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Executive Summary

Within weeks of his inauguration, President George W. Bush unveiled his first budget, *A Blueprint for a New Beginning*. His budget included an ambitious and unprecedented agenda for improving the management of the Federal Government. Six months later he issued the *President's Management Agenda*, which outlines specific goals and strategies to address the federal government's most pressing management issues. In his agenda, President Bush outlines five government-wide and nine agency-specific areas that need revamping to better serve the American people. One of the five Government-wide targets is to improve financial performance by ensuring that Federal financial management systems produce accurate, timely, and useful information to support operating, budget, and policy decisions, and to manage and reduce the extent of erroneous payments in Federal programs. This *Federal Financial Management Report* describes the financial performance challenges facing the Federal Government, chronicles efforts during the past year to resolve issues, and outlines strategies for future improvement.

In light of the events of September 11 and the enormous resource demands placed upon a Nation at war, now more than ever it is critical that we maximize the use of every tax dollar to ensure the safety of America and its citizens. This Administration believes that Americans should be able to compare performance and cost across programs to ensure the effective and efficient operation of the Federal Government. Such comparisons must be based upon accurate, timely, and consistent financial information. Transparency in financial reporting is crucial when making the hard choices about where to allocate resources. As a prime example, the *Financial Report of the United States Government* for Fiscal Year (FY) 2001 stated a fact that has implications for our financial future as a Nation. For the first time ever, retirement benefit liabilities for Federal civilian and military retirees and veteran compensation benefits exceeded debt held by the public as our greatest liability. Financial statements recognize liabilities/expenses when they are incurred, and the budget generally reflects costs when paid. The FY 2001 financial statements included a "catch up" liability that will result in significant and rising costs for each subsequent budget year, a consequence of expanded retirement health benefits granted to military retirees in the FY 2001 Defense Authorization Act.

The President advocates an active but limited government that focuses on priorities and executes them well. Through the framework of the *President's Management Agenda*, this Administration is determined to tackle and resolve serious management challenges that defy quick solutions—yet pose major risks to performance and accountability of major government programs and operations. Referred to as "high risk" or material weaknesses, these problems have been identified through numerous audit reports and agency reviews of operations. Many

have plagued the agencies for years. Beginning with the FY 2004 budget cycle, which will begin this summer, agencies will be expected to submit with their budget requests clear and concise plans for fixing the underlying conditions that spawn these problems, along with ambitious timelines and milestones for which agency officials will be held accountable.

The President's emphasis on performance and accountability has energized the Chief Financial Officers (CFO) Council as well. Rather than pursue an array of financial performance initiatives, the Council has restructured its committees to address the glaring problems identified by the five government-wide areas in the *President's Management Agenda*. The Council is working closely with the other interagency Councils to resolve crosscutting issues and further the President's initiatives. For example, the CFO Council has formed a joint working group with the Inspectors General through the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency to reduce erroneous payments to beneficiaries. Under the leadership of the Department of Health and Human Services, the 26 grant-making departments and agencies have projects underway to transition the entire grants process to an electronic format, thus simplifying the process, saving time and resources for grantees and the Federal Government and, at the same time, ensuring that grant funds are used for their intended purposes.

For financial information to be useful, it must be reliable and available on a regular basis, not just once a year as of September 30, and five months after the fact. To ensure that financial and performance information is available to the President and the Executive Branch during the budget formulation timeframe, the Office of Management and Budget (OMB) is accelerating the due date for audited agency financial statements from February 27 in 2001 to November 15 in 2004. The government-wide financial statements will then be completed by December 15, instead of at the end of March, as is the current practice. OMB also is requiring agencies to produce comparative and interim reports. To meet these accelerated due dates, agencies must reinvent their business processes and improve their systems to produce more readily the financial information necessary to prepare financial statements.

In addition, the FY 02 statements, due in February 2003, agencies will be required to submit combined *Performance and Accountability Reports*, which will contain the audited financial statements and performance information, thus providing a more complete picture of an agency's progress and results achieved. Integration of performance information with the budget is another of the five government-wide initiatives of the *President's Management Agenda*. Acceleration of the timeframes for producing financial and performance information will mean that the President, Congress, and the American people will have vital financial and performance information available to make informed decisions about the use of America's resources before they are allocated through the budget process.

OMB is not waiting for these future events. The Administration launched with the FY 2003 Budget a process that seeks to reinforce provably strong programs and to redirect funds in some cases from programs that demonstrably fail, or cannot offer evidence of success. Based on all the information we could gather, we have made judgments about whether programs are effective, ineffective, or, where data was simply unavailable, that the level of program effectiveness was unknown. We seek to change the burden of proof, asking agencies and advocates to supply evidence of program effectiveness instead of assuming effectiveness in the absence of evidence to the contrary.

To reinforce the Budget and Performance Integration initiative, OMB is working to establish effectiveness ratings for approximately 20 percent of Federal programs that will be published with the President's FY 2004 Budget. OMB already has begun an extensive effort to identify a subset of programs and evaluation metrics for these programs. In addition, OMB is developing evaluation metrics for several major crosscutting, government-wide functions. Consistent with this effort, the President submitted to Congress on October 1, 2001, legislation that would make the necessary statutory changes to ensure that appropriations charge employee costs to the agency accounts where the individuals are employed. The President's full cost accounting proposal simply makes a change in the way those benefits are accounted for so that we can get a more accurate sense of the full cost of government programs.

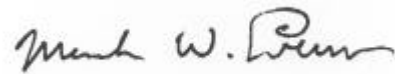
All of these steps are designed to achieve the spirit of the Government Performance and Results Act of 1993, rather than simply comply with the requirements of what has become in most cases just a paperwork exercise.

In another effort to improve federal financial management, in August 2001, the Principals of the Joint Financial Management Improvement Program (JFMIP) began meeting regularly to address long-standing issues confronting the Federal financial community. These issues include cost accounting, transparency in accounting, and the quality of financial systems, as well as financial statement preparation and acceleration. JFMIP's Principals include the Director of OMB, the Secretary of the Treasury, the Director of the Office of Personnel Management, and the Comptroller General. The Principals also agreed to reconstitute the Federal Accounting Standards Advisory Board (FASAB), which promulgates generally accepted accounting principles (GAAP) for the Federal Government. Membership on FASAB has been reconfigured to increase private sector representation. This step will strengthen the Board's independence while adding private sector perspectives and expertise to the Federal Government's accounting practices.

This Administration is committed to achieving real and lasting improvements in Federal financial performance. We are off to a good start. Although the government-wide financial statements received a disclaimer for the fifth year in a row, CFOs and their agency heads are mak-

ing steady progress toward removing the two key impediments to a clean opinion. First, the Department of Defense has launched a major initiative to clean up its poor financial management by developing and consolidating its financial architecture and systems. Second, OMB and the Department of the Treasury are leading an effort to develop accurate accounting and standardized processes for billions of dollars of transactions among Federal Government entities. For the FY 2001 reporting cycle, we saw modest, but genuine improvement in agencies' financial reporting. Eighteen of the 24 major agencies received clean opinions on their financial statements. The Departments of Transportation and Justice moved up and received clean opinions, while two agencies with previously clean opinions slipped. The two agencies that lost their clean opinions—the National Aeronautics and Space Administration and the Federal Emergency Management Agency—are already hard at work to resolve the issues that clouded their financial statements.

The CFO Council will continue to play a vital role in our efforts to improve financial performance. The challenges we face are formidable, but with sustained energy and resources targeted at the priorities identified by the *President's Management Agenda*, I am confident that we will achieve the lasting management improvements envisioned by the President.



Mark W. Everson
Controller

The Chief Financial Officers Council

The CFO Act of 1990 created the CFO Council as a mechanism to advise and coordinate the activities of the agencies of its members on such matters as consolidation and modernization of financial systems, improved quality of financial information, financial data and information standards, internal controls, legislation affecting financial operations and organizations, and other financial management matters. The CFO Council consists of the CFOs and Deputy CFOs of the 24 major Federal departments and agencies covered by the CFO Act of 1990—collectively known as the “CFO Act agencies.” The Deputy Director for Management at OMB chairs the Council. Other members include the Controller, Office of Federal Financial Management, OMB, and the Fiscal Assistant Secretary of the Treasury. Two-thirds of the CFOs are appointed by the President with the advice and consent of the Senate.

CFO Act agencies include:

- Department of Agriculture
- Department of Commerce
- Department of Defense
- Department of Education
- Department of Energy
- Department of Health and Human Services
- Department of Housing and Urban Development
- Department of the Interior
- Department of Labor
- Department of Justice
- Department of State
- Department of Transportation
- Department of the Treasury
- Department of Veterans Affairs
- Agency for International Development
- Environmental Protection Agency
- Federal Emergency Management Agency
- General Services Administration
- National Aeronautics and Space Administration
- National Science Foundation
- Nuclear Regulatory Commission
- Office of Personnel Management
- Small Business Administration
- Social Security Administration

The Executive Branch Management Scorecard: Measuring Results

The Administration is using an Executive Branch Management Scorecard to ensure accountability for performance and track results toward achieving the goals of the *President's Management Agenda*. The scorecard employs a simple “traffic light” grading system common today in well-run businesses. Based upon a comprehensive set of standards, an agency is “green” if it meets all of the standards for success, “yellow” if it has achieved some but not all of the criteria, and “red” if it has even one of a number of serious flaws. “Getting to green” on the Executive Branch Management Scorecard will require significant and sustained effort by Federal agencies, but will result in unprecedented improvements in the management of the Federal Government. The scorecard currently tracks 23 of the 24 CFO Act agencies, the U.S. Army Corps of Engineers, OMB, and the Smithsonian Institution.

The grades on the Executive Branch Management Scorecard submitted with the FY 2003 President's Budget could be described as a “sea of red.” The Administration's baseline evaluation of departments and agencies against the standards for success for the five government-wide initiatives shows mostly poor scores with 85 percent red—and only one green rating in Improved Financial Performance at the National Science Foundation. The standards for Improved Financial Performance (see next page) are ambitious, but must be met to ensure progress in all of the President's management initiatives. They were reviewed by the Principals of the JFMIP, which include the Secretary of the Treasury, the Comptroller General, and the Directors of OMB and the Office of Personnel Management. The Administration is setting the standards by which financial management will be measured, rather than reacting to assessments of Executive Branch performance by the Congress, the General Accounting Office, and others. The chart that follows shows the September 30, 2001 baseline grades for Improved Financial Performance for each agency. Appendix D provides a summary discussion of these grades.






Executive Branch Management Scorecard

Financial Management*

USDA	●	Treasury	●
Commerce	●	VA	●
DOD	●	USAID	●
Education	●	Corps of Engineers	●
Energy	●	FEMA	●
EPA	●	GSA	●
HHS	●	NASA	●
HUD	●	NSF	●
DOI	●	OMB	●
DOJ	●	OPM	●
DOL	●	SBA	●
State	●	Smithsonian	●
DOT	●	SSA	●

* FY 2001 Baseline Evaluation -- NASA and SBA will now move to red.

Green 	Yellow 	Red 
Must Meet All Core Criteria:	Achievement of Some but not All Core Criteria; No Red Conditions:	Has Any One of the Following Conditions:
<ul style="list-style-type: none"> • Financial management systems meet Federal financial management system requirements and applicable Federal accounting and transaction standards as reported by the agency head. • Accurate and timely financial information. • Integrated financial and performance management systems supporting day-to-day operations. • Unqualified and timely audit opinion on the annual financial statements; no material internal control weaknesses reported by the auditors. 		<ul style="list-style-type: none"> • Financial management systems fail to meet Federal financial management systems requirements and applicable Federal accounting standards as reported by the agency head. • Chronic or significant Anti-deficiency Act violations. • Agency head unable to provide unqualified assurance statement as to systems of management, accounting, and administrative controls. • Auditors cite material non-compliance with laws and regulations, or repeat material internal control weaknesses; or are unable to express an opinion on the annual financial statements.

Challenges to Improved Financial Performance

The standards for “getting to green” are similar to those you would expect to find in a well-run private sector organization, but applied to Federal Government agencies. “Getting to green” will take focused and sustained agency leadership. The ultimate goal is to ensure transparency over the government’s finances—having timely and reliable financial information on a regular, recurring basis and using that information to make informed decisions about agency or program management. Transparency means knowing the costs and measurable results of government programs and operations and being able to judge the best return on investment for the American people. The key obstacles to achieving Improved Financial Performance are described below.

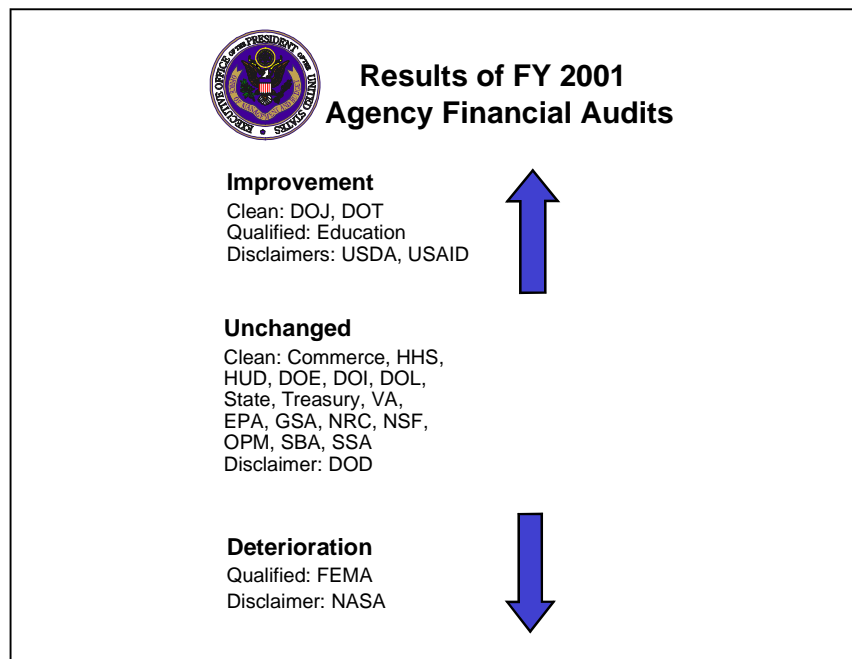
Financial Systems

To provide timely and reliable information, agency financial systems must transition to business processes and internal controls that “build in” data quality at the start of the transaction. With the accelerated reporting timeframes mandated by OMB, agencies simply will not have time to conduct the cumbersome, manual reconciliation processes that have produced financial statements in the past. Agencies must standardize business rules and financial data, integrate data, and make greater use of electronic processes.

The current inventory of Federal financial systems is not well positioned to meet this higher bar. Agency audit reports provide a litany of limitations: significant numbers of agencies with inadequate reconciliation procedures, lack of timely and accurate recording of transactions, poor financial system integration, noncompliance with accounting standards, and weak information security.

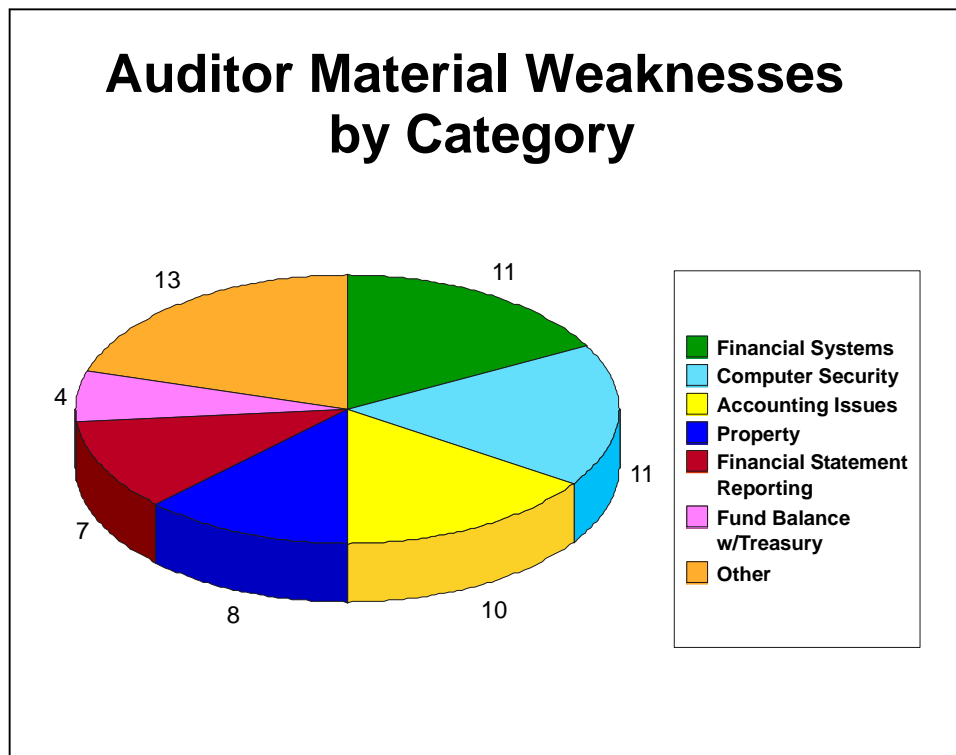
Many agencies have worked around systems problems for years to obtain clean audit opinions—but this successful audit outcome was achieved only by expending significant resources and making extensive manual adjustments after the end of the fiscal year. The result is a five month old snapshot of the agency’s financial position as of September 30 of any given year—interesting perhaps, but not valuable for day-to-day decision-making. For some agencies, these accelerated dates must be met using antiquated systems. Agencies will need to undertake a combination of initiatives, and alternative strategies including using re-engineered business processes until new systems can be brought up.

The FY 2001 financial statements of the 24 CFO Act agencies demonstrated modest but important progress in improving financial performance. As in the FY 2000 reports, 18 agencies received unqualified opinions, although the government-wide statement was disclaimed. Four agencies received disclaimers of opinion, and two received qualified opinions. Five agencies—the Departments of Justice, Transportation, Education, and Agriculture and the Agency for International Development—showed marked improvement in the quality of their financial statements. The Departments of Justice and Transportation improved and received clean opinions this past year. The Department of Education reduced its material weaknesses from three to only one. For the first time ever, three of five components of the Department of Agriculture obtained clean opinions; a fourth received a qualified opinion. The U.S. Forest Service is the only major remaining problem area holding back the Department of Agriculture from a clean opinion. This is also the first year the Agency for International Development was able to conduct a complete financial statement audit; three of the five principal financial statements received qualified opinions, rather than disclaimers. Two agencies—the Federal Emergency Management Agency and the National Aeronautics and Space Administration—deteriorated from last year, but already have rigorous plans in place to regain their clean opinions. While the FY 2001 results show progress, the standards for success in Improved Financial Performance are ambitious, and “getting to green” across the board will require much more work. (Appendix A lists the results of both CFO Act agency and component audits for FY 2001.)



Material Weaknesses

Obviously, one of the greatest barriers to adequate financial systems and information is the fact that Federal agencies are plagued by repeat material control weaknesses—areas so problematic year after year that they detrimentally affect the reliability of financial information and could endanger program delivery. These weaknesses are highlighted by several sources. Independent auditors cite weaknesses in internal control over financial reporting in their reports that accompany the agencies’ audited financial statements. Auditors cited 61 and 64 material weaknesses throughout the Federal Government in 2000 and 2001, respectively. The following pie chart shows the distribution of these weaknesses by category:



In addition to the material weaknesses related to financial reporting disclosed by the auditors, the Federal Managers’ Financial Integrity Act (FMFIA) of 1982 and OMB implementing guidance require the head of each executive agency to report annually on whether there is reasonable assurance that the agency’s controls are achieving their intended objectives and whether the agency’s financial management systems conform to government-wide requirements.

Agency heads are required to identify material weaknesses related to agency programs and operations (pursuant to Section 2 of FMFIA) and nonconformances with government-wide financial systems requirements (pursuant to Section 4 of FMFIA). Section 2 seeks to assess agency internal controls necessary to ensure compliance with applicable laws; protect against loss from waste, fraud, and abuse; and to ensure certain receivables and expenditures are properly recorded. Section 4 nonconformances deal with weaknesses in Federal accounting systems. From 2000 to 2001, the number of FMFIA weaknesses and nonconformances dropped by three—from 422 to 419. The chart below shows only minimal achievement in the past two years; Appendix B lists the numbers of auditor-reported material weaknesses and FMFIA material weaknesses and nonconformances by agency. Eighty-four percent of the open Section 2 FMFIA material weaknesses relate to just five agencies: the Departments of Agriculture, Defense, Energy, the Interior, and the Treasury. Eighty-one percent of the open Section 4 material weaknesses relate to the Department of Defense.

FMFIA Issues Identified by Agency Heads		
	Section 2 (Internal Control Weaknesses)	Section 4 (Systems Nonconformances)
Beginning in FY 2000	257	205
New	62	6
Resolved	88	20
Ending FY 2000	231	191
New	70	6
Resolved	70	9
Ending FY 2001	231	188

In addition to the issues discussed above, many of the CFO Act agencies face challenges in building and maintaining financial management systems that comply with the Federal Financial Management Improvement Act (FFMIA). Under FFMIA, the agency head certifies whether or not the agency is in substantial compliance with the three requirements of FFMIA: agency financial management systems must comply substantially with (1) Federal financial management systems requirements; (2) Federal accounting standards; and (3) the U.S. Government Standard

General Ledger at the transaction level. At the end of 2001, only 8 of the 24 CFO Act agency heads could certify that their agencies were FFMIA-compliant.

Erroneous Payments

One area of particular vulnerability is erroneous payments. Federal agencies make trillions of dollars of benefit payments each year. Audits and investigations continue to disclose payments made in error or as the result of fraud or abuse. In fact, agency financial statements have disclosed more than \$20 billion in erroneous payments in just a few Federal programs.

In the *President's Management Agenda*, President Bush announced his intention to address the problem of erroneous payments made in Federal benefit programs:

Federal agencies recently identified \$20.7 billion in erroneous benefit and assistance payments associated with just 13 programs. That amount represents more than the total annual expenditures of seven states . . . The Administration will first establish a baseline of the extent of erroneous payments . . . OMB will work with agencies to establish goals to reduce erroneous payments for each program.

To match the commitment in the *President's Management Agenda*, OMB provided guidance to agencies on how to provide erroneous payment data with their annual budget submissions, assessments of agency internal controls, and action plans to reduce erroneous payments. The guidance included a list of 57 Federal programs responsible for distributing more than \$1.2 trillion each year.

Many agencies complied with budget requirements to supply estimates of erroneous payments and set targets to reduce them. Some agencies provided substantive plans to estimate and reduce erroneous payments. Others initially attempted to justify why no estimate was necessary. Inadequate, some plans and justifications are being strengthened.

In FY 2001, Medicare made erroneous payments of \$12.1 billion (6.3 percent) and HUD made erroneous rental subsidy payments of \$3.281 billion (10.7 percent). Programs like Medicare and Military Health have shown trends in reducing erroneous payments rates, while others show an increase in their rates. All agencies, however, are showing a renewed commitment to reducing these estimates. For instance, the Department of Housing and Urban Development has set a goal to reduce erroneous rental subsidy payments by 50 percent by 2005.

The Administration is focused on reducing erroneous payments in the government's major benefit programs. While the national Food Stamp erroneous payment rate fell from 8.91 percent in FY 2000 to 8.6 percent in FY 2001, the Department of Agriculture is aggressively enforcing its quality control program in states with high error rates. For example, for the first time ever,

California and Michigan, with Food Stamp payment error rates of 17.37 percent and 13.93 percent respectively, are being assessed cash sanctions called for under the law.

Many of the programs the Administration is monitoring in the area of erroneous payments are administered through third parties: states, localities, non-profits, etc. Agencies must have the tools they need to hold these third parties accountable for the administration of Federal funds. The Farm Bill, now Public Law 107-171, severely limits the authority of the Department of Agriculture's Food and Nutrition Service to hold states accountable for the administration of the Food Stamps program. The Administration was disappointed with these provisions and will work with the Congress to ensure the integrity of programs that provide benefits to American people in need.

Agencies will continue to estimate, track, and monitor erroneous payment rates in the programs they administer. A recent report by the Internal Revenue Service said of erroneous payments in the Earned Income Tax Credit (EITC) program, "Of the estimated \$31.3 billion in EITC claims made by taxpayers who filed returns in 2000 for tax year 1999, it is estimated that approximately \$8.5 to \$9.9 billion (27.0 percent to 31.7 percent) should not have been paid." This estimate represents the 1999 tax year and is not included in the overall erroneous payment estimate. Treasury has convened a high-level task force to address these problems.

Asset Management

The balance sheet of the Federal Government shows a historical value of over \$900 billion in physical and financial assets. This estimate is not comprehensive because it does not include natural resources, stewardship land (national parks, forests, and grazing lands), national defense assets, or heritage assets (e.g., the Hope Diamond). Managing and maintaining the assets listed on the government's balance sheet represents an effort that consumes substantial Federal resources in staff time and administrative costs. Sound asset management is critical to efficient government operations and effective financial management. Improved asset management enables better agency performance and can produce budgetary savings, allowing staff resources to be redirected towards the agency's core mission. Yet, there is substantial evidence of weaknesses in the Federal Government's management of assets, including acquiring and retaining unneeded or poorly performing assets, excess holding costs, and ineffective asset disposal. Agencies are hampered in their efforts to identify and correct these problems by the lack of strategies, procedures, information, and incentives needed to manage a wide range of assets.

OMB is developing a mechanism to measure agency progress in addressing the challenges associated with asset management. Asset management is integral to an agency's efforts to improve its financial management. We expect to include asset management in the criteria we use

to measure progress toward achieving the Improved Financial Performance initiative. This effort will be aimed at implementing principles and systems for effective asset management; transferring unneeded assets out of the Federal inventory; outsourcing, where appropriate, asset management activities to the private sector.

As part of his Freedom to Manage initiative, the President submitted to Congress legislation to give Federal agencies the tools and incentives they need to improve asset management. Included in the Managerial Flexibility Act, which the President sent to Congress in October 2001, were provisions to improve life cycle planning and management; allow greater flexibility to optimize asset performance; and provide incentives for better property management.

Serious Financial Management Problems at the Department of Defense

The largest impediment to removing the disclaimer on the government-wide financial statements remains the Department of Defense's (DOD) serious financial management problems. These problems are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. Soon after his appointment in 2001, Secretary of Defense Donald Rumsfeld directed Pentagon leadership to conduct a complete overhaul of financial management practices and processes. The Secretary's vision will allow the DOD to be managed in an efficient, business-like manner in which accurate, reliable, and timely financial information, affirmed by clean audit opinions, is available on a routine basis to support informed decision-making at all levels throughout the department. Secretary Rumsfeld gave his Under Secretary of Defense (Comptroller) and Chief Financial Officer, Dr. Dov S. Zakheim, the authority and resources to get the job done. The reform effort now underway plans fundamental and sweeping changes to business and financial management practices and supporting infrastructure.

A key step is imposing discipline. In order to begin the transformation process, DOD had to inventory the current environment. To date the department has identified 1,127 separate financial and financial feeder systems, with the interfaces between these systems numbering over 3,500. These systems execute the business processes of the department. Personnel, acquisition, payroll, and finance systems are examples of the types of systems and/or their feeder systems that generate a business and financial event. To end the proliferation of these stove-piped systems, the department's CFO has issued guidance on which types of systems initiatives will be allowed to proceed. This action will guide the department's prudent investment until the financial management enterprise architecture is developed and deployed.

This enterprise architecture will serve as the blueprint to construct the department's future business and financial management infrastructure. The enterprise architecture will include DOD-wide data standards and will articulate how to modernize and link both systems and

business processes that span functional areas such as logistics, personnel, health care, accounting, finance, and others. This is a huge undertaking with many steps. Overcoming cultural changes will remain a challenge, but DOD's leadership has shown the commitment to see the effort through.

As part of its effort to reform its business management practices, DOD recently took the first major step by awarding a contract to develop its DOD-wide financial management enterprise architecture. The enterprise architecture will propose new ways of conducting DOD business activities, offering solutions for modernizing the department's financial practices, and integrating systems and business processes across all applicable business lines. Within the first year, the contractor will deliver a financial management enterprise architecture blueprint; a transition plan; and a definition of data standards; and recommend a reorganization and streamlining of business processes to enable the department to adopt industry best practices.

DOD and OMB have renewed efforts to work together on this important initiative. In 2003, DOD will begin validating and testing its architecture. DOD will move aggressively to implement the solution along the timelines defined in the enterprise architecture implementation plan.

Intragovernmental Transactions

Another major impediment to an opinion on the government-wide financial statements is the government's inability to account for billions of dollars of transactions between Federal Government entities. The government lacks clearly articulated business rules for these transactions to ensure that they are handled consistently by agencies. As a result, agencies cannot reconcile intragovernmental balances with their trading partners.

Currently, when a Federal entity obtains goods or services from another Federal entity, this purchase is treated as a financial transaction rather than an acquisition. Entries are generally recorded in financial systems upon the transfer of the funds to the providing entity and not when the request is initiated. These intragovernmental transactions are paper-based, which increases the risk of errors, omissions, and discrepancies. Since there are no standards or common rules for the business process or the data to be exchanged, each entity essentially has its own unique process. This lack of standardization makes it practically impossible to verify that both parties to the business transaction have captured it correctly. Enormous resources are expended each year in futile attempts to identify, reconcile, and eliminate intragovernmental transactions.

In March 2001, OMB and JFMIP launched the Intragovernmental Transaction Project to design and provide an integrated acquisition environment under which business transactions between

Federal agencies will be recognized and treated as acquisitions. Commercially available technology will be used to create a gateway and clearing house to implement E-Government between Federal agencies. Uniform business rules—similar in concept to the Federal Acquisition Regulation but significantly less stringent—and standard data elements will be developed this summer to support this electronic intragovernmental acquisition process.

Budgeting for Results

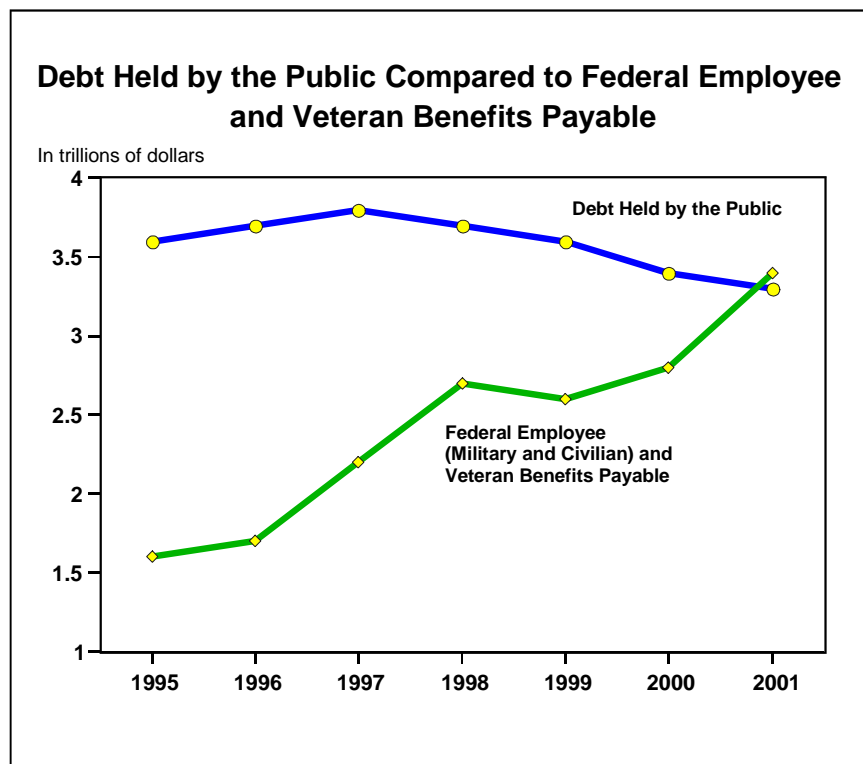
In the *President's Management Agenda*, President Bush stated that: "Government should be results-oriented—guided not by process but guided by performance. There comes a time when every program must be judged either a success or a failure." Judging a program, however, requires complete cost information to determine its value. To ensure that public officials and the American people are armed with the necessary cost information to make informed decisions about programs, the FY 2003 President's Budget proposes to charge all employee costs, including those related to retirement, to the programs themselves. By recording the accruing costs as employees earn benefits, managers can get a better sense of the true costs of operations. The proposal would bring budgeting for Federal employees in the Civil Service Retirement System (and several smaller retirement systems) in line with budgeting for employees in the Federal Employees Retirement System and the Military Retirement System. The proposal similarly would affect the Federal Employees Health Benefits Program (FEHBP). It would have no effect on total budget outlays.

The Administration has proposed the necessary statutory changes to ensure that appropriations charge employee costs to the agency accounts where the individuals are employed. This is part of the Managerial Flexibility Act, which the President sent to Congress on October 1, 2001. Like the changes to the President's Budget, this proposal would have no effect on the amount of money we allocate for employee benefits, nor would it lessen any payment to retirees—Federal employees have earned these benefits. The President's proposal simply changes accounting for those benefits to provide a more accurate sense of the full cost of government programs.

The accounting changes called for in the Managerial Flexibility Act have been supported by a broad coalition in the accounting community. As the Joint Financial Management Improvement Program recently stated, "A key element of financial planning and evaluations is clear measurement of the full costs of agencies' activities during each fiscal year. Including these costs in data used for budgetary decision-making would enhance both the planning process and the evaluation of the cost of operations. It would also provide for enhanced consistency and transparency relating to presentation of this information and greater accountability for results." The American Institute of Certified Public Accountants has stated similar support: "We support providing for the full costs of agencies' activities, including Federal employee retirement costs,

in individual agency budgets. This would enhance the evaluation of the true costs of operations within each Federal agency, and more closely align the Federal government’s budgetary process with its financial accounting and reporting processes.” The 18,000-member Association of Government Accountants (AGA) has indicated: “AGA supports the integration of accounting and budgeting concepts proposed by OMB with respect to Federal post-employment benefits.”

The accrual-based financial statements, which generally provide a transparent and comprehensive picture of government operations and obligations, show that for the first time, future civilian employee and military retirement benefits payable in the amount of \$3.4 trillion exceed the debt held by the public of \$3.3 trillion. The following chart shows the growth of Federal employee, military, civilian, and veteran benefits. Financial statements recognize liabilities/expenses when they are incurred, and the budget generally reflects costs when paid. As a result, the FY 2001 financial statements included a “catch up” liability that will result in significant and rising costs for each subsequent budget year. As the government’s liability to Federal military and civilian employees and veterans grows, greater transparency will help improve the decision-making process by depicting the true costs of government programs and operations.



Committees of the Chief Financial Officers Council

To help agencies meet the goals of the *President's Management Agenda*, the CFO Council recently established a new committee structure to mirror the five government-wide initiatives. The committees are chaired by Council members and include agency CFOs and Deputy CFOs, as well as representatives from OMB, the Department of the Treasury, and the Joint Financial Management Improvement Program. The Erroneous Payments working group is co-chaired by an Inspector General. The committees include Best Practices, Budget and Performance Integration, Erroneous Payments, Financial Statement Acceleration, Financial Systems and E-Government, and Human Capital.

Best Practices Committee

Co-Chair: Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller)/CFO, Department of Defense

Co-Chair: Ed Kingman, Assistant Secretary for Management/CFO, Department of the Treasury

This committee enhances the CFO Council's ability to resolve common financial management problems across Federal agencies through exposure to new ideas from "best practice" organizations, and the ongoing discussion of alternative perspectives on achieving world class excellence by both government and industry leaders. The committee is considering partnership arrangements with other organizations in order to leverage its resources. Three major initiatives are planned over the next year, which will serve as the foundation for best practice efforts over the next five years. These include:

- **Survey of Inventory**—By June 2002, all CFO Act agencies will be asked to respond to a survey to identify and prioritize at least five specific areas of focus (i.e., enterprise financial management systems, cost accounting, travel card programs, performance management metrics, and/or improved financial reporting) related to improvements made or planned for by those organizations as they promote the *President's Management Agenda*.
- **Targeted Practices**—By September 2002, an analysis/study will be conducted on one or more of the priorities identified in the survey and/or through discussions with the committee's proposed partnership arrangements. The committee envisions that the priorities

identified will tie to the Executive Branch Management Scorecard. The committee will share its findings with the Council through reports, forums, and other events to assist agencies in “getting to green.”

- **Speakers/Recognition**—The committee will arrange for speakers at each CFO Council meeting to discuss best practices. At the April 2002 meeting, Council members received a thorough briefing on the Department of Defense’s financial management enterprise architecture program. As the committee develops an inventory of improvements/best practices, it will create a mechanism for recognizing those agencies that have developed world class organizations which exemplify the committee’s vision.

The synergy of these best practice initiatives for FY 2002 will begin to build a foundation of excellence for Federal financial management and tie directly to the *President’s Management Agenda*. Clearly, best practices linked to improving financial systems, especially in the cost accounting area, serve as the backdrop for “getting to and beyond green” in improving financial reporting and performance, integration of budget and performance data, and competitive sourcing cost comparisons. Overall, best practices in financial management should lead to a value proposition of both a continuous lowering of the average cost of Federal financial management, while delivering higher quality and more timely performance management information to effectively manage large Federal programs.

Over the next five years, the committee will build upon this foundation to offer a “community of best practices” that systematically identifies, catalogs, and promotes best practices across the Federal financial management spectrum, thereby raising the standards in those specific financial areas with the greatest potential for improvement. Each priority identified through the survey will be addressed by the end of 2003. Future activities may include: targeted best practices initiatives across multiple agencies, annual best practices conferences, and regular measurement of the cost savings.

Budget and Performance Integration Committee

Chair: Donna McLean, Chief Financial Officer, Department of Transportation

This committee will identify recommendations that will lead to improved linkage between budgetary resources and program performance. The goal is to provide the Executive Branch, the Congress, and the public with useful, complete, consistent, reliable, accurate, and timely information that relates budgetary resources with performance outcomes. This is essential for:

- Effective oversight of government programs;
- Effective and efficient management of government programs;

- Informed decision-making about budget priorities; and
- Public understanding of the performance of the government.

In completing its objectives, the committee will:

- Identify and evaluate budgeting, accounting, program management, performance measurement, and individual and organizational accountability principles, standards, and related requirements needed to improve the linkage and integration of budgetary resources to performance outcomes.
- Determine deficiencies and recommend solutions to existing budget, financial, and performance reporting structures and processes.
- Evaluate proposed guidance by OMB, the Office of Personnel Management, the General Accounting Office, the Department of the Treasury, the General Services Administration, and other organizations for impact on the budgetary, financial, and performance processes of Federal departments and agencies.
- Determine and provide support for methods that financial managers could use to promote cooperation among their organizations for improving the integration of budget, finance, and performance data.
- Interact with the President's Management Council, President's Council on Integrity and Efficiency, Chief Information Officers Council, and similar organizations and their respective work groups on matters involving committee responsibilities.

Budget guidance in OMB Circular A-11, *Preparing and Submitting Budget Estimates*, will provide a clear (but not the only) path to begin moving agencies to develop and present budget in an integrated fashion.

During the next five years, the committee will support and enhance the process of effective budget and performance integration by annually recognizing agencies that have applied innovative practices to the general task of integration. The committee will foster improved communication with outside expertise (consultant, university, and other) regarding the continuous process of budget and performance integration. In addition, it will identify and define next generation processes and practices for improving budget and performance integration by maintaining ongoing liaison with the CFO Act agencies.

Erroneous Payments Committee

Chair: Mark Carney, Deputy Chief Financial Officer, Department of Education

Agencies encounter substantial difficulties in arriving at the erroneous payment estimates required under the *President's Management Agenda*. The programs for which the Administration is requiring erroneous payment estimates are often saddled with onerous and complex qualifications that are used to identify beneficiaries entitled to payments. Many of these programs also rely on states, localities, or other third parties to deliver the benefits authorized by law. These complications—barriers to estimating erroneous payment rates—are the very difficulties that put these programs at risk of high erroneous payment rates. The CFO Council formed the Erroneous Payments Committee to address these problems.

Prior to the committee's initial meeting on March 8, 2002, the CFO Council decided that a joint working group between the CFO Council and the President's Council on Integrity and Efficiency (PCIE)—the council of Federal agency Inspectors General—should be established to do the primary work of this committee. The Inspector General community has a great deal of experience in the area of identifying potential erroneous payments and its input to the work of the Erroneous Payments Committee will be invaluable.

The work group convenes to discuss and develop best practices and other methods to reduce or eliminate, where possible, improper and erroneous payments made by or on behalf of Federal Government agencies. These methods may include, but are not limited to: completing risk assessments to determine the nature and extent of the issue and categorizing the risk as low, medium, or high; exploring data sharing, data mining, and neural networking techniques; and highlighting successful contract auditing and prepayment investigations. Membership is restricted to Federal employees, although partnerships with other levels of government and the private sector are encouraged.

The work group's mission is to assist in fostering changes in Federal Government policies and practices that reduce the risks associated with the expenditure of program and administrative funds. The work group will provide the CFO Council/PCIE leadership with strategies, tactics, and information to enable it to promote the efficient management and disbursement of government resources and assets. Primary tasks are to:

- Develop strategies to reduce or eliminate, where possible, improper and erroneous payments. This includes underpayments as well as overpayments.
- Initiate and share best practice methods that minimize risk and reduce and eliminate, where possible, improper and erroneous payments.
- Establish indicators that identify the nature and extent of the problem and can aid Federal agencies in measuring their progress in reducing and preventing improper and erroneous payments.

- Monitor and track success throughout agencies.
- Explore alternative funding mechanisms such as the use of programmatic savings to fund administrative costs.

The work group plans to provide the Federal community with the following products:

- A report that defines the work group's position on mitigating and managing payment risks. This report will build on work already completed by the General Accounting Office, OMB, the Offices of Inspector General, and other organizations in this area.
- A critique on the effectiveness of the differing processes used to determine erroneous payment rates, including actual and target rates for benefit and assistance programs over \$2 billion (required with FY 2003 agency budget submissions).
- A set of indicators that represent the nature and extent of the problem of improper and erroneous payments in Federal agencies, and establish Federal benchmarks.
- Based on completed risk assessments, guidance for agencies to ensure sufficient oversight and monitoring, adequate eligibility controls, and automated systems of agencies experiencing improper and erroneous payments.

The work group will be successful when the following objectives and outcomes are realized:

- Agencies complete risk assessments, control activities, and other applicable tests to identify and prevent improper and erroneous payments.
- Based on the results of the risk assessments and the extent of improper and erroneous payments identified, agencies will develop corrective action plans to help reduce and prevent improper and erroneous payments, including, as applicable, the collection of improper payments identified.
- Agencies closely monitor and revise corrective action plans as necessary to ensure the appropriateness and effectiveness of actions taken.
- Agencies establish and institutionalize communication and information pathways thereby enhancing data sharing.
- Agencies monitor performance against established performance goals and indicators, and make adjustments where needed.

Financial Statement Acceleration Committee

Chair: Don Hammond, Fiscal Assistant Secretary, Department of the Treasury

A key step to improving the financial performance of agencies is to improve the quality and usefulness of the financial information produced by the agencies. Toward this end, the Joint Financial Management Improvement Program Principals decided and OMB subsequently directed that the timeframes for issuing the agency and government-wide financial statements should be accelerated so that the issuance dates for the FY 2004 reporting cycle would be November 15 for agency statements and December 15 for the government-wide statements.

The purpose behind accelerating the issuance of these statements is twofold: (1) to shift the agency focus from taking extraordinary measures to produce annual audited financial statements to maintaining accurate financial data throughout the year, and (2) to make the financial statements available early enough after year-end so as to be useful in the coming year's budget development process. In the private sector, the ability to produce timely financial information is not a hallmark of excellence; it is a baseline that is simply expected. The requirement to produce quarterly financial information will also force agencies to reengineer their business and financial management processes to meet the accelerated deadlines while providing more frequent and timely information.

Achieving the objectives prescribed by OMB will necessitate fundamental changes in the way that many agencies process their financial information and prepare their reports. It will require cooperation between program offices and the financial management staffs to identify information requirements and then align them with the system capabilities. The effort can only succeed if OMB, the Department of the Treasury, and other central agencies are willing to reengineer business processes and make changes. Success will require a relationship based on common purpose and understanding of the importance of this quest among all parties.

The CFO Council created this committee to assist the agencies in reaching the accelerated reporting goals. The committee's charge is to identify and share agency best practices for statement preparation, identify barriers or "roadblocks," and explore the expanded use of techniques such as estimation. To carry out this responsibility, the committee will provide its findings and information to the CFO Council in phases so that information could be available to the agencies as soon as possible. The committee's work is structured but informal. The output will not be polished reports but instead subject-related information that can be easily digested by the various agencies. The committee will also establish an effective working relationship with the audit subcommittee of the PCIE to facilitate communication in this fast-moving area.

The committee's first area of emphasis is to identify practices already in use by some agencies that would be valuable to share across the council membership. A component of this is to review the timelines used by the agencies for producing their financial statements to find unique steps that if more broadly applied, could assist other agencies. In addition, the committee will

identify accelerated dates in use by agencies that can be used by other agencies as they seek to meet these interim dates. A few agencies already meet or come very close to the new issuance dates. Two of these entities, the United States Postal Service and the Social Security Administration, have conducted open houses to discuss the various measures that they employ to allow them to produce their reports so quickly. These forums were open to the CFO community and provided an excellent opportunity to discuss challenges that exist and how they can be overcome.

Next on the committee's agenda is to identify the current external barriers that require action or change to make the transition to accelerated financial reporting. These external barriers come from several sources and many of them will need to be addressed soon so that they can be resolved in time to meet the FY 2004 schedules. The types of items that fall into this category are reporting requirements or formats, data availability, and different agency schedules. For example, certain key assumptions provided by OMB are essential for the preparation of the financial statements. The dates that these assumptions become available to the agencies must be changed in order to support the new issuance dates. Additionally, the processing of agency financial information by central agencies (i.e., Department of the Treasury) must allow for the agency to have access to the processed transactions in time for report preparation. The committee is currently compiling a list of these external barriers for distribution to the CFO Council.

Many agencies will need to implement new preparation techniques or expand the use of them in order to meet these timeframes. The use of estimation techniques for certain closing period balances will become very important as actual figures may not exist at the time the statements are prepared. The use of estimates needs to be consistent and well documented and will undoubtedly require more than one year in order for agencies to get this right. Therefore, it is important for them to start now on identifying those areas where estimates will be necessary and begin the initial work that will ultimately require close coordination with each auditor. Additionally, agencies will need to review their processes for key accruals. In particular, this is an area where the production of quarterly statements will be valuable. The committee intends to aid the agencies in these areas by collecting and disseminating information on both government and corporate practices and arranging forums on selected topics to provide for effective sharing of the information.

Obviously, the timing of the issuance of audited financial statements is also dependent on the completion of the audit. This area will also require attention and provides the opportunity for creative cooperation between the agency preparers and the auditors. Like the other areas, this one must be addressed as early as possible to allow for the revision of schedules, the balancing of workload, the amendment of contracts, and the changes to business practices. The commit-

tee hopes to facilitate the exchange of ideas between preparers and auditors and promote more uniform and effective communications.

Financial Systems and E-Government Committee

Chair: Don McCrory, Deputy Chief Financial Officer, National Science Foundation

The Financial Systems and E-Government Committee's objective is to facilitate improvements of Federal financial systems to ensure that such systems provide useful, complete, consistent, reliable, accurate, and timely financial information about the operations and condition of the Federal Government in support of the *President's Management Agenda*. To enable Federal agencies to "get to green" in financial performance, the committee is focusing on the following projects and initiatives:

- Federal Financial Management Improvement Act of 1996 (FFMIA) Compliance—Many Federal departments continue to struggle with the broad definitions of achieving compliance with FFMIA and, therefore, lack the ability to focus on the actual results produced by their financial systems. Consequently, noncompliance with FFMIA has been an impediment to "getting to green." This committee will review the compliance recommendations of FFMIA and re-focus them on high-level capabilities and results of systems that provide useful and timely reporting of financial information to senior management for their use in decision-making. By August 2002, the committee plans to recommend to OMB revised FFMIA implementation guidance to focus agencies on systems and results of timely, accurate, and useful data to improve management.
- Financial System Policy Update—OMB Circular A-127, *Financial Management Systems*, prescribes the policies and standards that Executive departments and agencies must follow in developing, operating, evaluating, and reporting on financial management systems. OMB will revise these requirements and incorporate them into a single financial management circular by September 2002. The new guidance will cover (1) procurement of financial management systems and services; (2) clarification of financial management system requirements; and (3) achieving accelerated financial reporting.
- Security of Financial Management Systems—Virtually every agency now conducts business using various aspects of the electronic environment, such as the Internet, Intranets, and local and wide-area networks. The electronic environment has changed the way the public, industry, and state and local governments interact with the Federal Government. To meet public and private demands, agencies are offering more online services as well as electronic forms and transaction capabilities. Today's financial management environment depends on this technology, which presents new security challenges. The committee will work with the systems security committees of the other interagency management councils to ensure proper security is integral to all financial

management systems, as well as those non-financial systems that impact financial data. Such security is essential to “getting to green” in both the Improved Financial Performance and Expanded E-Government initiatives. Plans include best practices workshops and action items to examine security and privacy issues with the Chief Information Officers Council, the Procurement Executive Council, and the private sector community on financial systems security.

- **Electronic Government**—The committee is actively participating in the Expanded E-Government initiative that includes participation on the E-Government Management Council (which includes the CFO, the Chief Information Officers, the Procurement Executive, and the Human Resources Councils). The committee will be involved with the 24 crosscutting E-Government initiatives. Specific initiatives include E-Grants, E-Payroll, Integrated Human Resources, E-Travel, Integrated Acquisition Environment, Federal Enterprise Architecture, and Federal Asset Sales. As examples, the E-Grants initiative, led by the Department of Health and Human Services with 11 partner agencies, will create a single grants “portal” to increase awareness of grant opportunities, simplify the application process, and reduce the burden for grant administration. It is estimated that this effort will save \$1 billion in Federal funds currently devoted to the administration of grants. The E-Payroll initiative, led by the Office of Personnel Management, seeks to lessen the administrative burden on agencies by better defining, standardizing, and reengineering payroll processing. The Administration will consolidate the numerous Executive Branch civilian payroll systems now in place into three.

Human Capital Committee

Chair: Angela Antonelli, Chief Financial Officer, Department of Housing and Urban Development

The CFO Act defined the need for a new class of financial managers within the Federal Government. Agency CFOs recognize their organizational success depends upon a highly talented and multi-disciplinary workforce. Indeed, our ability to deliver on any of our statutorily-defined goals depends on the qualifications, productivity, and motivation of our workforce. The CFO Council leads efforts to develop such a diversified corps of financial management professionals for the Federal Government through the Human Capital Committee.

The Human Capital Committee assists CFOs in performing their congressionally-mandated duties by facilitating the improvement of government-wide financial personnel policies and programs. The primary objective of the committee is to develop and maintain a high quality Federal financial management workforce to support the successful implementation of agency missions.

The Human Capital Committee facilitates improvement of government-wide financial personnel policies and programs to develop and maintain a high quality Federal financial management workforce by:

- Promoting effective financial management education and training within the Federal Government; and
- Assisting agencies in recruiting and retaining highly qualified financial management personnel.

The Human Capital Committee uses many tools to achieve these two primary objectives. Plans and activities are already in progress to implement programs, which will facilitate substantial improvements in Federal financial personnel management. The committee will:

- Serve as a forum for CFOs to identify, discuss and collectively address financial personnel challenges.
- Identify and publicize innovative financial management training programs currently conducted by Federal agencies.
- Develop a senior financial executive program to identify and train the next generation of senior financial managers.
- Identify and publicize financial personnel best practices among Federal agencies.
- Recommend improvements to government-wide financial personnel policies and programs, particularly those related to recruitment, retention, training, and promotion.

The Human Capital Committee will not limit itself to only short-term goals. Over the next five years, the committee will advance the President's initiatives by:

- Identifying barriers to hiring, retaining, and training staff in Federal financial positions and formulating improved financial management personnel policies to overcome these barriers.
- Establishing a program to help agencies develop financial management human capital plans. This program will serve as a resource CFOs can turn to for examples of best practices, training resources available from government or private sector sources, recruiting tools and lessons learned.
- Taking financial training programs to new levels of excellence, which will maximize their potential to develop future senior Federal financial executives. Following the initial focus on developing a senior financial executive program, the Hu-

man Capital Committee will focus on entry-level orientation programs, junior staff training programs, and mid-level financial manager development programs.

Successful implementation of these initiatives will lead to a Federal financial management workforce that sets the standard for excellence and competes successfully with the private sector for the best available financial talent.

Appendix A: Summary of FY 2001 Financial Statement Results by Agencies and Selected Components

The 24 CFO Act agencies are required under the CFO Act to prepare audited financial statements under the CFO Act; OMB designates the individual agency components that must prepare audited financial statements.

Fiscal Year 2001 Financial Statements

Agency	Type of Opinion
<i>CFO Act Agencies:</i>	
Department of Agriculture (USDA)	Disclaimer
Department of Commerce	Unqualified
Department of Defense (DOD)	Disclaimer
Department of Education	Qualified
Department of Energy	Unqualified
Department of Health and Human Services (HHS)	Unqualified
Department of Housing and Urban Development (HUD)	Unqualified
Department of the Interior	Unqualified
Department of Labor	Unqualified
Department of Justice	Unqualified
Department of State	Unqualified
Department of Transportation (DOT)	Unqualified
Department of the Treasury	Unqualified
Department of Veterans Affairs (VA)	Unqualified
Agency for International Development (AID)	Disclaimer
Environmental Protection Agency (EPA)	Unqualified
Federal Emergency Management Agency (FEMA)	Qualified
General Services Administration (GSA)	Unqualified
National Aeronautics and Space Administration (NASA)	Disclaimer

Fiscal Year 2001 Financial Statements

Agency	Type of Opinion
<i>CFO Act Agencies:</i>	
National Science Foundation (NSF)	Unqualified
Nuclear Regulatory Commission (NRC)	Unqualified
Office of Personnel Management (OPM)	Unqualified
Small Business Administration (SBA)	Unqualified
Social Security Administration (SSA)	Unqualified
<i>Agency Components:</i>	
Food and Nutrition Service (USDA)	N/A*
Forest Service (USDA)	Disclaimer
Rural Development Mission Area (USDA)	Unqualified
Department of Army General Funds (DOD)	N/A*
Department of Navy General Funds (DOD)	Disclaimer
Department of Air Force General Funds (DOD)	Disclaimer
Military Retirement Trust Fund (DOD)	Unqualified
U.S. Army Corp of Engineers Civil Works Program (DOD)	Disclaimer
Department of Army Working Capital Fund (DOD)	N/A*
Department of Navy Working Capital Fund (DOD)	Disclaimer
Department of Air Force Working Capital Fund (DOD)	Disclaimer
Centers for Medicare and Medicaid Services (HHS)	Unqualified
Federal Aviation Administration (DOT)	Unqualified
Highway Trust Fund (DOT)	Unqualified
Bureau of Alcohol, Tobacco and Firearms (Treasury)	N/A*
Internal Revenue Service (Treasury)	Unqualified
United States Customs Service (Treasury)	N/A*
Civil Service Retirement and Disability Fund (OPM)	Unqualified
Federal Employees Health Benefits Program (OPM)	Unqualified
Federal Employees Life Insurance Program (OPM)	Unqualified

* Component received OMB waiver from audit for FY 2001.

Appendix B: Material Weaknesses Reported by Auditors and Federal Managers' Financial Integrity Act Tables

OMB audit guidance requires auditors to disclose material weaknesses in internal control over financial reporting. The Federal Managers' Financial Integrity Act (FMFIA) of 1982 and OMB implementing guidance require the head of each executive agency to report annually on whether there is reasonable assurance that the agency's controls are achieving their intended objectives and whether the agency's financial management systems conform to government-wide requirements. Agency heads are required to identify material weaknesses related to agency programs and operations (pursuant to Section 2 of FMFIA) and nonconformances with government-wide financial systems requirements (pursuant to Section 4 of FMFIA). Reporting of material weaknesses under FMFIA is not limited to weaknesses over financial reporting.

The following tables include the number of material weaknesses identified by auditors, material weaknesses reported by Agency heads pursuant to Section 2 of the FMFIA, and financial system nonconformances reported by Agency Heads pursuant to Section 4 of the FMFIA.

Fiscal Year 2001: Auditor-Reported Material Weaknesses

	Beginning	New	Resolved	Ending
Agriculture	7	1	1	7
Commerce	3	0	2	1
Defense	15	0	0	15
Education	3	0	2	1
Energy	0	0	0	0
HHS	2	0	0	2
HUD	4	1	0	5
Interior	11	0	5	6
Justice	3	0	0	3
Labor	0	0	0	0
State	1	0	0	1
DOT	1	1	0	2
Treasury	2	0	0	2
VA	2	4	0	6
AID	3	0	0	3
EPA	0	0	0	0
FEMA	2	4	0	6
GSA	0	0	0	0
NASA	0	1	0	1
NSF	0	0	0	0
NRC	2	1	1	2
OPM	0	0	0	0
SBA	0	1	0	1
SSA	0	0	0	0
TOTALS	61	14	11	64

**Fiscal Year 2001: Section 2 Reporting in Agency FMFIA
(on Accountability) Reports**

Agency	Adequate and Effective Management Controls*		Number of Material Weaknesses			
	Yes	Yes, with Material Weaknesses	Beginning	New	Resolved	Ending
Agriculture		X	29	9	10	28
Commerce		X	0	2	0	2
Defense		X	103	50	38	115
Education		X	4	1	0	5
Energy		X	12	2	1	13
HHS		X	2	0	0	2
HUD		X	1	0	0	1
Interior		X	19	1	3	17
Justice		X	10	0	2	8
Labor	X		3	0	3	0
State		X	3	0	0	3
DOT		X	0	1	0	1
Treasury		X	21	2	3	20
VA		X	4	1	2	3
AID		X	4	0	0	4
EPA		X	5	0	1	4
FEMA	X		0	0	0	0
GSA		X	5	0	2	3
NASA		X	0	1	0	1
NSF	X		0	0	0	0
NRC	X		0	0	0	0
OPM	X		4	0	4	0
SBA	X		1	0	1	0
SSA		X	1	0	0	1
TOTAL	6	18	231	70	70	231

* Agency head has provided overall assurance that the agency has adequate and effective management controls, except for the material weaknesses identified.

**Fiscal Year 2001: Section 4 Reporting in Agency FMFIA
(or Accountability) Reports**

Agency	Systems Conform to Requirements			Number of Nonconformances			
	Yes	Yes, with Non-conformances*	No	Beginning	New	Resolved	Ending
Agriculture			X	4	0	0	4
Commerce		X		1	0	0	1
Defense		X		153	0	0	153
Education		X		2	0	0	2
Energy	X			0	0	0	0
HHS			X	1	0	0	1
HUD			X	2	0	0	2
Interior			X	0	1	0	1
Justice		X		4	2	2	4
Labor	X			1	0	1	0
State			X	1	0	0	1
DOT		X		1	0	0	1
Treasury			X	11	2	4	9
VA		X		5	0	2	3
AID			X	0	0	0	0
EPA	X			0	0	0	0
FEMA		X		1	1	0	2
GSA		X		2	0	0	2
NASA	X			0	0	0	0
NSF	X			0	0	0	0
NRC	X			0	0	0	0
OPM		X		2	0	0	2
SBA	X			0	0	0	0
SSA	X			0	0	0	0
TOTAL	8	9	7	191	6	9	188

* Agency head has provided overall assurance that the agency has adequate and effective management controls, except for the material weaknesses identified.




Appendix C: Government Corporations Required to Submit Audited Financial Statements to OMB






FY 2001 Opinion






Community Development Financial Institutions Fund	Unqualified
Corporation for National and Community Service	Unqualified
Export-Import Bank of the United States (EX/IM)	Unqualified
Federal Crop Insurance Corporation	Unqualified
Federal Deposit Insurance Corporation	Unqualified
Federal Home Loan Banks	Unqualified
Federal Housing Administration Fund	Unqualified
Federal Prison Industries, Incorporated	Unqualified
Financing Corporation	Unqualified
Government National Mortgage Association	Unqualified
National Credit Union Administration Central Liquidity Facility	Unqualified
Overseas Private Investment Corporation	Unqualified
Pension Benefit Guaranty Corporation	Unqualified
Resolution Funding Corporation	Unqualified
Rural Telephone Bank	Unqualified
Saint Lawrence Seaway Development Corporation	Unqualified
Tennessee Valley Authority	Unqualified







Appendix D: Baseline Scorecard Grades as of September 30, 2001



<p>The Department of Agriculture—Auditors have been unable to express an opinion on the combined USDA financial statement since 1996 when the agency first began submitting financial statements to OMB. Also, the auditors were unable to render an opinion on U. S. Forest Service’s financial statement due to their inability to obtain timely, sufficient, and competent information. USDA’s financial systems do not comply with federal financial management systems requirements or applicable federal accounting standards. U. S. Forest Service also has significant and chronic Anti-Deficiency Act violations. USDA has made significant progress in improving its performance. Examples include: (1) implementation of a financial system that will comply with federal financial management system requirements is scheduled for completion in October 2002, (2) in FY 2001, 4 of 5 stand-alone audits received an unqualified opinion, and (3) USDA is continuing efforts to reduce the error rate in the Food Stamp and School Lunch programs.</p>	●
<p>Department of Commerce—Commerce currently fails to fully meet Federal financial management systems requirements. However, the department’s integrated system should be completely deployed by October 2003. Commerce has had unqualified audit opinions since 1999.</p>	●
<p>Department of Defense (DOD)—With over 1,000 systems providing financial data, DOD has several serious failings in financial management:</p> <ul style="list-style-type: none"> • it is not substantially compliant with Federal financial management standards; • it cannot provide a clean assurance statement about its internal controls; and • it has consistently received a disclaimer by its auditors on its financial statements. <p>The DOD Inspector General and the General Accounting Office (GAO) have issued a series of reports critical of DOD’s financial management. For example, a recent GAO report criticized DOD’s excessive use of funds in “canceled accounts” to pay contractor bills.</p> <p>Until adequate progress is made at DOD, the financial statements of the entire government will not receive an opinion from GAO. DOD has launched a major initiative to improve business and financial processes and systems. It is working closely with OMB to develop an enterprise architecture and systems that will support efficient operations, and provide accurate, timely, and useful financial information. This will take a number of years, but DOD has documented a clear commitment to improvement and is moving forward.</p>	●

<p>Department of Education—For 2000, the Department of Education received a “qualified” opinion on its financial statements. The auditors continued to cite material weaknesses from prior audits, including failure to reconcile financial data from different sources and inadequate internal controls. In 2000, the general ledger was not compliant with Federal requirements. The department is taking aggressive steps to fix past problems. Improvements were noted in the FY 2001 audit, but significant problems still remained. This year, it will implement Oracle Federal Financials (an accounting package), prepare quarterly instead of only annual financial statements, and reconcile transaction-level data with summary balances in the general ledger. Because of these changes, the Department of Education expects to achieve a clean audit opinion for the 2002 financial statements.</p>	
<p>Department of Energy (DOE)—DOE was one of only six agencies to receive an unqualified audit opinion on its first consolidated financial statement. It has continued to receive unqualified opinions every year, except 1998 because of its environmental liabilities, and received one again this year. DOE was also one of four agencies whose financial systems met the Federal Financial Management Improvement Act (FFMIA) requirements. Despite these successes, DOE is still reporting material management control weaknesses. DOE will continue to work on resolving these issues and will:</p> <ul style="list-style-type: none"> • Develop a financial management plan that includes a schedule and addresses system integration, especially with its contractor systems; • Integrate financial, budget, and program information in its systems in order to provide cost information related to performance; and, • Ensure implementation of its Business Management Information System (BMIS) is on track to be deployed in FY 2003 and that it will correct managerial accounting issues as planned. 	
<p>Department of Health and Human Services (HHS)—HHS’ financial management systems have been non-compliant with Federal laws and regulations since 1996, and its systems remain inadequate to produce reliable financial information. To solve these problems, HHS has begun planning and implementation of a seven-year Unified Financial Management System project. HHS will continue to produce the Medicare comprehensive error rate. The Administration for Children and Families will review its major programs to assess risks and establish methodologies to reduce overpayments.</p>	

<p>Department of Housing and Urban Development (HUD)—HUD’s financial systems have been plagued with deficiencies for many years. HUD’s financial statements improved last year to merit an unqualified audit opinion for the second consecutive year, albeit with citations for 9 reportable conditions and five material weaknesses. In 2002, actions were completed to close five financial statement audit recommendations, resulting in the elimination of two reportable from the 2000 audit. In 2002, HUD will work to maintain an unqualified opinion and complete corrective actions to address other audit recommendations, reportable conditions, and material weaknesses. HUD will revamp its funds control system in 2002 to overcome internal control deficiencies that led to overspending its appropriation in 2000. It will improve the inadequate Federal Housing Authority (FHA) accounting system with a new FHA general ledger by October 2002. A HUD task force has been working with HUD intermediaries and clients for several months on plans to reduce overpayment of rent subsidies; HUD has set aggressive interim targets to reduce overpayments in 2003, 2004, and 2005.</p>	
<p>Department of the Interior (DOI)—The department received a clean audit opinion. However, FFMIA problems and material weaknesses in internal control remain. In particular are problems in its tribal trust accounting. DOI cannot provide assurances that its trust management systems and internal controls meet Federal standards and they represent a material weakness in internal control for the audit. DOI has committed to provide a strategic plan in July on trust reforms, including computer security.</p>	
<p>Department of Justice (DOJ)—DOJ is not in compliance with the requirements of the Federal Financial Management Improvement Act. It also does not meet Federal accounting standards related to property accounting. Since DOJ has material system nonconformances, it cannot provide a full assurance statement about its controls. DOJ received a clean opinion in FY 2001 on all of its statements. DOJ has made progress in addressing issues identified by its auditor during the course of its annual financial audit. It expects to continue to receive unqualified opinions in the future. In addition, DOJ will move forward to migrate its components from old financial systems to new systems that meet applicable standards.</p>	
<p>Department of Labor (DOL)—Although DOL has received unqualified opinions from independent auditors on its financial statements since 1997, in FY 2000 it has identified two small systems in its Wage and Hour Division that did not comply with accepted Federal standards for financial management and internal controls. With subsequent improvements made, these systems were not cited in the FY 2001 audit as being non-compliant with the Federal Financial Management Improvement Act, although reportable conditions remained. Recognizing the importance of financially sound systems, DOL will correct these problems in 2002. DOL will improve its oversight of the performance of its grantees and contractors and increase its auditing and technical assistance to states to identify fraud and reduce erroneous payments in Unemployment Insurance.</p>	
<p>Department of State—The department received an unqualified opinion on its 2000 and 2001 financial statements and submitted them on time. Nonetheless, its financial systems are not compliant with Federal requirements and have received only a qualified assurance statement. The department plans to fix these issues through office consolidation and installing a new system that will meet the FFMIA requirements. The new system will be completed by the end of 2003.</p>	

<p>Department of Transportation (DOT)—DOT’s financial systems fail to meet financial management requirements and standards, receiving a material control weakness for FAA’s property accounting in its audit. DOT also does not have integrated financial and performance management systems. However, senior management is addressing these shortfalls, has submitted a new plan to comply with financial management standards, and is implementing a new, integrated financial system. DOT received an unqualified audit opinion for FY 2001 consolidated financial statements. DOT has a solid plan to address the erroneous payments in its four programs: AIP, Federal Highway Administration Planning and Construction, Transit Capital, and Formula grants.</p>	
<p>Department of the Treasury—The department received an unqualified opinion on its 2000 financial audit. However, substantial weaknesses in financial management systems and controls at the U.S. Customs Service and the Internal Revenue Service (IRS), the two largest bureaus in Treasury, hamper effective management and make it difficult for the department to sustain an unqualified opinion in the future. Improvements are also needed to reduce the number of improper payments. An estimated 25 percent of Earned Income Tax Credit payments were made incorrectly for tax year 1997. The department is working to improve its financial systems and has a \$154 million compliance program to reduce errors in the Earned Income Tax Credit program. It is also moving aggressively to accelerate the preparation of monthly financial statements and expects to set the standard for the government in timely statements by the summer of 2002. In addition, the budget proposes legislative change to allow IRS to match the income reported on student aid applications with tax return data. This will help reduce errors in the Department of Education’s student aid programs and save an estimated \$138 million in 2003.</p>	
<p>Department of Veterans Affairs (VA)—A has persistent problems with internal controls, which include nine material weaknesses, four of which have been carried over from prior years. However, VA has developed a financial management plan to address its problems, and is now moving towards implementing an acceptable financial system in 2004.</p>	
<p>Agency for International Development (AID)—Although a core accounting system is in place in Washington, it has not yet been deployed overseas. Therefore, almost 50 percent of AID-managed funds are not within the new system. Until its field systems are modernized, AID will be unable to gain the benefits of modern business practices in accounting, finance, procurement, and e-government. Further, while the first full audit of AID’s financial statement is being conducted for 2001, it is not clear that the Inspector General will be able to render an opinion. AID will submit and implement a targeted remediation plan for its financial systems. The agency study of business practices will include strategies to accelerate deployment of the core accounting system.</p>	
<p>Corps of Engineers—The Corps received a disclaimer of opinion on its financial statements. The FY 2001 audit highlighted the same issues as in FY 2000: (1) problems with determining the original costs of older existing plant, property and equipment (PP&E), which affects the balance sheet, and (2) a material weakness with computer security.</p>	

<p>Environmental Protection Agency (EPA)—EPA is unable to provide an unqualified assurance statement as to systems of management accounting and administrative controls because of material weaknesses, including information security and NPDES permits. EPA is working to correct these material weaknesses.</p>	
<p>Federal Emergency Management Agency (FEMA)—FEMA is not FFMIA-compliant; cannot provide a clean assurance statement on its controls; and does not have integrated financial and performance management systems. FEMA continues to have a problem with its financial management systems and reporting. The systems, processes and infrastructure are not yet stable nor subject to the appropriate levels of supervision and review in order to support timely and reliable financial information. This year, the auditors have provided more details on where FEMA has weaknesses (this was a concern of management from the last year.)</p> <p>In addition, FEMA needs to improve its disaster cost projections, oversight of state administration of public assistance and mitigation grants, and monitoring of unspent funds. FEMA will develop an implementation plan for system improvements and develop improved disaster cost projections by mid-2002.</p>	
<p>General Services Administration (GSA)—GSA has received unqualified opinions on its financial statements since it first began submitting them to OMB in FY 1996 and has been in compliance with FFMIA since 1997. GSA has no material weaknesses as reported by the auditor and was able to provide a clean FMFIA assurance statement for Section 2 and Section 4. GSA has resolved two of its 5 weaknesses associated with Section 2 of FMFIA. GSA still has two nonconformances with Section 4 of FMFIA. To “get to green,” GSA needs to successfully implement PEGASYS and demonstrate the integration of performance and financial management systems.</p>	
<p>National Aeronautics and Space Administration (NASA)—Despite its past success in producing timely and unqualified financial statements, NASA’s financial statements received a disclaimer of opinion, and the auditor cited one material weakness. Because of the disclaimer, NASA’s score has been adjusted from its original yellow to red. NASA still lacks systems to support day-to-day operations and track task completion. Implementation of NASA’s Integrated Financial Management System (IFMS) in 2004 will provide support in the future and implement full cost management with NASA’s 2004 budget. NASA will proceed with IFMS implementation and seek to accelerate it where justified.</p>	
<p>National Science Foundation (NSF)—NSF is the Federal leader in financial management and has met all core criteria for a green rating for financial management. NSF’s financial management systems meet Federal financial management system requirements and it has received unqualified and timely audit opinions on its annual financial statements. NSF expects to maintain this position.</p>	
<p>Office of Personnel Management (OPM)—Despite receiving an unqualified audit opinion on its FY 2001 consolidated statements, OPM has yet to resolve major problems with the Salaries and Expenses and Revolving Fund accounts. OPM has two outstanding material nonconformances under the Federal Managers Financial Integrity Act (FMFIA). Non-compliance with FFMIA (e.g., unresolved discrepancies with Treasury over intragovernmental transaction reconciliations) was also reported. OPM implemented Phase I of a new financial system and expects to have all FMFIA weaknesses and nonconformances corrected in FY 2002.</p>	

<p>Small Business Administration (SBA)—SBA has had an unqualified opinion for six years in a row. This year, however, SBA’s head reported the agency not in substantial compliance with FFMIA due to material weakness in SBA’s financial reporting process; thus resulting in an adjustment of SBA’s score from its original yellow to red. This occurred because SBA ambitiously attempted to meet the FY 2003 reporting deadline of February 1. Auditors indicated that SBA was unable to provide complete, reliable, timely, and consistent financial management information on operations to enable management to fulfill its responsibility of being accountable to the public and provide timely information for managing current operations. SBA did, however, provide accurate information for the February 27 due date. In FY 2000, auditors indicated that the financial reporting processes and procedures were not adequately documented and a fully effective quality assurance process was not in place. This year, the auditors found that the documentation had improved, but the overall process had worsened. SBA implemented JAAMS, its new core financial management system in October 2001 that uses Oracle COTS and is reported to be running fine.</p> <p>SBA’s financial management system is compliant with relevant Federal law. In addition, SBA is improving the accuracy of cost estimates for its general business loan program and will continue its successful asset sales program. In contrast to these successes, the Loan Monitoring System (LMS) technology project is over budget, behind schedule, and not performing as expected. SBA’s inability to implement LMS adversely affects its risk management and oversight of its \$50 billion loan portfolio. SBA is refining the LMS project and developing specific implementation milestones.</p>	
<p>Smithsonian Institution—Although it has received clean opinions on its audited financial statements, the Smithsonian is concerned that the unqualified opinion may be in jeopardy due to the inadequacy of its accounting system. The recent National Academy of Public Administration report notes that “the Smithsonian’s accounting system provides useful information only at the summary level and does not support either Federal requirements for obligation and outlay information or the Smithsonian’s internal project management requirements.” The Smithsonian is in the process of implementing an Enterprise Resource Planning (ERP) system which is key to improvement in the Improved Financial Performance area. Initial deployment is scheduled for October 2002 with system completion scheduled for April 2005. Smithsonian is currently developing an integrated timeline and expected deliverables, and updating/establishing procedures for accounts payable, payroll, and accounts receivable. ERP progress is on track.</p>	

Social Security Administration (SSA)—In 2001, SSA received an unqualified audit opinion on its financial statements, and its accounting and internal control systems met Federal standards. However, SSA does not have fully integrated financial and operating management systems, which support day-to-day decision-making. SSA is on track to integrating its financial and performance management system, and will continue to integrate it through several functional improvements that will be completed in 2002. These improvements will link source databases to the system and consolidate several reporting systems while retaining the capability to produce all the data needed. SSA is also committed to and is beginning the implementation of a new cost accounting system in 2002. Another key performance area is reducing erroneous payments. The problem plagues the agency's Supplemental Security Income (SSI) program, which remains a high-risk program due to improper payments. In recent years, SSA has increased its funding for initiatives focused on identifying erroneous payments. The 2003 budget will enable SSA to increase SSI non-disability redeterminations by nine percent and achieve a payment accuracy rate of 94.7 percent.

