U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

INTERNATIONAL TRADE ADMINISTRATION

Financial Statements Fiscal Year 1997

Audit Report No. FSC-9862-8-0001/March 1998

PUBLIC RELEASE

Office of Audits, Financial Statements Audit Division

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

March 19, 1998

MEMORANDUM FOR: David L. Aaron
Under Secretary for International Trade

FROM: Johnnie E. Frazier
Acting Inspector General

SUBJECT: Audit of ITA's FY 1997 Financial Statements
Audit Report No. FSC-9862-8-0001

The attached audit report presents the results of the audit of the International Trade Administration's (ITA) Statements of Financial Position as of September 30, 1997, and 1996, and the related Statements of Operations and Changes in Net Position for the years then ended. Also provided are reports on ITA's internal controls and compliance with laws and regulations, including management's comments. The accompanying overview and financial statements were prepared by ITA.

In accordance with the Chief Financial Officers (CFO) Act of 1990, as amended by the Government Management Reform Act of 1994, an audited consolidated financial statement must be prepared covering all accounts and associated activities of each office, bureau, and activity of the Department. To facilitate the consolidated audit process, the independent certified public accounting firm of Price Waterhouse LLP (PW) was contracted to audit ITA's FY 1997 financial statements. The Office of Inspector General defined the audit scope, oversaw the process of selecting the contractor, and oversaw the performance and delivery of the audit.

As a result of the limitations and weaknesses described in the following paragraphs, PW was unable to determine the amounts of the adjustments that may be necessary to fairly state the financial statement balances in accordance with OMB Bulletins No. 94-01 and 97-01. As a result, the scope of the audit was not sufficient to enable them to express an opinion on the Statements of Financial Position and the Statements of Operations and Changes in Net Position as of and for the years then ended September 30, 1997, and 1996, and accordingly expressed no opinion.

PW was unable to audit material ITA account balances because of deficiencies in internal controls and automated systems. The nature and extent of the internal control deficiencies reported by PW clearly indicate serious problems in ITA's financial management. The following material internal control weaknesses were identified as reasons for disclaiming on ITA's financial statements:

- ITA did not maintain adequate support for financial statement balances, did not perform sufficient reconciliation of recorded balances to supporting documentation, recorded inconsistent coding for similar transactions, and did not completely or correctly adhere to authoritative guidance in the following areas: accounts receivable, property and equipment, accounts payable, capital lease liabilities, unearned revenue, Foreign Service National voluntary separation pay liability, and unliquidated obligations. Also, inventory balances are not compiled or recorded, and equity balances are not accurately recorded.

- During FY 1997, ITA did not have an effective personnel structure in place to establish proper financial management control over its operations. This weakness was evident at all levels of ITA's financial management, but was particularly acute at the highest level since ITA did not have a Chief Financial Officer or equivalent individual with authority over all financial management personnel, activities, and systems.

- Financial systems risk being interrupted during FY 1998 as ITA's accounting systems provider has indicated they may discontinue servicing the current system. In addition, ITA financial systems were not fully integrated and source data entered into off-line systems was not ultimately reconciled to the official accounting system.

- There was inadequate segregation of recording, reconciling, and adjusting financial data from functions relating to automated system programming and security.

- ITA financial systems were inadequate to identify and record overseas activity affecting all of ITA's asset and liability balances.

- Key reconciliations to ensure all cash collections were properly deposited and recorded were not being performed.

These material weaknesses must be addressed before ITA can have reasonable assurance that amounts reported in the financial statements are fairly stated. In addition, PW identified four reportable conditions in the bureau's internal controls and several instances of material non-compliance in its Report on Compliance with Laws and Regulations which were also considered in its decision to disclaim an opinion.

Instances of material non-compliance reported by PW include the following:

- ITA did not meet the requirements referred to in Section 2 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and related guidance by not citing ITA's financial management system as materially weak.

- ITA has not complied with provisions of OMB Circular No. A-127, Financial Management Systems. The bureau has not taken corrective actions to resolve identified internal control deficiencies timely, does not have an integrated financial management system, has not developed a set of performance measures accepted throughout the organization and does not have systems to capture performance measurement information.

- ITA has not funded and transferred to its trust fund an amount equal to the current accrual, $11.1 million, for voluntary Foreign Service National separation pay as required by Public Law 102-138, Section 151.

- In accordance with 3 U.S.C. Section 9701 (the Economy Act), which requires that trade event seminar and information sale activities operate on a full cost recovery basis. ITA policies have not required that all indirect costs be allocated to these activities, in accordance with generally accepted cost accounting principles. Therefore, ITA cannot ascertain which activities are on a full cost recovery basis, which earned excess receipts, and which were subsidized by appropriated funds.

- ITA was in substantial non-compliance with Federal Financial Management Improvement Act due to material weaknesses, including the non-integration of key systems, inadequate security and internal control over those systems, and weaknesses noted in the integrity of financial data and the compilation of financial information into the annual financial statements. In addition, ITA had not fully implemented the Standard General Ledger (SGL) at the transaction level as evidenced by its inability to trace many transactions to feeder systems and supporting documentation, as well as the incorrect usage of many SGL budgetary and closing accounts.

Our office reviewed a draft version of ITA's overview to its FY 1997 financial statements. The overview provides the linkage between the financial statements and the Government Performance and Results Act of 1993, the legislation that requires government entities to collect and report information on their performance in meeting goals and objectives. We shared our observations and recommendations in a January 12, 1998, discussion paper and a subsequent meeting with ITA management. ITA was responsive to our comments, making some revisions to the overview for FY 1997 and indicating they will make further improvements in FY 1998 and future years. PW also noted the overview as a reportable condition in its Report on Internal Controls.

The overview (1) links the bureau's planned performance measures with ITA programs and the bureau's goals and objectives included in the Department's *Strategic Plan;* (2) contains some performance results on trade performance and the Import Administration; (3) defines the measures being used; and (4) provides discussion on financial management challenges and plans. Specific aspects of the overview that still require improvement are as follows: (1) the inclusion of several years worth of data; (2) a comparison of actual results versus target levels of performance; (3) strengthened discussion of performance results and management plans for corrective action; and (4) improved linkage of performance results to the bureau's goals and objectives. Also, the bureau needs to strengthen its discussion of financial measures and results; provide actual data for its identified measures or explain why the information is not currently available; and include additional measures of cost effectiveness.

In order to improve the usefulness of the overview to decision-makers, such as OMB and the Congress, we encourage ITA to address the observations contained in our discussion paper. Also, continued improvement will be needed for the overview to be consistent with OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, to "provide a clear and concise description of the reporting entity and its mission, activities, program and financial results, and financial condition." The OIG realizes that improving the overview is an iterative process and encourages ITA to strengthen next year's overview.

ITA's failure to resolve its weaknesses in internal controls and make significant progress toward improving the reliability of its financial statements is of particular concern to the Office of Inspector General. All of the material weaknesses and three of the four reportable conditions reported in ITA's FY 1997 financial statements are repeat conditions from last year's audit report. Many of these deficiencies have been reported since FY 1994. ITA received a disclaimer of opinion on its FY 1996 and 1995 financial statements and on its FY 1994 statement of financial position. The number and magnitude of ITA's material weaknesses and reportable conditions and its inability to produce reliable financial statements necessitate that the bureau take immediate corrective actions.

At the request of the then Acting Under Secretary of ITA, the Office of Inspector General developed a blueprint in July 1997 to improve the bureau's financial management and the quality of its financial statements by identifying critical areas needing immediate corrective actions. The late date of the blueprint, however, limited ITA's ability to correct most of these weaknesses before the fiscal year-end. We encourage ITA management to continue to make a concerted effort to implement these corrective actions.

One of the blueprint's recommendations was to appoint a Chief Financial Officer. ITA continued to operate without a CFO during FY 1997 although one was appointed after fiscal year-end. In addition, the appointment of a Deputy CFO is still pending. We recommend that the individual appointed to the Deputy CFO position have a strong financial background to resolve the accounting challenges facing ITA. Also, additional financial management resources are needed to ensure the timely resolution of internal control deficiencies.

The accounting requirements set forth in OMB Bulletin 97-01 will need to be addressed during preparation of the FY 1998 financial statements. Implementation of OMB Bulletin 97-01 poses tremendous challenges for various reasons. In particular, this bulletin requires six statements to be prepared as compared to OMB Bulletin 94-01, which required two. One of the six statements, the Statement of Net Cost, requires ITA to report its costs by sub-organizations and programs, which should be based on the missions and outputs described in ITA's GPRA strategic and annual plans, its budget structure, and the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards*. As the federal government has not been required previously to report information in such a manner for financial or budgetary purposes, ITA will need to place appropriate emphasis on implementation of OMB Bulletin 97-01.

As required by DAO 213-5, please provide an audit action plan addressing the recommendations in the attached report within 60 days of this memorandum. The format for the plan is Exhibit 7 of the DAO. Under the DAO, the Office of Inspector General must concur with your proposal. The DAO prescribes procedures for handling any disagreements this office may have with the audit action plan.

If you wish to discuss the contents of this report, please contact George E. Ross, Assistant Inspector General for Auditing, on (202) 482-1934, or Thomas McCaughey, Director, Financial Statements Contract Audits Division, on (703) 603-0301. We appreciate the cooperation and courtesies extended by ITA during the audit.

cc: W. Scott Gould
Chief Financial Officer and
Assistant Secretary for Administration

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