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Improving Financial Management at USAID

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Mr. Chairman and members of the Subcommittee, thank you for the opportunity to provide this testimony that addresses the financial management challenges facing the U.S. Agency for International Development (USAID) and key steps for reforming financial management and business processes.

USAID has worked for a number of years to improve its financial management performance. USAID's efforts, and those of the Office of Inspector General (OIG), have resulted in significant improvements. These improvements are reflected, for example, in the opinions that the OIG has expressed on USAID's financial statements over the last seven years:

Fiscal Year	Opinion
1996	Disclaimer
1997	Disclaimer
1998	Disclaimer
1999	Disclaimer
2000	Disclaimer
2001	Qualified Opinion on three financial statements and Disclaimer on two financial statements
2002	Unqualified opinion on four financial statements and qualified opinion on one financial statement

The OIG's latest audit report on USAID's financial statements, covering fiscal year 2002, included unqualified opinions on USAID's balance sheet, statement of changes in net position, statement of budgetary resources, and statement of financing. The OIG expressed a qualified opinion on the statement of net cost because USAID had not developed a process to consistently allocate expenses to funding sources, strategic objectives, and goals when grants are financed from multiple sources and impact on more than one goal. Therefore, the OIG was not able to obtain sufficient evidence to support USAID's allocation of about $384 million to the related goals (responsibility segments) in the statement of net costs.

In our fiscal year 2002 audit report on USAID's financial statements, the OIG reported on seven material internal control weaknesses that affected USAID's ability to:

- Allocate program expenses on the statement of net costs.
- Reconcile its fund balance with the U.S. Treasury.
- Calculate and report on accounts payable.
- Record and classify advances to grantees and related expenses.
- Review and analyze unliquidated obligations and deobligate them when necessary.
- Recognize, record, and report accounts receivable.
- Calculate credit program allowances.

Moreover, USAID's financial management systems were not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996. These problems limit USAID's ability to produce reliable, timely financial information for day-to-day decision-making. Thus, USAID has not fully achieved the results anticipated by the FFMIA and the President's management agenda.

USAID has reported to the OIG that it has taken final actions on six of the seven material internal control weaknesses reported in our fiscal year 2002 financial statement audit. Currently, the OIG is conducting the fiscal year 2003 audit and is following up on the final actions taken on the recommendations.

I would now like to provide some more specific information on these problems and USAID's efforts to correct them.

Allocating Program Expenses on the Statement of Net Costs
Our fiscal year 2002 GMRA audit found that USAID had not developed a process to consistently allocate program expenses to its funding sources, strategic objectives, and the related USAID goals when it finances grants from multiple sources that are associated with more than one goal. During fiscal year 2003, USAID changed its process for allocating expenses for grants for which the payment process is managed by the Department of Health and Human Services. The OIG's fiscal year 2003 Government Management and Reform Act (GMRA) audit is evaluating the effectiveness of USAID's new expense allocation process.

Reconciling Fund Balance with the U.S. Treasury
In fiscal year 2002, the OIG determined that USAID had not implemented effective internal controls to ensure that its fund balance with Treasury is reconciled in a timely manner. USAID's Office of Financial Management and its overseas missions did not consistently reconcile—that is, research and resolve—differences between the records of USAID, the State Department's disbursing offices, and the U.S. Treasury. As reported in the OIG's most recent Semiannual Report to the Congress, this issue still presents a

challenge to USAID. USAID is in the process of implementing a new reconciliation system which we are reviewing as part of our fiscal year 2003 GMRA audit. The fiscal year 2002 audit recommendations for this material weakness have not had final action completed. The audit results, to date, indicate that this issue still exists.

Calculating and Reporting Accounts Payable
In fiscal year 2002, the OIG determined that significant portions of USAID's accounts payable were not supported by adequate financial documentation. During fiscal year 2003, USAID has issued detailed revised accrual procedures to its Cognizant Technical Officers. These procedures are designed to facilitate reporting of reliable accounts payable information through the accrual reporting system and the mission accounting and control system. Our fiscal year 2003 GMRA audit is examining the effectiveness of these revised accrual procedures.

Recording and Classifying Advances to Grantees and Related Expenses
Our fiscal year 2002 GMRA audit found that, as of September 30, 2002, USAID had not recorded about $88 million in expenses related to advance liquidations submitted by grantees. This management challenge continues to occur because USAID does not have a worldwide integrated financial management system that includes procurement and assistance data. Therefore, USAID must manually enter obligations for grant agreements and modifications into the Department of Health and Human Service's payment management system so that grantees can report advance liquidations (expenses) against the corresponding obligations. In our fiscal year 2002 GMRA audit report, the OIG recommended that USAID enter obligation information within 10 days after its financial management office receives the obligation document from its procurement office. While USAID has issued procedures to correct the weakness, work under the OIG's fiscal year 2003 GMRA audit indicates that this material internal control weakness has not yet been corrected.

Reviewing, Analyzing, and Deobligating Unliquidated Obligations
USAID records obtained by the OIG during our fiscal year 2002 GMRA audit showed about $153 million in unliquidated obligations that had no payment activity against them for more than one year, indicating that the obligations might no longer be needed for their original purpose. At that time, USAID was in the process of reviewing, analyzing, and deobligating unneeded obligations. USAID has reported significant progress in the area of reviewing and deobligating obligations that may no longer be needed for the original purposes. During the OIG's fiscal year 2003 audit, we are assessing USAID's performance in this area.

Recognizing, Recording, and Reporting Accounts Receivables
During our fiscal year 2002 GMRA audit, the OIG determined that USAID continues to lack an integrated financial management system with the ability to account for accounts receivable arising from USAID's worldwide operations. USAID is in the process of implementing a worldwide financial management system with the ability to immediately recognize and record accounts receivable. After this system is implemented, the OIG will evaluate the effectiveness of USAID's process for recognizing and recording accounts receivable.

Calculating Credit Program Allowances
During fiscal year 2002, USAID initially calculated and reported credit program allowances that were about $2.3 billion higher than the required amount. Our fiscal year 2002 GMRA audit found that USAID did not forward information to its loan management division that the division needed for the allowance calculation. Therefore, the fiscal year 2002 credit program allowance was calculated using incorrect data. USAID subsequently adjusted the credit program allowances to correctly reflect credit receivables. USAID has responded to a related OIG recommendation by establishing revised procedures for communicating critical information to its loan management division. During the OIG's fiscal year 2003 GMRA audit, we are evaluating the effectiveness of USAID's revised procedures.

In addition to the control weaknesses previously discussed, USAID will need to continue its efforts to address weaknesses in its financial management systems. In the fiscal year 2002 audit report, the OIG reported that USAID implemented a new core financial system in Washington during December 2000. In addition, during fiscal years 2001 and 2002, USAID completed efforts to upgrade or interface five major systems (which process transactions outside of the core financial system) to the core system.

Despite USAID's progress in implementing recommendations made over the years, a major weakness that continues to hinder progress toward substantial compliance with FFMIA is the continued use of a legacy system (the mission accounting and control system) that does not comply with the standard general ledger at the transaction level. USAID intends to deploy Phoenix worldwide to correct this problem. USAID plans to implement Phoenix in three pilot missions beginning in April 2004 and deploy the system to all overseas accounting stations by the end of fiscal year 2005.

Additionally, the OIG has identified weaknesses in USAID's security controls for its financial management systems. USAID has made significant progress in this area by, among other things, upgrading the system software for USAID/Washington and most missions, building a set of web-based surveys that migrate information directly into a formalized draft security plan, and implementing practices to standardize the security configuration of computer operating systems. However, some needed security improvements remain to be made. For example, USAID needs to provide computer security training to its key personnel to ensure that they can fulfill their security responsibilities and continue to certify its overseas accounting system at each accounting station. Currently, USAID has conducted certifications at 9 of 40 overseas accounting stations.

The problems affecting USAID's financial management systems were caused by the absence of effective controls for managing USAID's information technology resources. To address this issue, USAID has established a business transformation executive committee, which functions as USAID's investment review board. USAID is also developing enterprise architecture, including current and target architecture for financial systems. Moreover, USAID is initiating a program management office to oversee the management of information technology projects. While USAID has taken positive steps, these are beginning steps and challenges remain in each of the areas.

Finally, successful financial management of USAID will depend on producing data that provides useful information for senior management decision-making. To do this, USAID needs to reap the full benefits of Phoenix—the new integrated financial management system—to provide timely, relevant, and reliable information needed to make program funding decisions, manage costs, and measure performance. However, technology on its own will not solve USAID's financial management challenges. The key to transforming USAID's financial management operation into a world-class organization hinges on fully implementing information technology processes, such as those discussed earlier, sustaining CFO leadership and management accountability to implement needed financial reforms, and establishing clear lines of responsibility and authority.

The President's Management Agenda, announced in the summer of 2001, is an aggressive strategy for improving the management of the Federal Government. The Office of Management and Budget (OMB) has prepared a scorecard to track how well Federal agencies are doing in addressing five management areas, including financial performance.

For the quarter ending June 30, 2003, OMB rated USAID's current status for achieving the President's management agenda in the financial performance area as "red" (the lowest rating). This rating was given because (1) USAID's financial managements systems did not meet Federal financial management system requirements, (2) almost 50 percent of USAID-managed funds were not tracked with its core accounting system, and (3) USAID was unable to provide unqualified assurance as to the system of management, accounting, and administrative controls. In addition, USAID had not received an unqualified audit opinion on its annual financial statements.

However, OMB rated USAID's progress toward implementing the President's Management Agenda as "green" (the highest rating). USAID achieved the "green" rating for progress because USAID reported that it completed all planned action items for the third quarter of fiscal year 2003. For example, during the third quarter USAID:

- Completed top priority financial reports identified by system users.
- Closed the Federal Financial Management Improvement Act material weaknesses of financial reporting.
- Closed ten audit recommendations related to material weaknesses from the fiscal year 2002 audit of financial statements.
- Submitted second quarter and third quarter financial statements by the appropriate deadlines. Currently, my staff is conducting testing on the third quarter financial statements. Fourth quarter financial statements are due in the middle of October, and USAID fully expects to meet that deadline as well.

In addition, OMB noted that USAID and the Department of State are committed to collaborating on a shared financial management system. USAID is also examining, and OMB is encouraging, the potential cost savings and efficiencies of the regionalization of financial management functions.

As noted previously in my testimony, as part of the fiscal year 2003 financial statement audit the OIG is reviewing the effectiveness of USAID's action taken in response to our fiscal year 2002 audit recommendations. The OIG will also be evaluating the USAID's efforts to implement the Phoenix system in its overseas environment. Once USAID has effectively implemented (1) the Phoenix system worldwide and (2) procedures to eliminate the reported material internal control weaknesses, it will have taken significant steps toward meeting all the requirements established by OMB for being considered "green" on the President's management agenda for financial performance.

At this time, I will be happy to respond to any questions that you may have.