The second and third stages are report approval and certification, respectively. Both of these stages have an accounting impact.

[7] The 530 consists of 13 reports totaling over S3.4 million that had not been registered, approved or certified; 465 reports totaling over $232 million had been registered, but not approved and certified; and 52 reports totaling over $29 million had been registered and approved, but not certified.

The Statement of Federal Financial Accounting Standard No. 1, which became effective in Fiscal Year 1994, states:

> Advances and Prepayments are reduced when goods or services are received...Advances should be initially recorded as an asset and should be subsequently reduced when expenses are actually incurred.

Office of Financial Management officials said that the Cash Management and Payments Division had not been tasked or aware of the responsibility to adjust these accounts. We are currently assisting the Cash Management and Payments Division with identifying and establishing a methodology for accruing expenditures and adjusting advances and prepayments processed through the Letter of Credit Support System until a compliant integrated accounting and financial management system is established.

As a result of not adjusting the accounts, the financial statements may not be complete, reliable, and consistent. The Office of Financial Management needs to develop and implement a methodology to appropriately estimate the amount of expenditures against outstanding advances and prepayments.

Reports To
Regulatory Agencies

The Office of Financial Management inconsistently reported unobligated balances to Federal regulatory agencies and did not file quarterly reports on its budget execution during FY 1997. The staff attributed these problems to human error. Further, the Office did not conduct second party reviews or perform management oversight prior to submitting the reports. As a result, USAID's reports to the regulatory agencies contained errors totalling an absolute difference of over $143 million.

The Office of Financial Management reported unobligated balances to the Department of Treasury which were inconsistent with the unobligated balances reported to the Office of Management and Budget for the same balances. This inconsistent reporting occurred on the Report on Budget Execution* and the Year-End Closing Statement.'

---

[8] The Office of Management and Budget's Standard Form 133," Report on Budget Execution," reports budgetary resources, status of budgetary resources, and relation of obligations to outlays.

Preparation of Program
Performance Measures

USAID and its operating units did not follow USAID policies and procedures for establishing performance measures and performance monitoring systems because (1) the operating units did not fully understand the policies and procedures, (2) operating units had not yet instituted procedures to validate data reported by their partners (e.g,. private voluntary organizations or host governments), and (3) USAID was still developing common indicators. To facilitate the use of better indicators by operating units and to facilitate USAID's ability to aggregate program results, USAID needs to complete its efforts to establish a common set of indicators.

USAID's internal control guidance (TIPS No. 6) states:

> Performance indicators are at the heart of a performance monitoring system-they define the data to be collected to measure progress and enable actual results achieved over time to be compared with planned results. Thus, they are an indispensable management tool for making performance-based decisions about program strategies and activities.

USAID's policies and procedures (Automated Directive System Section E203.5.5) require USAID and its operating units to establish systems for monitoring performance which meet USAID standards for developing performance indicators and baseline data, managing and documenting the process for data collection, and ensuring the quality of performance data. USAID and its operating units shall define performance indicators for which quality data are available at intervals consistent with management needs and that are direct, objective, practical and one-dimensional. Quantitative performance indicators are preferred and shall be used in most cases. If qualitative indicators are used, they must be defined to permit regular, systematic and relatively objective judgement regarding change in the value or status of the indicator.

USAID's policies and procedures require that data quality be assessed as part of the process of establishing performance indicators and choosing sources and methods for collecting data. Also, to the extent possible, comparable data for all strategic objectives that encompass more than one country shall be collected and reviewed regularly. The operating units' Strategic Plans are to include the performance indicators, targets and, to the extent possible, baseline

---

[9] The Financial Management Service's 2108,"Year-End Closing Statement" is a reconciliation tool used by an agency and the Department of Treasury to track amounts available under the various agency appropriations at the end of the fiscal year.

data. The "Results Review and Resources Request Reports" (Results Reports) are to report annually the progress toward achieving the anticipated program results. The policies and procedures further state that USAID needs to ensure that information on performance and results are used in decision-making for USAID's resource allocation.

In our March 1998 audit report on GMRA, we identified problems with common indicators. Specifically, we recommended that Agency management establish a common set of indicators for use by its operating units to measure progress in achieving USAID's strategic goals and objectives and that allow for the aggregation of program results reported by operating units. As of February 1999, the OIG and Agency management had not reached a management decision on this issue. This has not been the first time we have brought the issue of common indicators to USAID management. We had previously identified problems with USAID's development of common indicators in a June 1995 audit report.[10] The recommendation in that report to develop plans and time frames for establishing and monitoring a set of common indicators for USAID strategic goals (and objectives) was closed by the Bureau of Management based on USAID's assertion that the common indicators would be developed by November 1997.

Integrated Management System for Reporting
<u>Program Results and Related Funding:</u>

USAID has not yet developed and maintained an integrated system for reporting program results and related funding. The lack of a compliant integrated accounting and financial management system inhibits USAID's ability to relate (1) obligations and expenditures to USAID's overall strategic goals and objectives, and in support of each operating unit's strategic objective and intermediate results; and (2) program results to budget components included in its financial statements. This in turn impairs USAID's ability to manage for results and to report results in relation to funding.

Annual Reports
<u>on Program Results</u>

USAID has not designed and implemented effective policies and procedures to enable USAID to comply with the Office of Management and Budget's current and future requirements for reporting program results under the Government Management and Reform Act of 1994. This occurred because (1) USAID has not emphasized to its operating units the importance of reporting on a fiscal year basis and has not ensured that the results reported occurred during

---

[10] <u>Audit on USAID's Systems for Measuring Program Results</u> (Audit Report No. l-000-95-006, June 30, 1995).

that period, and (2) the Chief Financial Officer did not fulfill all his requirements under the Chief Financial Officers Act of 1990 to maintain an integrated agency accounting and financial management system which includes financial reporting and internal controls for the systematic measurement of performance.

We reported in March 1997[11] serious problems with the program results identified in the overview section of USAID's consolidated financial statements and the Annual Performance Report for fiscal year 1996. Neither of these reports provided a clear and concise description of USAID's 1996 accomplishments compared to what was anticipated; but, instead the reports contained mostly information from earlier years. Both reports also reported high-level results that were difficult, if not impossible, to attribute to USAID's activities.

---

[11] Second Survey Report on USAID's Implementation of the Government Performance Act of 1993 (Audit Report No. 9-000-97-002-S, March 31, 1997)

STATUS OF UNCORRECTED FINDINGS AND RECOMMENDATIONS FROM PRIOR AUDITS THAT AFFECT THE CURRENT AUDIT OBJECTIVES

Office of Management and Budget Circular, No. A-50 states that a management decision on audit recommendations shall be made within a maximum of six months after issuance of a final report. Corrective action should proceed as rapidly as possible. The following audit recommendations directed to USAID remain uncorrected and final actions have not been completed at the time of this report.

Audit of the Fiscal Year 1994 Annual Financial Statement for USAID's Housing Guaranty Program Under the CFO Act Audit Report No. O-000-95-037 June 30, 1995

Recommendation No. 1: We recommend that the USAID Chief Financial Officer fully develop and implement adequate claims and receivable controls which address the concerns raised in the FY 1994 Deloitte and Touche audit report.

Recommendation is pending final action by USAID.

Audit of USAID's Miscellaneous U. S. Dollar Trust Funds Financial Statements for the Years Ending September 30, 1995 and 1994 Audit Report No. O-000-96-013 April 1, 1996

Recommendation No. 1: We recommend that USAID's Chief Financial Officer establish procedures to assure that receipts, expenditures and balances of the U.S. Dollar Advances from Foreign Governments Trust Fund are periodically verified with the participating host governments

Recommendation is pending final action by USAID.

Audit of USAID's Direct Loan Program Financial Statements for the Year Ending September 30, 1995, Audit Report No. O-000-96-017 July 1, 1996

Recommendation No. 1: We recommend that Direct Loan Program Division Chief:

1.1 Establish detailed policies and procedures which provide adequate guidance to Direct Loan Program employees to properly execute day-to-day transactions;

1.2 Train Direct Loan Program Personnel to properly execute day-to-day transactions;

1.3 Reconcile applicable subsidiary ledger balances to the general ledger; and

1.4 Establish internal controls, with the proper segregation of duties and checks and balances that will ensure, to a higher level, that transactions are properly recorded. ,

Recommendation is pending final action by USAID.

Reports on USAID's Financial Statements, Internal Controls, and Compliance for Fiscal Year 1996 Audit Report No. 0-000-97-001-C February 24, 1997

Recommendation No. 1: We recommend that USAID's Chief Financial Officer:

1.1 Develop and implement procedures to ensure that journal vouchers for the general ledger are properly prepared by accounting staff and reviewed by supervisors;

1.2 Require that journal vouchers be adequately supported prior to entering the financial data into the general ledger; and

1.3 Provide adequate supervision to ensure that all adjusting entries entered into the general ledger system are supported and authorized.

Recommendation is pending final action by USAID.

Recommendation No. 2: We recommend that USAID's Chief Financial Officer:

2.1 Identify and reconcile all suspended and unapplied balances;

2.2 Develop and implement detailed written procedures, which provide adequate guidance to the financial management staff for properly recording transactions as they occur;

2.3 Develop and implement detailed written procedures to ensure that personnel perform timely reconciliation's and the identified differences are resolved;

2.4 Provide qualified and continuous supervision to ensure that personnel properly perform reconciliation; and

2.5 Require documentation of the second party reviews to ensure that personnel properly perform reconciliation and resolve the differences.

Recommendation is pending final action by USAID.

Recommendation No. 3: We recommend that USAID's Chief Financial Officer:

3.1 Establish an internal committee within the Financial Management Division responsible for ensuring that applicable accounting standards and Office of Management and Budget requirements are properly implemented;

3.2 Develop written procedures and methodologies which are in compliance with the applicable standards established as required by the committee mentioned above;

Recommendation is pending final action by USAID.

3.3 Investigate and resolve the apparent over-expended obligations; and

Recommendation is pending a management decision by USAID.

REPORTS ON USAID'S FINANCIAL STATEMENTS,
INTERNAL CONTROLS, AND COMPLIANCE
FOR FISCAL YEARS 1997 AND 1996
Audit Report No. 0-000-98-001-F March 2, 1998

Recommendation No. 1: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer ensure that the account balances for appropriations are reviewed for validity at least annually to properly certify obligated and unobligated balances pursuant to Title 31 of the United States Code, Section 1108(c).

Recommendation is pending final action by USAID.

Recommendation No. 2: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer implement a tracking system for Letter of Credit Financial Status Reports and ensure that all transactions are promptly recorded.

Recommendation is pending final action by USAID.

Recommendation No. 3: Until USAID implements a compliant accounting and financial management system, we recommend that the Chief Financial Officer develop and implement a methodology to accrue expenditures and adjust outstanding advances and prepayments to ensure that the financial statements are not materially overstated.

Recommendation is pending a management decision by USAID.

Recommendation No. 4: We recommend that the Chief Financial Officer require that figures be adequately supported by the general ledger before transmission to the regulatory agencies.

Recommendation is pending final action by USAID.

Recommendation No. 5: We recommend that the Assistant Administrator/Bureau for Policy and Program Coordination establish a common set of indicators for use by operating units to measure progress in achieving USAID's strategic goals and objectives and that allow for the aggregation of program results reported by operating units.

Recommendation is pending a management decision by USAID.

Recommendation No. 6: We recommend that the Chief Financial Officer develop plans and time frames for USAID's accounting, and financial management system to permit, tracking of obligations and expenditures according to USAID's overall strategic goals and objectives and in support of each operating unit's strategic objective and intermediate results.

Recommendation is pending final action by USAID.

Recommendation No. 7: We recommend that USAID:

7.1 Establish procedures to ensure (1) operating units report results for the year ended September 30 and (2) results reported in the'overview section of USAID's financial statements and Annual Performance Report be clearly shown as achievements for that year; and

Recommendation is pending a management decision by USAID.

Recommendation No. 8: We recommend that the Chief Financial Officer:

8.1 Implement a comprehensive policy that will incorporate an automatic assessment of interest charges against all delinquent receivables, and that these assessments be actively monitored for managerial and statutory reporting purposes; and

Recommendation is pending final action by USAID.

Recommendation No. 9: We recommend that the Chief Financial Officer develop and implement policies and procedures to ensure adherence to the requirements of the Debt Collection Act of 1982 and the Debt Collection Improvement Act of 1996. These policies and procedures should at a minimum ensure that:

9.1 All billing offices incorporate due process rights into demands for payment;

9.2 All delinquencies in excess of 180 days are identified in a timely manner, and referred to the United States Treasury; and

9.3 The issuance or guarantee of consumer credit is reported to consumer credit reporting agencies.

Recommendation is pending final action by USAID.

Interim Audit Report of Acordia Healthcare Solutions, Inc.,
Excess Federal Cash Being Held Contract No. FAO-C-00-93-00012-00;
Audit Report No. 0-000-98-002-F March 26, 1998

Recommendation No. 3: We recommended that USAID's Office of Financial Management return all the funds recovered from the Acordia Healthcare Solutions, Inc. contract to the U.S. Treasury when it has determined that these funds are no longer needed for claim payments.

Recommendation is pending a management decision by USAID.

Review and Certification of Unliquidated Obligations
for Project and Non-Project Assistance,
Audit Report No. 9-000-98-003-F March 27, 1998

Recommendation No. 3: We recommend that the Bureau for Management develop a training course and/or training video, to be provided to appropriate staff, describing roles and responsibilities for reviewing unliquidated obligations.

Recommendation is pending a management decision by USAID.

Audit of USAID/Washington's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance Audit Report No. 9-000-98-004-F March 30, 1998

Recommendation No. 3: We recommend that:

3.2 the Office of Financial Management, Bureau for Management, lead USAID/Washington efforts to review and deobligate the balances described in Appendix V of this report.

Recommendation is pending final action by USAID.

Audit of USAID/Washington's Review and Certification of Funds Obligated for Operating Expenses Audit Report No. A-000-97-001-P February 7, 1997

Recommendation No. 1: We recommend that M/FM/CONT:

1.2 ensure adequate staffing and supervision for the Section 13 11 review process in Bureau for Management Operating Branch and Loan Management Division: and

1.3 ensure that Bureau for Management Accounting Division completes its management control and risk assessment of the Operating Expense Branch and takes action to correct any deficiencies noted.

Recommendation is pending final action by USAID.

Audit of USAID's Assessment of the Year 2000 Problem Audit Report No. A-000-98-006-P

Recommendation No. 1: We recommend that the Administrator clarify the assignment of responsibility to implement an effective Year 2000 compliance program and provide the responsible official with adequate authority and resources to complete the program.

Recommendation is pending final action by USAID.

Recommendation No. 2: We recommend that the responsible official for the Year 2000 compliance program direct USAID Bureaus and Missions to develop and test contingency plans to ensure continuity of operations in the event of disruptions to systems from Year 2000 problems.

Recommendation is pending final action by USAID.

Audit of Post Transaction Review Activities Under the Commodity Import Program
Audit Report No. A-000-98-007-P

Recommendation No. 1: We recommend that the Assistant Administrator, Bureau for Management, develop a cost-effective approach to perform post transaction reviews through a systematic selection of transactions to be reviewed.

Recommendation is pending a management decision by USAID.

Recommendation No. 2: In order to ensure that no one individual controls or appears to control all key aspects of a single transaction, we recommend that the Assistant Administrator, Bureau for Management increase management supervision regarding the separation of duties.

Recommendation is pending a management decision by USAID.

Recommendation No. 3: We recommend that the Assistant Administrator, Bureau for Management establish documentation requirements that provide sufficient information about transactions including such things as the overpayment discovery date, a detailed computation of the overpayment, supplier contact date and disposition, check copies, and supporting financial documentation for funds owed to USAID.

Recommendation is pending a management decision by USAID.

Recommendation No. 4: We recommend that the Assistant Administrator, Bureau for Management:

4.1 strengthen internal controls by specifying procedures and responsibilities for recording identified overpayments and the receipt of voluntary refunds.

4.2 make a final management decision on all outstanding overpayments identified, including the $2.3 million noted in this report.

4.3 establish procedures to account for negotiated voluntary refunds.

Recommendation is pending a management decision by USAID.

This page left intentionally blank.

LISTING OF PERFORMANCE MEASUREMENT-RELATED AUDIT REPORTS AND DOCUMENTS

Audit Reports by the USAID Office of Inspector General

Audit Report on USAID's Systems for Measuring Program Results (Audit Report No. l-000-95-006, June 30, 1995)

Second Survey Report on USAID's Implementation of the Government Performance and Results Act of 1993 (Audit Report No. 9-000-97-002-S, March 31, 1997)

Audit of USAID's Status in Implementing the Government Performance and Results Act of 1993 (Audit Report No.9-000-97-003-P, September 30, 1997)

Reports on USAID's Financial Statements. Internal Controls. and Compliance for Fiscal Years 1997 and 1996 (Audit Report No. 0-000-98-001-F. March 2, 1998)

Agency-wide Audit of Civil Society, Natural Resources Management, and Biodiversity Activities by USAID Missions in Support of the Agency's Actions to Implement the Government Performance and Results Act (Audit Report No. 9-000-98-001-P, March 26, 1998)

Audit of the Status of USAID's Implementation of the Government Performance and Results Act of 1993 (Audit Report No.9-000-98-005-P, September 30, 1998)

OIG audit reports pertaining to the quality of results reported in USAID operating units' Results Review and Resource Request (R4) reports prepared in 1997

Audit of the Quality of Results Reported for the Republic of Georgia in USAID/Caucasus' Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. B-114-98-005-P, August 26, 1998)

Audit of the Quality of Results Reported in USAID/Regional Center for Southern Africa (RCSA)'s Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 4-690-98-004-P, August 28, 1998)

Audit of the Quality of Results Reported in the Bureau for Humanitarian Response's Office of Food for Peace Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 9-000-98-003-P, September 3, 1998)

Audit of the Quality of Results Reported in USAID/India's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. B-386-98-006-P, September 3, 1998)

Audit of the Quality of Results Reported in USAID/El Salvador's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 1-519-98-003-P, September 10, 1998)

Audit of the Quality of Results Data Presented in USAID/Guinea's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 7-675-98-003-P, September 24, 1998)

Audit of the Quality of Results Data Presented in USAID/Nigeria's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 7-620-98-004-P, September 24, 1998)

Audit of the Quality of Results Reported in the Global Bureau's Center for Human Capacity Development Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 9-000-99-001-P, October 5, 1998)

Audit of the Quality of Results Reported in the Bureau for Humanitarian Response's Office of American Schools and Hospitals Abroad Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 9-000-99-002-P, October 7, 1998)

Audit of the Quality of Results Reported in USAID/Bangladesh's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 6-388-99-001-P, October 8, 1998)

Audit of the Quality of Results Reported in USAID/Mexico's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 1-523-99-001-P, October 13, 1998)

Audit of the Quality of Results Reported in USAID/Ecuador's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report So. 1-518-99-002-P, October 13, 1998)

Audit of the Quality of Results Reported in USAID/Madagascar's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 4-687-99-001-P, October 26, 1998)

Audit of the Quality of Results Data Presented in USAID/Senegal's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 7-685-99-001-P, October 28, 1998)

Audit of the Quality of Results Reported in USAID/Colombia's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 1-514-99-003-P, October 30, 1998)

Audit of the Qualitv of Results Reported in USAID/Zimbabwe's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 4-613-99-002-P, November 10, 1998)

Audit of the Quality of Results Reported in USAID/Haiti's Results Review and Resource Request (R4) Report Prepared in 1997 (Audit Report No. 1-521-99-004-P, November 30, 1998)

Audit of the Quality of Results Reported by the Africa Bureau's Office of Sustainable Development in its Results Review and Resource Request Report Prepared in 1997 (Audit Report No. 9-000-99-003-P, December 17, 1998)

Audit of the Quality of Results Reported in USAID Operating Units' Results Review and Resource Request (R4) Reports Prepared in 1997 (Audit Report No. 9-000-99-006-P, scheduled to be issued in March 1999)

Audit Reports by the General Accounting Office

The Results Act: Observations on USAID's Fiscal Year 1999 Annual Performance Plan (GAO/NSIAD-98-194R, June 25, 1998)

Managing for Results: Agencies' Annual Performance Plans Can Help Address Strategic Planning: Challenges (GAO/GGD-98-44, January 1998)