

**LIMITED AUDIT OF THE FISCAL YEAR 2005
FEDERAL MANAGERS' FINANCIAL
INTEGRITY ACT SECTION 2 AND
SECTION 4 ASSURANCE STATEMENTS
REPORT NUMBER: A050249/A/F/F06001
NOVEMBER 4, 2005**



U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

November 4, 2005

Reply to Eugene L. Waszily
Attn of: Assistant Inspector General for Auditing (JA)

Subject: Limited Audit of the Fiscal Year 2005 Federal Managers' Financial Integrity Act Section 2 and Section 4 Assurance Statements
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To: David L. Bibb
Acting Administrator (A)

Kathleen M. Turco
Acting Deputy Administrator (AD)

This report presents the results of the Office of Inspector General's (OIG) limited audit of the General Services Administration's (GSA) Fiscal Year 2005 Federal Managers' Financial Integrity Act (FMFIA) Section 2 and Section 4 Assurance Statements. The assurance statement questionnaires prepared by the Regional Administrators (RAs) and the Heads of Services and Staff Offices (HSSOs) are used by the Management Control and Oversight Council as a basis for developing the Administrator's FMFIA Assurance Statement to the President and Congress. The objective of the audit was to determine whether the Section 2 and Section 4 Assurance Statement questionnaires, as prepared by the RAs and the HSSOs, adequately disclosed all known control weaknesses and non-conformances in the Agency's programs, operations, and systems.

To accomplish our objective we reviewed the FMFIA Section 2 and Section 4 Assurance Statement questionnaires submitted by the RAs and HSSOs, internal and external audit reports, and the findings noted to date by PricewaterhouseCoopers LLP (PwC), an independent public accounting firm, in their audit of GSA's Fiscal Year 2005 Financial Statements.

The audit was performed in accordance with generally accepted government auditing standards from August through October 2005. However, we did not perform an assessment of the internal control structure over the agency's FMFIA evaluation and reporting process. Accordingly, we do not express an opinion on the adequacy of the basis used in the preparation of the assurance statements submitted by the RAs and HSSOs.



RESULTS OF AUDIT

In reviewing those management and systems control weaknesses reported in the FMFIA Section 2 and Section 4 Assurance Statement questionnaires as prepared by GSA management, we noted two weaknesses that resulted in qualified statements of FMFIA Section 2 assurance -- budgetary reporting and contracting practices. In addition to these weaknesses, our review of audits performed by the OIG and other external organizations identified three additional weaknesses in the areas of Construction in Progress, reconciliations of intragovernmental balances, and weaknesses in the management of the development and secure operations of automated information systems.

Budgetary Reporting

The Chief Financial Officer identified GSA's budgetary standard general ledger accounts as an area of concern in her Fiscal Year 2005 Section 2 Assurance Statement questionnaire. PwC has also identified budgetary reporting issues. Since first identifying the controls over budgetary reporting as a reportable condition in Fiscal Year 2004, PwC has continued to identify problems in this area during Fiscal Year 2005. Specifically, during the internal control testing phase of their Audit of GSA's Financial Statements, PwC determined that the controls surrounding unfilled customer orders and undelivered orders were ineffective. As a result, GSA performed statistical sampling of its budgetary accounts to gain comfort with the reported year-end balances. In turn, PwC will perform further testing on these statistical samples to substantiate GSA's budgetary account balances. As of the date of this report, this testing is still ongoing and has not been finalized.

Contracting Practices

While GSA made significant progress in addressing contracting practices during Fiscal Year 2005, this issue continues to warrant attention. The Regional Administrators for the New England, Heartland, and Rocky Mountain Regions each reported concerns over GSA's contracting practices in their Fiscal Year 2005 FMFIA Section 2 Assurance Statement questionnaires. The OIG, through its Fiscal Year 2005 audits performed within the Federal Technology Service's (FTS) Client Support Centers (CSCs) and other contracting programs, identified issues affecting GSA's contracting practices. These contracting issues include: FTS contracting practices require further strengthening, potential Anti-Deficiency Act (ADA) and Purpose Statute breaches arising from prior-year contracts, and proposed changes to the regulations governing subcontractor costs.

FTS Contracting Practices

The OIG's report entitled, *Compendium of Audits of Federal Technology Service Client Support Center Controls*, dated June 14, 2005, found one CSC was fully compliant and that the other eleven regional CSCs, while not fully compliant with procurement regulations, are "making significant progress toward being compliant." GSA's newly implemented controls provide greater assurance that future systemic breaches of contract, accounting, and appropriations law are unlikely to reoccur. FTS has made significant progress in the implementation of new controls governing procurement activities through programs such as the "Get It Right" plan.

Potential Anti-Deficiency Act and Purpose Statute Breaches

As a result of the testing performed on prior-year contracts awarded by FTS Client Support Centers, the OIG identified potential ADA and Purpose Statute breaches. In the first instance, real property services were provided through the Information Technology and General Supply Funds for the relocation of the Army Material Command Headquarters, potentially in non-compliance with the Purpose Statute. In the second instance, GSA contracted for security upgrades to the Air Force Electronic Systems Center using funds which may have been expired.¹ Finally, an overarching ADA issue was identified pertaining to the inappropriate accounting for and misapplication of customer funds. Although weaknesses in internal controls existed in prior periods that led to the potential ADA breaches identified above, no new potential ADA breaches were identified during the OIG's testing of Fiscal Year 2005 contracts.

Proposed Changes to Regulations Governing Subcontractor Rates

The Federal Acquisition Regulation (FAR) Council is currently considering a proposed change to FAR §52.232-7, *Payments Under Time-and-Materials and Labor-Hour Contracts*, which would relax the regulations governing the payment of subcontractors by allowing for payment of subcontract costs at the contract fixed labor rate (prime rate) at the discretion of the Contract Officer. As some GSA Schedules contracts cite FAR §52.232-7, the Office of the Chief Acquisition Officer and the Federal Supply Service have proposed acquisition letters effective for the Agency and FSS addressing the proposed change in the regulations.

If approved, the changes to FAR §52.232-7 may have a significant effect by lowering the value received by the Government under Schedules contracts. Instances may occur in which the Government pays the prime contractor's rate, when in actuality the work is being performed by a subcontractor at a

¹ The discussion as to whether the Air Force security upgrades constitute a matter subject to reporting under the ADA provisions currently centers on timing issues, and is subject to a formal legal opinion.

substantially lower rate. Also, the proposed changes may increase the risk to the quality of work received by the Government in instances where a less qualified subcontractor is used.

Construction in Progress

The controls over transferring substantially complete Construction in Progress (CIP) projects continued to remain an area of concern during Fiscal Year 2005. In May 2005, the OIG issued separate reports to the Office of the Chief Financial Officer and the Public Buildings Service regarding the need for strengthened controls over the CIP statistical sample adjusting journal entry as recorded in the Federal Buildings Fund. Additionally, PwC has continued to note significant issues with respect to the controls over transferring substantially complete CIP projects during their audit of GSA's Fiscal Year 2005 Financial Statements. The CIP issue has been identified as a reportable condition in PwC's past four consecutive reports on GSA's financial statements.

Reconciliations of Intragovernmental Balances

Office of Management and Budget Circular A-136, *Financial Reporting Requirements*, requires agencies to report intragovernmental asset, liability, and revenue amounts by trading partner, and Chapter 4700 of the Treasury Financial Manual, *Agency Reporting Requirements for the Financial Report of the United States Government*, requires agencies to reconcile intragovernmental balances by trading partner. However, during their audit of GSA's Fiscal Year 2005 Financial Statements, PwC has found that the Agency continues to face challenges in its efforts to reconcile its non-fiduciary intragovernmental activity and balances, and is unable to fully perform reconciliations of intragovernmental balances with its trading partners.

Systems Issues

Systems issues continue to be identified as an overall weakness by GSA management and audits performed by the OIG and external organizations. During Fiscal Year 2005, these issues included: overall systems issues, implementation of GSA Preferred, and GSA's implementation of the Federal Information Security Management Act.

Previously Identified Systems Issues

In Fiscal Year 2004, PwC reported that, with the exception of FSS, GSA had taken the necessary steps to address the reportable condition regarding network and application security controls. However, during their Fiscal Year 2005 testing,

PwC has once again identified significant, Agency-wide issues with network application and security controls. Additionally, PwC continues to find that the Agency needs to take action to improve development, implementation, and change controls over its financial systems.

Implementation of GSA Preferred

During Fiscal Year 2005, PwC has continued to identify a number of issues with respect to the limited implementation of GSA Preferred in the Mid-Atlantic and Rocky Mountain Regions. Although GSA Preferred was intended to interface with Pegasys, GSA's financial system of record, PwC has found that the interface between these two systems is not functioning properly. As a result, GSA's financial staff has been required to perform a significant number of manual reconciliations between the financial data in GSA Preferred and Pegasys. The high volume of manual reconciliations were reported in the Section 2 Assurance Statement questionnaires prepared by the Federal Acquisition Service Commissioner for FTS and the Acting RA for the Mid-Atlantic Region. Additionally, PwC has identified issues with GSA Preferred involving segregation of duties and data integrity.

GSA's Implementation of the Federal Information Security Management Act

As required, the OIG performed the Fiscal Year 2005 review regarding GSA's progress in implementing the Federal Information Security Management Act (FISMA). The purpose of FISMA is to provide a framework for securing Federal information systems. The auditors found that, although steps have been taken to improve GSA's Information Technology Security Program, management, operational, and technical controls weaknesses continue to require management attention. Specifically, the auditors reported that GSA's certification and accreditation process was not consistently applied, contingency plans were not developed and tested for three systems, system owners were not comprehensively identifying and managing technical security weaknesses, and comprehensive oversight and evaluation of contractors remains an issue.

We appreciate the cooperation and courtesies extended to our staff during this audit. Should you or your staff have any questions, please contact Kristin Wilson on (202) 501-0006 or me on (202) 501-0374.


Eugene L. Waszily
Assistant Inspector General for Auditing (JA)

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