October 13, 2006

INFORMATION MEMO FOR THE ADMINISTRATOR

/s/

FROM: Donald A. Gambatesa
           Inspector General

SUBJECT: U.S. Agency for International Development's (USAID) Most Serious
           Management and Performance Challenges

This memorandum summarizes what the Office of Inspector General (OIG) considers to be the most serious management and performance challenges facing USAID.

The Report Consolidation Act of 2000 (Public Law 106-531) requires that agency performance and accountability reports (PAR) include a statement prepared by each agency's Inspector General that summarizes what the Inspector General considers to be the most serious management and performance challenges facing the agency and an assessment of the agency's progress in addressing those challenges. Our statement for inclusion in USAID's fiscal year 2006 PAR is attached.

We have discussed the management and performance challenges summarized in this statement with the responsible Agency officials. If you have any questions or wish to discuss this document further, I would be happy to meet with you.

Attachment: a/s

USAID continues to face management and performance challenges in the areas of:

- **Financial Management**

- **Managing for Results**

- **Acquisition and Assistance**

- **Human Capital Management**

- **Information Technology Management**

The OIG has been reporting on these five areas since we issued our first statement in 2001.

Financial Management

Although USAID has made progress towards improving its financial management systems, significant challenges still exist in this area as follows:

Accrual Accounting and Reporting

USAID's system for capturing accrued expenditures and accounts payable information remains a material weakness that we plan to report in our annual financial statement audit. Errors associated with this weakness required a restatement of USAID's fiscal year 2004 financial statements ($383 million) and material adjustments to its fiscal year 2005 financial statements (net $309 million). This weakness includes errors associated with system-generated accruals as well as those calculated by Cognizant Technical Officers. In October 2006, USAID stopped using a separate system and began capturing accruals directly in its core accounting system—Phoenix. Since USAID is working with a new process and the OIG has not yet determined if USAID has resolved the deficiencies of its old accrual process, we continue to report accrual accounting and reporting as a management challenge.

Reconciliations of USAID's Fund Balance with the U.S. Treasury

USAID's process for reconciling its fund balance with the U.S. Treasury needs improvement. Specifically, USAID has not been consistently investigating and resolving reconciling items with the Department of Treasury and has been required to make significant end-of-year adjustments to bring its fund balance into agreement with Treasury's balance. USAID's fund balance with Treasury exceeded $20 billion throughout 2005 and represented the largest single line item on its financial statements. USAID's net unreconciled amount with

Treasury grew between 2004 and 2005 from $95 to $115 million, and it will likely grow further until USAID implements procedures designed to resolve unreconciled transactions. The net amount contains significant unreconciled positive and negative values that are material to USAID's financial statements and significant to USAID's overall fund balance. Since USAID has not resolved significant unreconciled differences, we are reporting this as a management challenge.

<u>Extensive Use of Manual Processes Limits Agency Compliance with Federal Financial Management System Requirements</u>

OIG believes that USAID's reliance on manual processes for a significant portion of its financial management reporting limits its ability to comply with Federal financial management systems requirements. USAID's financial reporting process involves the consolidation of many accounting adjustments and system queries which require a multitude of data sources and complex calculations. The process is heavily dependent on manual adjustments that will continue to challenge USAID until it can demonstrate that the automated processes within Phoenix can consistently produce accurate quarterly and year-end financial information. OIG will continue to address these issues in our yearly financial statement audit.

Managing for Results

Managing a complex and diverse portfolio of worldwide activities is an inherent challenge for USAID managers. USAID conducts development programs in over 100 countries. These programs promote a wide range of objectives related to economic growth, agriculture and trade; global health; and democracy, conflict prevention and humanitarian assistance. Federal laws, such as the Government Performance and Results Act of 1993, require that Federal agencies develop performance measurement and reporting systems that establish strategic and annual plans; set annual targets; track progress; and measure results. In addition, government-wide initiatives, such as the President's Management Agenda, require that agencies link their performance results to budget and human capital requirements.

USAID managers continue to make progress in this area. For example, each quarter the Office of Management and Budget (OMB) scores each agency's status and progress towards implementing the President's Management Agenda. OMB developed a scoring system based upon the colors green, yellow, and red. A "green" rating indicates success and a "yellow" rating signifies mixed results, while a "red" rating is unsatisfactory. For the quarter ending June 30, 2006, OMB rated USAID's current status and progress in the budget/performance integration initiative as "green." However, the "green" rating only applies to this one aspect of Managing for Results. Therefore, although USAID is making progress towards meeting its budget/performance integration goals, more work remains to be done.

USAID's primary method for reporting the results of its activities is through its Annual Report. Each USAID operating unit provides information on the results attained with USAID resources; requests additional resources; and explains the use of, and results expected from, these additional resources. Information in these unit-level reports is consolidated to present an agency-

wide picture of achievements in USAID's annual Performance and Accountability Report (PAR). A recent OIG audit report[1], however, found weaknesses in the reporting system. Further, subsequent to field work on this audit, the OIG learned that components of the reporting system will be replaced by an integrated system to support the Department of State's Office of the Director of U.S. Foreign Assistance, which OIG believes may increase the challenges faced by USAID management.

The OIG continues to monitor USAID's progress in improving its performance management and reporting system. For performance information reported in the Management's Discussion and Analysis section of USAID's PAR for fiscal year 2005, OIG found no inconsistencies between financial and performance data or nonconformance with OMB guidance. This was an improvement over the prior fiscal year, when OIG reported that certain information included in the Management's Discussion and Analysis section did not contain a clear picture of USAID's planned and actual performance for that year. Moreover, OIG reported that the primary performance information included was based on results achieved in the prior fiscal year. USAID uses actual results for the first six months of the year and estimates results for the remaining six months. During the following year, USAID issues an addendum that updates actual results for the entire fiscal year. OIG is currently performing audit work on the results reported by selected missions in the addendum for fiscal year 2005 to determine the quality of the data reported.

Also for fiscal year 2005, the Management's Discussion and Analysis used USAID's New Strategic Planning Framework and Goal Structure contained in the Joint USAID/State Strategic Plan. This new framework was designed to present a more coherent, concise and logical reflection of how the Department of State and USAID organize their work towards results and outcomes. OIG will continue to review progress in this area, including any consolidated systems within the Department of State's new Office of the Director of U.S. Foreign Assistance.

Acquisition and Assistance

The majority of USAID's development results are achieved through intermediaries such as contractors, grantees and recipients of cooperative agreements. Because of the innate complexities in Federal acquisition and assistance—numerous laws, regulations, policies, procedures, definitions, etc.—USAID faces challenges in its acquisition of supplies and services, as well as in its delivery of foreign assistance.

For the quarter ending June 30, 2006, OMB's scorecard reported that USAID is making some progress in implementing the President's Management Agenda for competitive sourcing. Nevertheless, the scorecard rated the status of USAID's competitive sourcing as "red" or unsatisfactory—no change since the last report in March 2006.

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[1] Audit of Selected Application Controls over the Annual Report Application System, A-000-06-005-P, dated September 27, 2006

During the past year, the OIG issued several performance audit reports dealing with acquisitions and assistance. One audit[2] involved the adequacy of scopes of work that USAID used in awarding field support task orders under indefinite quantity contracts. This audit determined that the scopes of work for the sampled field support task orders did not clearly define the specific goods and services being procured. The OIG recommended that USAID develop and issue improved policies and procedures, which USAID accomplished.

Another audit[3] pertained to USAID's procurement evaluation program. The audit determined that USAID's evaluations of its procurement operations did not verify and ensure that USAID effectively implemented an Executive Order on Federal Procurement Reform. OIG made two recommendations to address the deficiencies identified in the audit.

Also, to help provide accountability over appropriated funds paid to contractors and grantees, USAID has a financial audit program that consists of financial audits conducted by the Defense Contract Audit Agency, as well as U.S. and foreign public accounting firms, with oversight by the OIG. However, USAID needs to make further improvements in this program, particularly overseas. For example, a series of seven OIG performance audits conducted in Africa during fiscal year 2006 found that many foreign recipients in that region were not always being audited on a timely basis and some were not being audited at all. Specifically, during fiscal years 2003 through 2005, less than 25 percent of planned financial audits of USAID contracts and grants were submitted on time, and over 100 contracts and grants, valued at more than $300 million, should have been audited, but were not.

Human Capital Management

The President's Management Agenda identifies the strategic management of human capital as one of five government-wide areas that needs improvement. A decade of downsizing, insufficient funding, staff reductions, and reductions in training have created human capital gaps at USAID. These gaps include a workforce that is nearing retirement, has a void in the mid-management ranks, and is losing skills and institutional memory. In response to the President's Management Agenda's initiative on human capital and to address its own human capital challenges, USAID has undertaken a major effort to improve and restructure its human capital management. As of June 30, 2006, OMB gave USAID a "yellow" rating, reflecting mixed results for its overall status in the area of human capital management. USAID needs to continue to implement its workforce planning to close skill gaps through recruitment, retention, training, succession planning, and other strategies.

Also, the USAID Administrator now serves concurrently as the Director of U.S Foreign Assistance within the Department of State. He is charged with directing the transformation of the U.S. Government approach to foreign assistance to ensure that foreign assistance is used as effectively as possible to meet broad foreign policy objectives. This new management structure

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[2] Audit of Scopes of Work for Field Support Task Orders Issued under USAID/Washington Indefinite Quantity Contracts, 9-000-06-008-P, dated May 17, 2006

[3] Audit of USAID's Procurement Evaluation Program, 9-000-06-007-P, dated May 11, 2006

will create challenges such as how the Department of State and USAID consolidate functions. The challenge USAID faces in managing human capital may also increase with the ongoing Agency restructuring to align more fully the foreign assistance activities carried out by the Department of State and USAID. OIG plans to audit USAID's implementation of its human capital strategy during fiscal year 2007.

Information Technology Management

USAID has made progress towards addressing weaknesses in its information technology management. However, USAID faces management challenges as follows:

Implementing Homeland Security Presidential Directive – HSPD-12

The inherent challenges for integrating and coordinating with other Federal agencies represent only some of the numerous challenges USAID is likely to face in implementing this Government-wide initiative-- the Homeland Security Presidential Directive (HSPD) 12.

HSPD-12, signed by the President on August 25, 2005, is entitled "Policy for a Common Identification Standard for Federal Employees and Contractors." The Directive requires the development and agency implementation of a mandatory, Government-wide standard for secure and reliable forms of identification for Federal employees and contractors[4] in gaining physical access to Federal facilities and logical access to Federal information systems. HSPD-12 is being implemented in two phases. OMB required agencies to begin complying with phase I by October 27, 2005, and phase II by October 27, 2006.

Preliminary data indicates that USAID is complying with phase I, but is unlikely to fully comply with phase II. According to USAID, it lacked the resources to fully comply. Potential challenges that USAID will likely face include:

- Defining an overall framework and policy for coordinating issues between USAID and the Department of State in support of HSPD-12.
- Defining and coordinating the managerial, operational and technical integration aspects between USAID and the Department of State for implementing physical and logical access.
- Tailoring an implementation plan for USAID's Washington, DC and overseas posts. (USAID intends to rely on the Department of State's implementation plan until one can be developed for USAID.)
- Obtaining resources to adequately define and develop logical access interfacing mechanisms to USAID's information systems.

OIG is monitoring USAID's progress in implementing HSPD-12, and a formal review on USAID's progress is planned for fiscal year 2007.

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[4] This standard applies to all employees (i.e., direct hire, Personal Service Contractors, employees on "loan" from other Federal agencies, etc.).

Information Technology Governance

In our March 2006 Semiannual Report to the Congress, we identified a management challenge in the area of information resource management [now referred to as Information Technology (IT) governance]. IT governance involves not only the duties and functions within the Office of the Chief Information Officer but that of all bureaus, divisions and offices in USAID. As such, IT governance is an Agency-wide challenge rather than a Chief Information Officer challenge. IT governance provides the structure that links Agency-wide strategies and objectives to IT processes, resources and information—which is especially important in an environment where funds are limited.

An OIG audit[5] that assessed USAID's Phoenix Overseas Deployment and Procurement System Improvement Program (PSIP) projects reported that, among other things, USAID needs to:

- Develop an enterprise architecture.
- Enhance and fully utilize the capabilities of its Program Management Office.
- Develop complete policies and procedures governing its IT projects.

Moreover, OMB identified PSIP and the Joint Assistance Management System (a joint project with the Department of State) projects on its high risk investments list in its quarterly report ending June 30, 2006.

According to USAID management, the following steps have been taken to correct weaknesses:

- With respect to developing an enterprise architecture, USAID published the Data Architecture for Program Management and Results Reporting.
- To enhance the capabilities of the Program Management Office, USAID conducted an organizational assessment and developed a plan to combine the Program Management Office and the Office of Information Resources Management.
- Regarding policies and procedures, USAID published a standard IT Project Life Cycle Methodology that prescribes the recommended IT project baselines and government reviews.

USAID management further stated that a priority of the new Acting Chief Information Officer is IT governance policy, process, and standards development and implementation. We believe it is still a challenge for USAID to acquire, implement, and deploy systems, and we will monitor USAID's progress as corrective actions are taken in this area.

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[5] Audit of USAID's Information Technology Governance Over Its Phoenix Overseas Deployment and Procurement System Improvement Program Projects, A-000-06-001-P, dated February 21, 2006