



September 27, 2004

MEMORANDUM

FOR: Mission Director, USAID/Macedonia, Dick Goldman

FROM: Regional Inspector General/Budapest, Nancy J. Lawton /s/

SUBJECT: Report on the Risk Assessment of USAID/Macedonia
(Report No. B-165-04-004-S)

This memorandum transmits our final report on the subject risk assessment. In finalizing the report, we considered your comments on our draft report and have included your response as Appendix II.

This is not an audit report and does not contain any recommendations for your action.

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

Background

Maintaining peace and stability in Macedonia remain the top foreign policy interests of the United States for this small but strategically-placed Balkan country. Development work in Macedonia takes place within a very challenging political environment. Public confidence in democracy is relatively low, as citizens do not always feel that political parties represent their interests or that the parties are, in all cases, responsive to popular needs. In addition, Macedonia's civil society has not yet developed to where it can exert significant influence over the political players' actions or function proactively on the citizens' behalf.

In addition to the political challenges, USAID/Macedonia is also working to address the country's serious economic problems. The unemployment rate, estimated to be 32 percent in 2002, rose to almost 37 percent in 2003. Half of unemployed persons are under the age of 30 and salaries in real terms for those who are employed remain well below their early 1990s levels. The Macedonian economy does not have the flow of private capital funds from domestic and foreign direct investment needed to ensure adequate rates of growth to absorb unemployment. Political uncertainty and investors' lack of confidence have inhibited foreign investment.

USAID/Macedonia includes three Program-related offices, a Program Office, and an Executive Office:

- The Economic Growth (EG) office seeks to accelerate economic growth in Macedonia by bringing industry, government and labor together to find ways to make Macedonian industry more competitive. USAID's projects strengthen financial institutions in order to improve the access to capital for firms of all sizes. USAID's projects also support modernization of Macedonia's tax policy and business law, implementation of World Trade Organization membership and economic development at the local level.
- The Democracy and Local Governance (DLG) office focuses on, among other things, increasing participation in political and social decision making and enhancing adherence to the rule of law.
- The Social Transition Office (STO) facilitates the transition to a market-based economy in Macedonia. USAID/Macedonia and its partners are working to improve education and strengthen human capacity through development projects.
- The Program Office is responsible for program development, program budget management, and public awareness of Mission activities. The office is also responsible for managing the participant training program and facilitating the Mission's cross-cutting initiatives.
- The Executive Office (EXO) manages administrative functions such as personnel management, general services, motor pool, and property management.

The Mission plans to streamline its activities by completing older programs and only starting a few new, top priority activities.

The following table shows expenditures, in millions, for Mission programs during fiscal years 2001-2003, along with the current strategic objectives (SOs) and the proposed budget for fiscal year (FY) 2004.

USAID/Macedonia Programs	FY 2001	FY 2002	FY 2003	FY 2004 (budgeted)
Economic Growth Office: <i>Strategic Objectives - 1.3: Accelerated Development and Growth of the Private Sector and portions of SO 3.4: Mitigation of Adverse Social Impacts of the Transition to a Market-Based Democracy</i>	\$11.6	\$17.7	\$16.2	\$12.2
Democracy and Local Governance: <i>Strategic Objective - 2.0: More Legitimate Democratic Institutions</i>	9.4	12.8	15.8	11.8
Social Transition Office: <i>Strategic Objective - portions of SO 3.4: Mitigation of Adverse Social Impacts of the Transition to Market-Based Democracy</i>	-	3.2	3.1	6.4
Program Office: <i>Strategic Objective - 4.2: Cross-cutting Initiatives</i>	4.0	4.3	4.4	4.3
TOTALS	\$25.0	\$38.0	\$39.5	\$34.7

The Government Accountability Office (GAO), formerly the General Accounting Office, has stated in the *Standards for Internal Control in the Federal Government* that internal controls are an integral component of an organization's management. They should provide reasonable assurance that the following objectives are being met: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. GAO has also stated that internal controls should provide for an assessment of the risks the agency faces from both external and internal sources. This survey focused on the risk assessment component of internal controls.

The purpose of this assessment was to identify the more significant areas of vulnerability within USAID/Macedonia's administrative and program operations and to assist RIG/Budapest in planning future program audits.

Appendix I contains a discussion of the scope and methodology for this assessment.

Discussion

In judging the risk exposure for the offices in USAID/Macedonia, we considered, where appropriate:

- The amount of funding the individual programs received relative to the overall Mission budget,

- The level of involvement and support provided by the Government of Macedonia,
- The experience of key staff members,
- The adequacy of written procedures and the level of compliance with procedures throughout the Mission,
- The adequacy and use of performance standards and internal audits,
- Evidence of consistent implementation of activities that clearly support program objectives,
- The adequacy of controls over its data systems, equipment and vehicles, and
- Correction of Mission-identified weaknesses from the Federal Managers' Financial Integrity Act (FMFIA) report for FY 2003.

Function Description	Risk Exposure
Economic Growth (EG) Office: This office is responsible for SO 1.3: Accelerated Development and Growth of the Private Sector and portions of SO 3.4: Mitigation of Adverse Social Impacts of the Transition to Market-Based Democracy	Moderate
Risk Assessment Factors	
<ul style="list-style-type: none"> • This office expended \$16.2 million, about 41 percent of the Mission's FY 2003 program funding. • Because Macedonia has a population of only about 2.1 million, activities have the potential to significantly improve the country's economic well-being. However, as a consequence, the country's small size means that EG projects face increased risk of disruption by external factors such as actions by the Government of Macedonia or disruptions to key businesses. • The success of many EG initiatives depend on actions by the Government of Macedonia, including the removal of legal, policy, regulatory and procedural impediments to rapid, private sector-led growth. Instead of enacting these economic reforms, the new government focused on such issues as maintaining stability and combating corruption. As a result, the SO 1.3 targets for FY 2003 were not achieved. • To achieve its objectives, EG must coordinate with the Government of Macedonia, the European Union, the World Bank, other international donor organizations, as well as some private industry representatives that are working to reform the Macedonian economy. Conflicts or differences in 	

opinions among these stakeholders may sometimes impede the Mission's progress to achieve timely results.

- The current EG Director has provided stable leadership for the past seven years. The five additional EG staff members are knowledgeable, experienced, and aware of their assigned responsibilities. They manage thirteen activities under SO 1.3 and SO 3.4.
- Personnel have up-to-date job descriptions and receive detailed performance appraisals that often specifically mention employees' internal control responsibilities. The Mission upgraded several EG positions through the Computer Aided Job Evaluation (CAJE) process, and staff have received regular training opportunities to improve their job skills.
- Program activities are well documented and reflect the active engagement of EG personnel with the implementing partners to improve programs and achieve the office's objectives. Personnel meet regularly with implementers, review work plans, performance schedules, quarterly and annual reports to assess progress.
- EG has effectively utilized management tools such as portfolio reviews and Performance Management Plans. The Mission assessed EG data quality in FY 2001, and a new data quality assessment is currently underway. Such management tools are important control mechanisms that help limit risk.
- The Mission's Federal Managers' Financial Integrity Act (FMFIA) report for FY 2003 did not disclose any new or uncorrected material weaknesses related to EG programs.

Function Description	Risk Exposure
<p>Democracy and Local Governance (DLG) Office: This office is responsible for SO 2.0: More Legitimate Democratic Institutions</p>	Moderate
Risk Assessment Factors	
<ul style="list-style-type: none"> • The Mission spent \$15.8 million on programs during FY 2003, representing 40 percent of the USAID/Macedonia's program funds for that fiscal year. • Macedonia's political challenges, combined with continued ethnic tensions and the need to coordinate with other donors, may limit DLG's program success. • DLG personnel are actively engaged with the implementing partners to improve DLG programs and results. Activity managers and Cognizant Technical Officers (CTOs) are well trained. Personnel have up-to-date job descriptions, have received required performance appraisals, and have received regular training opportunities. These human capital management factors help to reduce organizational risk. 	

- DLG personnel were aware of the potential for fraud, corruption and mismanagement. Based on DLG information, the Mission Director identified and reported a potential vulnerability to the Regional Inspector General during an audit of the DLG program. The identification and mitigation of such risk helps ensure that DLG meet their intended results and objectives.
- A recent RIG/Budapest audit report (Report Number B-165-04-004-P, dated March 25, 2004) stated that USAID/Macedonia monitored DLG programs to ensure that activities achieved their intended results. However, the Mission's annual performance reporting does not fully reflect USAID's impact in Macedonia because of USAID/Macedonia's predominant use of public perception surveys to measure results of DLG activities. The report recommended that the Mission should review its performance indicators and select a new mix of indicators that better represents their program's performance.
- DLG has utilized management tools such as the review of project files and site visits to enhance its system for monitoring. Also, DLG personnel meet weekly with the Mission Director to discuss activities and progress.
- A contractor is currently assessing the adequacy of SO 2.0 performance indicators and the quality of data collection efforts. This assessment should help to enhance the quality and accuracy of reportable data and help DLG personnel to meet program objectives.
- The Mission's FMFIA Report for FY 2003 did not disclose any new or uncorrected material weaknesses related to DLG operations.

Function Description	Risk Exposure
Social Transition Office (STO): This office is responsible for portions of SO 3.4: Mitigation of Adverse Social Impacts of the Transition to Market-Based Democracy	Low
Risk Assessment Factors	
<ul style="list-style-type: none"> • This office expended \$3.1 million, about 8 percent of the Mission's FY 2003 program funding. • Because Macedonia is a small country with only 340 primary and 90 secondary schools, the programs have the potential to have a significant impact on the country's education system. For example, under USAID's E-schools initiative, USAID and other donors will provide a computer lab to every secondary school in Macedonia. • To implement programs, STO coordinates with the Government of Macedonia's Ministry of Education, and political concerns can, at times, slow progress. The office's relations with the Ministry have improved significantly, and the proposed decentralization of Macedonian education should reduce program dependence on the Ministry for access to schools. 	

- STO programs are coordinating with other donors to maximize results and avoid duplication of effort.
- Two CTOs with extensive education experience—one U.S. Personal Services Contractor (USPSC) and one Foreign Service National (FSN)—have been with the program since its inception in 2002 and have provided stable leadership. As the program expanded, the office added a program assistant who will assume increased program management responsibilities. The STO Director position is currently vacant, but a U.S. Direct Hire (USDH) is scheduled to arrive in August 2004 to fill that position.
- Personnel have up-to-date job descriptions and have received detailed performance appraisals that often specifically mention employees' internal control responsibilities. The Mission upgraded one STO position during the CAJE process, and staff has received regular training opportunities to improve their job skills.
- Program activities are well documented and reflect the active engagement of STO personnel with the implementing partners to improve programs and achieve the office's objectives.
- STO has effectively utilized management tools such as portfolio reviews, the Performance Management Plan, and annual reports of activities. Portfolio reviews include the staff's assessment of vulnerability issues for each project. A contractor is currently assessing the adequacy of the SO 3.4 performance indicators and the quality of data collection efforts. Such management tools are important control mechanisms that help to limit risk.
- The Mission's FMFIA report for FY 2003 did not disclose any new or uncorrected material weaknesses related to STO programs.

Function Description	Risk Exposure
<p>Program Office: This office is responsible for program development, program budget management, and public awareness of Mission activities. The office is also responsible for facilitating activities under SO 4.2: Cross-cutting Initiatives</p>	<p>Low</p>
<p>Risk Assessment Factors</p>	
<ul style="list-style-type: none"> • The Program Office received \$4.4 million, about 11 percent of the Mission's FY 2003 program funding. The office managed \$2.9 million in program funds to support participant training. The remaining \$1.5 million was spent on program development and support for the Mission's cross-cutting initiatives. • The office is led by a USDH Program Office Director and a USPSC Program Development Advisor, both with extensive USAID experience. • The office implements the participant training program using an experienced 	

training contractor. The office utilizes the Automated Directives System (ADS) and Europe and Eurasia Bureau Handbook for program guidance and has drafted a separate Mission Order on participant training which incorporates Mission-specific objectives. The office plans to submit the draft to all Mission offices for coordination before it goes to the Mission Director for approval.

- The office issued an updated Mission Order regarding activity design and approval that described relevant documentation expected for each new activity. Such documentation includes descriptions of results to be achieved, necessary supporting analyses, and a performance management plan with specific indicators and targets.
- The office coordinates the Mission’s annual portfolio reviews, which thoroughly and consistently document both program achievements and implementation concerns.
- Program Office personnel serve as representatives on each SO team. The representatives advise team members on programmatic decisions and facilitate information-sharing between various USAID activities.
- A Program Development Advisor serves as the Mission’s environmental officer to ensure that Initial Environmental Evaluations are completed in accordance with ADS 204.5. The evaluations help to assure that USAID projects will not harm the environment.
- The office has been responsible for the completion and submission of the annual FMFIA report in conjunction with the other Mission offices.
- The Mission’s FY 2003 FMFIA report did not disclose any new or uncorrected material weaknesses.

Function Description	Risk Exposure
Executive Office (EXO): This office manages administrative functions such as personnel management, general services, motor pool, and property management.	Low
Risk Assessment Factors	
<ul style="list-style-type: none"> • This office provides the basic support for the Mission and had an Operating Expense budget for FY 2003 of \$1.9 million. • Key managers within the Executive Office—including the Executive Officer—have training and experience with USAID policies and procedures relevant to their positions. The Mission considers that this office has greatly reduced its risk level relating to administrative errors by implementing computerized internal control systems. The Mission stated that, “This system includes ten programs to track and/or to make automated requests for the following services: real property, maintenance, financial management, simplified acquisitions, human resources, motor-pool, travel, information 	

resources, communications & records management and customs & shipping.”

- The EXO conducted unannounced cash counts as required by the Foreign Affairs Handbook (FAH), Verification of Funds – General Provisions and documented them. For security reasons, the Mission should consider relocating the cashier’s office to assure that administrative controls are properly applied and funds are safeguarded.
- The EXO maintained documentation regarding the office’s administrative control of funds.
- Employee files were organized in accordance with applicable guidance. However, sensitive files containing employee social security numbers were not always safeguarded in accordance with ADS 502.5.1c, Access to USAID Records.
- The EXO maintained appropriate use of internal controls related to computer access controls and security. A recent USAID scan of the computer system showed that the vulnerability was low. The Mission recently received an award for exceptional performance in information security, risk reduction, and leadership.
- The EXO developed a security plan for the general support system and has periodically tested it for general support and major applications.
- The EXO maintained adequate documentation for its six vehicles that included vehicle mileage, fuel consumption, and maintenance records. Although the office properly maintained daily vehicle use records, the records for one vehicle were not always documented as required by the Foreign Affairs Manual (6 FAM 228.6, Operating Motor Vehicles).
- The Mission’s FY 2003 FMFIA report did not disclose any new or uncorrected material weaknesses related to EXO operations.

Conclusion

We examined the risks associated with the various aspects of the USAID/Macedonia Mission. The table below summarizes our conclusions.

USAID/Macedonia Functions	Risk Exposure		
	High	Moderate	Low
Economic Growth Office		✓	
Democracy and Local Governance Office		✓	
Social Transition Office			✓
Program Office			✓
Executive Office			✓

The Mission considers that the level of risk relating to administrative controls was reduced by the implementation of an on-line computer program structured by the EXO's office. This system of internal controls creates checks and balances which may provide a cost saving to the U.S. government.

Based on our observations, interviews and limited review of documentation, we are offering the following suggestions for Mission management's consideration. These suggestions are not formal audit recommendations and do not necessarily represent deficiencies, but involve possible improvements or enhancements to activities which could already be in progress. Specifically, the Mission should:

- Consistently document records for vehicle use in accordance with 6 FAM 228.6, Operating Motor Vehicles.
- Verify that administrative procedures for the establishment of the current alternate cashier are consistent with USAID and federal requirements.
- Assure that the location of the cashier's office and the safeguarding of funds are in accordance with Agency requirements and 4 FAH-3.

**Evaluation of
Management
Comments**

USAID/Macedonia Mission officials agreed with the conclusions we reached during the risk assessment and concurred with our suggestions. As noted in their comments, they have already begun to implement the suggestions included in the risk assessment.

The Mission Director also provided documentation to support actions taken, including an updated Mission Order on cash procurements and the purchase of three combination-lock cash boxes. He also certified that everyone is signing the vehicle logs.

Scope and Methodology

Scope

The Regional Inspector General/Budapest (RIG/Budapest) conducted this risk assessment to gain an understanding of the programs and activities of USAID/Macedonia. This was not an audit and does not contain any formal recommendations. The risk assessment was conducted at USAID/Macedonia in Skopje, Macedonia, during the period June 7-24, 2004. The purpose of this assessment was to identify the more significant areas of vulnerability within USAID/Macedonia's administrative and program operations to assist RIG/Budapest in planning program audits for fiscal year 2006 and beyond. The risk assessment focused primarily on FY 2003 data and, as necessary, data from previous years.

Methodology

To perform this risk assessment, we interviewed USAID/Macedonia personnel and examined documentation to obtain an understanding of the Mission's objectives, programs and activities. We judged risk exposure by considering the likelihood of: significant abuse, illegal acts and/or misuse of resources, failure to achieve program objectives, noncompliance with laws, regulations and internal policies. We assessed overall risk exposure as low, moderate, or high. A higher risk exposure simply indicated that the particular function is more vulnerable to not achieving its program objectives or to experiencing irregularities.

Our overall risk assessments did not make definitive determinations of the effectiveness of internal controls. As a part of the scope of our review, we (a) obtained an understanding of the internal controls related to the programs and operations selected, and (b) assessed what was already known about the internal controls. Also, it should be noted, we did not (a) assess the adequacy of the internal control design, (b) determine if controls were properly implemented, or (c) determine if transactions were properly documented.

Our risk assessment of USAID/Macedonia considered the following limitations:

- Higher risk exposure assessments are not definitive indicators that program objectives were not being achieved or that irregularities were occurring. A higher risk exposure simply implies that the particular function is more vulnerable to the occurrence of such events.
- Comparison of risk exposure assessments between organizational units and implementing partners is of limited usefulness because the assessments consider both internal and external factors, some being outside the control of management.
- Risk exposure assessments in isolation are not an indicator of management's capabilities due to the fact that the assessments consider both internal and external factors, some being outside the control of management.

We determined a risk level of low, moderate, or high for the Mission's various programs and offices. The final assignment of the risk level to an office was judgmentally determined considering the external factors which could have had an effect on the programs in some cases. We also assessed how sufficiently we believed the Mission had met the prescribed regulations, operating guidelines and internal control procedures in its program, financial, accounting and administrative management.

**Management
Comments**



**USAID MACEDONIA
MEMORANDUM**

August 31, 2004

FROM: Dick Goldman, Mission Director /s/

TO: Regional Inspector General/Budapest, Nancy J Lawton

**SUBJECT: Draft Report on the Risk Assessment of USAID/Macedonia
(Report No. B-165-04-XXX-S)**

Thank you for the opportunity to provide comments on the USAID/Macedonia Risk Assessment Report. We enjoyed the collaboration with your staff and have already begun to implement the suggestions they made on how we can improve our performance to reduce risk and ensure we are complying to the fullest with Agency policies and procedures.

Suggested edits for RIG consideration:

- p. 2 bullet 3, insert "a" between to and market-based
- p. 6 bullet 2, the last sentence, "...will provide a computer lab to every secondary school in Macedonia.
- p. 6 bullet 4, "STO programs are coordinating with other donors...."
- p. 8 bullet 5, delete "generally"

Factual errors:

p. 8, bullet 2, last sentence should note ten programs not six. Therefore the sentence should read, "This system includes ten programs to track and/or to make automated requests for the following services: real property, maintenance, financial management, simplified acquisitions, human resources, motor-pool, travel, information resources, communications & records management and customs & shipping."

p. 9, third full bullet, the last sentence should be replaced with, "... the records were not

always documented for one vehicle of the motor pool as required by.....”

We note the following actions taken in response to your suggestions:

All vehicles are now fully in compliance with 6 FAM 228.6, Operating Motor Vehicles.

The sub-cashier is booked to take the one week Basic Overseas Cashier course in FY 05. We have issued a revised Mission Order MO533-1: Cash Procurement of EXP, NXP and it includes sections that address our policies and procedures for safeguarding petty cash funds and the formal designation of the sub-cashier and alternate sub-cashier.

In accordance with the 4 FAH -3 H-317 we have ordered manipulation-resistant cash boxes for the sub-cashier and for the alternate sub-cashier.