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FINANCIAL MANAGEMENT

Financial Audit Results at GSA, EPA, and DOT

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Mr. Chairman and Members of the Subcommittee:

We are pleased to provide a statement for the record for this hearing on financial data quality at the General Services Administration (GSA), the Environmental Protection Agency (EPA), and the Department of Transportation (DOT). Our statement today will provide a summary of the financial statement audit results of these three agencies. These audit results are key indicators of the quality of agency financial data. As you know, in March of this year, we reported on the results of our financial statement audit of the 1998 consolidated financial statements of the United States government.[1] We found that because of serious deficiencies in the government's systems, recordkeeping, documentation, financial reporting, and controls, amounts reported in the financial statements do not provide a reliable source of information for decision-making by the government or the public. We have designated the most serious examples of these deficiencies as high risk, including financial management at the Federal Aviation Administration (FAA)–a major component of DOT. Our statement will also discuss the problems that led to this designation.

Background

Federal decisionmakers need reliable and timely financial information to ensure adequate accountability, manage for results, and make timely and well-informed judgments. However, historically, such information has not been available across the government. Agencies' independent auditor reports, Inspector General (IG) reports, as well as our own work, have identified persistent limitations in the availability of quality financial data for decision-making. Major reforms, such as the Chief Financial Officers (CFO) Act, set expectations for agencies to develop and deploy more modern financial management systems and to routinely produce sound cost information. Toward that end, the 24 agencies covered by the CFO Act have been required to annually prepare financial statements and have them audited since the fiscal year 1996 financial statements. These audits have shown how far many agencies have to go to generate reliable year-end information. As of September 27, 1999, of the 24 CFO Act agencies, 9 agencies had received unqualified audit opinions on their fiscal year 1998 financial statements, indicating that their financial statements were reliable in all material respects; 4 agencies had received qualified opinions, indicating that at least one significant item on the financial statements was

[1] *Financial Audit: 1998 Financial Report of the United States Government* (GAO/AIMD-99-130, March 31, 1999).

unreliable; 5 agencies had received disclaimers, meaning that the auditor was unable to determine on an overall basis if the financial statements were reliable; 2 agencies had received mixed opinions[2]; and 4 agencies had not yet issued their audited financial statements, which were due by March 1, 1999.

For some agencies, the preparation of financial statements requires considerable reliance on ad hoc programming and analysis of data produced by inadequate financial management systems that are not integrated or reconciled. These systems problems often require significant adjustments to the financial statements. While obtaining unqualified "clean" opinions on federal financial statements is an important objective, it is not an end in and of itself. The key is to take steps to continuously improve underlying financial and management information systems and internal controls as a means to ensure accountability, increase the economy, improve the efficiency, and enhance the effectiveness of government. These systems must generate timely, accurate, and useful information on an ongoing basis, not just as of the end of the fiscal year. The overarching challenge in generating timely, reliable data throughout the year is overhauling financial and related management information systems.

More fundamentally, the Federal Financial Management Improvement Act of 1996 (FFMIA) requires that agency financial management systems comply with (1) financial systems requirements,[3] (2) federal accounting standards, and (3) the *U.S. Government Standard General Ledger* at the transaction level. As of September 27, 1999, financial statement audits for fiscal year 1998 had been completed for 20 of the 24 CFO Act agencies. Of the 20 agencies whose fiscal 1998 audited financial statements had been issued as of September 27, 1999, financial management systems for 17 agencies were found by auditors to be in substantial noncompliance with FFMIA's requirements.

[2]One of these agencies received an unqualified opinion on its balance sheet and a disclaimer on the rest of its statements. The other agency did not prepare consolidated statements and received unqualified opinions on three of its components and disclaimers on the remaining two of its components.

[3]The financial management systems requirements have been developed by the Joint Financial Management Improvement Program, which is a joint and cooperative undertaking of the Department of the Treasury, Office of Management and Budget, GAO, and Office of Personnel Management.

The following discussion focuses on the results of the fiscal years 1998 and/or 1997 audits of GSA,[4] EPA,[5] and DOT,[6] including the results of the auditor's review of FFMIA compliance. These audits were performed by the Inspector General of the agency or, in the case of GSA, by an independent public accountant (IPA) contracted for by the IG.

GSA Audit Results

GSA is the federal government's business manager and is responsible for space acquisition and management; retail and wholesale supply sales; fleet management; travel and transportation management; telecommunications and information management; and governmentwide policy on procurement, travel and transportation, and electronic commerce. GSA's mission is to work with industries, businesses, and federal agencies to provide competitively priced products and services to keep the government running smoothly. Its expenses for fiscal year 1998 totaled $ 11.7 billion.

GSA received an unqualified audit opinion on its fiscal years 1997 and 1998 financial statements. For fiscal year 1998, GSA's IPA, whose audit report was timely issued, concluded that internal controls over financial reporting were effective. However, the IPA identified three reportable conditions[7] and reported noncompliance with FFMIA financial systems requirements related to weak information technology access controls and application of security policies and procedures. These issues are described in the appendix.

[4]*GSA 1998 Annual Report and U.S. General Services Administration 1997 Annual Report.*

[5]*Office of Inspector General Audit Report, Financial Management, EPA's Fiscal 1997 and 1996 Financial Statements*, E1AML7-20-7008-8100058, March 2, 1998.

[6]*Office of Inspector General Audit Report, Fiscal Year 1998 Consolidated Financial Statements*, Department of Transportation, Report Number: FE-1999-081, March 30, 1999, and *Office of Inspector General Audit Report, Fiscal Year 1997 Consolidated Financial Statements*, Department of Transportation, Report Number: FE-1998-105, March 31, 1998.

[7]Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated because they represent significant deficiencies in the design or operation of internal controls that could adversely affect the organization's ability to meet the objectives of reliable financial reporting and compliance with applicable laws and regulations.

EPA Audit Results

EPA was established in 1970 to control pollution and other environmental risks to public health and the environment. The agency is responsible for carrying out various statutory authorities directed at controlling pollution and other human health and environmental risks. The states have the primary responsibility for day-to-day implementation of most environmental programs. EPA works with other stakeholders–including other federal agencies, business and industry, and environmental and public interest groups–and its activities include providing funds to states to implement programs to prevent pollution. A major program that EPA manages is the federal Superfund program to clean up the nation's most hazardous waste sites. It is primarily financed by the Superfund Trust Fund, which is funded primarily by taxes on crude oil and chemicals. EPA's expenses for fiscal year 1997 totaled $6.9 billion.

Although EPA received an unqualified opinion on its timely issued fiscal year 1997 financial statements, as of September 27, 1999, it had not released its audited fiscal year 1998 financial statements, which were due March 1, 1999.[8] According to agency officials, the delay results from difficulties in preparing the Statement of Budgetary Resources, which was required for the first time in fiscal year 1998 and contains certain budget information required by the Statement of Federal Financial Accounting Standards No. 7.[9] This statement, which reports the sources, availability, and uses of budgetary resources, includes balances related to unexpended obligations. Historically, EPA has not been prompt in closing out grants, contracts, and interagency agreements and deobligating related unexpended funds that are no longer available. Consequently, a major time-consuming effort was necessary to analyze agency obligations in order to prepare the fiscal year 1998 Statement of Budgetary Resources.

[8]On September 28, 1999, the EPA Office of the IG advised us that EPA had issued its fiscal year 1998 audited financial statements on that date. We have not received a copy of those audited financial statements. Therefore, this statement for the record is based on our review of the fiscal year 1997 EPA financial statements.

[9]Statement of Federal Financial Accounting Standards No.7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, is effective for fiscal years beginning after September 30, 1997.

Although EPA received an unqualified opinion on its fiscal year 1997 financial statements, the EPA IG reported one material weakness,[10] which related to the difficulties encountered by EPA in estimating the Superfund Trust Fund's year-end unbilled oversight costs for monitoring the cleanup of hazardous waste sites. At the request of the IG, the agency performed additional analyses and recalculated the accounts receivable balance related to these unbilled oversight costs. The IG was then able to determine that the September 30, 1997, balance for unbilled oversight costs was reasonably correct. However, because the agency's systems do not readily provide the data necessary to properly estimate these receivables on an ongoing basis, the IG concluded that internal controls related to tracking Superfund site information need to be strengthened.

The OIG also cited eight reportable conditions and three areas of noncompliance with laws and regulations, including FFMIA, which are described in the appendix. Noncompliance with FFMIA was related to Year 2000 (Y2K) computer requirements, financial systems security, financial systems inventory data requirements, and updating the CFO-required Five-Year Plan.

DOT Audit Results

DOT establishes and implements national transportation policy for the federal government. It is responsible for ensuring the safety of all forms of transportation, protecting the interests of consumers, establishing international transportation agreements, conducting transportation planning and research for the future, and helping cities and states meet their local transportation needs through financial and technical assistance. DOT fulfills its mission through 11 operating administrations including FAA, the U.S. Coast Guard, the Federal Highway Administration, and the Federal Transit Administration. DOT's reported net costs for fiscal year 1998 were $41 billion.

The DOT Inspector General was unable to express an opinion (disclaimer of opinion) on DOT's fiscal years 1998 and 1997 consolidated financial statements. Both reports were issued about 1 month after they were due.

[10]A material weakness is a reportable condition that precludes the entity's internal controls from providing reasonable assurance that material misstatements in the financial statements or material noncompliance with applicable laws or regulations will be prevented or detected promptly.

The reasons cited for the disclaimer for fiscal year 1998, which were also described as material internal control weaknesses, were as follows.

- Property, plant, and equipment (PP&E) reported at $21 billion could not be substantiated due to continuing property accounting weaknesses in FAA and the U.S. Coast Guard.
- Inventory reported at $2.3 billion could not be substantiated primarily because the U.S. Coast Guard was unable to determine the cost of its inventory using acceptable inventory valuation methods.
- In the Statement of Net Cost, $41 billion of operating costs for the Surface Transportation, Air Transportation, and Maritime Transportation reporting categories was not linked to the related 32 performance measures that address program results shown in the agency's performance plan as required. DOT's accounting systems were not able to determine cost accounting data by program in order to provide information for this linkage.
- The Statement of Budgetary Resources had six material financial line items that could not be substantiated, including the beginning unobligated balance, obligations incurred, and the ending obligated balance. DOT's accounting systems were unable to provide detailed supporting records for obligations incurred and obligated balances had not been properly determined.
- The Statement of Financing identified $11.6 billion of reconciliation and/or unexplained differences between financial and budgetary data. DOT accounting practices did not ensure that these data were properly reconciled.

These deficiencies mean that DOT's financial statements were not reliable for fiscal year 1998. Similar deficiencies concerning PP&E and inventory, reported at $28.5 billion as of September 30, 1997, were reported by the DOT Inspector General for DOT's fiscal year 1997 financial statements. Serious financial management weaknesses at FAA, whose PP&E and inventory were reported at $12.4 billion as of September 30, 1997, contributed to this situation. Consequently, in January 1999, we designated financial management at FAA as high risk.[11]

In addition, for fiscal year 1998, the DOT IG found that DOT was not in compliance with FFMIA and two other laws and regulations, which are described in the appendix. FFMIA noncompliance was due to

[11] *High-Risk Series: An Update* (GAO/HR-99-1, January 1999).

(1) inaccurate PP&E and inventory amounts on the Balance Sheet, (2) not using the general ledger system to prepare financial statements, and (3) unavailability of cost accounting data to evaluate performance against performance goals.

FAA Financial Management High-Risk Designation

We designated FAA financial management as a high-risk area in January 1999 because of serious and long-standing accounting and financial reporting weaknesses, particularly relating to PP&E and inventory. These weaknesses render FAA vulnerable to waste, fraud, and abuse; undermine its ability to manage operations; and limit the reliability of financial information provided to the Congress.

Recently, we performed an analysis of the weaknesses concerning PP&E and inventory as reported by the DOT Inspector General to determine (1) the key issues FAA must resolve in order to achieve accountability over its PP&E and inventory and (2) whether FAA is taking appropriate actions to resolve these issues promptly. As we reported in July 1999,[12] FAA's lack of accountability for PP&E and inventory generally stems from

- an historical lack of attention to basic recordkeeping,
- the continuing use of outdated systems that were not designed for financial management, and
- poor systems of internal controls to prevent and detect errors in accounting for these assets.

We reported that in order to address these issues for PP&E, FAA needs to determine what assets it has and then reconstruct its records to establish an historical cost baseline for those assets. Next it needs to establish adequate systems and controls to account for the assets on an ongoing basis.

During fiscal year 1999, FAA undertook an extensive effort to identify and record the baseline cost of unrecorded PP&E assets and to adjust its detailed records. Also, in fiscal year 1999, FAA began to comprehensively address its systems needs; however, it does not expect full implementation of these new systems until 2001. Without systems capable of maintaining PP&E accountability on an ongoing basis, accounting for the acquisition of

[12] *FAA Financial Management: Further Actions Needed to Achieve Asset Accountability* (GAO/AIMD-99-212, July 30, 1999).

these assets will continue to require costly, time-consuming manual processes. Because these manual processes are inherently prone to error, strong internal controls are needed to ensure accurate accounting. While some improvements have been made, FAA has not implemented such a system of controls.

With regard to inventory, FAA has made improvements in its Logistics Center (warehouse) inventory accounting, but still needs to strengthen its procedures and controls. However, it has made less progress with its field spares (spare parts) inventory located throughout the country that supports various systems. An accurate baseline of inventory quantities and costs needs to be established for field spares, and new procedures and controls need to be implemented in order to maintain accountability on an ongoing basis.

As a result, we made several recommendations in our July report regarding FAA's need to

- establish accountability for billions of dollars expended for PP&E in the past and institute upgraded systems, procedures, and controls to ensure that accountability is maintained on an ongoing basis and
- complete improvements over its inventory accountability, particularly those related to field spares.

In order to ensure financial accountability across the federal government, it is essential that attention to financial management issues be given high priority. Considerable effort is now being exerted throughout the government to address these issues, and several agencies have made good progress toward achieving financial management reform goals. While much remains to be done, these efforts, if sustained, will continue to move us step by step towards a more economic, efficient, and effective federal government.

This completes our statement.

Contact and Acknowledgements

For information about this statement, please contact Linda M. Calbom at (202) 512-9508. Individuals making key contributions to this statement included John Fretwell, Don Campbell, and Meg Mills.

Internal Control and Compliance Audit Results

The following summarizes the reportable conditions, including those that are classified as material weaknesses, and noncompliance with laws and regulations as reported by the IPA for GSA, and the IGs for EPA and DOT in their most recent financial statement audit reports discussed in this statement.

GSA's Fiscal Year 1998 Financial Statement Audit Report

Reportable Conditions Classified as Material Weaknesses

None were reported.

Other Reportable Conditions

- With regard to the Federal Buildings Fund, calculating errors, missing data, inadequate documentation, and failure to update leasing data led to overpayments to lessors, inaccurate rent bills, a lack of transaction level history needed for space management, and possible adverse funding effects for new leases.
- Data access security policies and procedures were incomplete and outdated and were not consistent with GSA requirements.
- Access controls over mission-critical systems that support GSA's financial statements were weak.

Noncompliance With Laws and Regulations

GSA was not in compliance with FFMIA systems requirements because (1) logical and physical access controls over its information technology environment were weak and (2) security policies and procedures were not uniformly applied across GSA's service lines.

EPA's Fiscal Year 1997 Financial Statement Audit Report

Reportable Condition Classified as a Material Weakness

Internal controls related to tracking Superfund site information need to be strengthened to allow the preparation of estimates of unbilled costs.

Other Reportable Conditions

- Accounts receivable were not recorded and billed promptly.
- Personal property that should have been capitalized was not capitalized, property was undervalued, and unresolved reconciliation differences existed in the property accounts.
- Financial managers did not have sufficient financial information to evaluate accounting activity, perform trend analysis, and identify accounting errors on an ongoing basis. This resulted in EPA officials being unable to effectively monitor various asset and liability accounts during the year.
- Although the process used to estimate grantee expenses owed at the end of the year was sufficient to allow for an unqualified opinion, it did not permanently resolve estimation process issues, which have been identified in previous audit reports on EPA's financial statements.
- Invoice approval forms for interagency agreements were not always promptly approved and returned to the finance office responsible for their payment.
- Adequate processes to identify, track, and report EPA's environmental liability were not implemented.
- Regional finance officials did not properly recognize revenues for Superfund State Contracts. As a result, accounts associated with Superfund State Contracts were misstated by nearly $29 million.
- Documentation for EPA's Integrated Financial Management System did not contain the level of detail necessary for a financial statement audit.

Noncompliance With Laws and Regulations

EPA was not in compliance with

- FFMIA with regard to the Office of Management and Budget's (OMB) Y2K requirements for financial systems activities, Y2K maintenance

activities for financial systems, financial systems security, financial systems inventory data requirements, and the annual update of its CFO Financial Management Report and Five-Year Plan for 1994-1999;
- the CFO Act, because EPA had not performed required biennial reviews of fees; and
- Title 31 U.S.C. section 1301, because EPA made disbursements for grants from the oldest available funding/appropriation first, without establishing that this was the appropriation that benefited from the work performed.

DOT's Fiscal Year 1998 Financial Statement Audit Report

Reportable Conditions Classified as Material Weaknesses

- Due to continuing property accounting weaknesses, PP&E reported at $21 billion could not be substantiated.
- Due to the inability of the U.S. Coast Guard to determine the cost of its inventory using acceptable inventory valuation methods, the amount reported for inventory could not be substantiated.
- DOT accounting systems are not able to determine cost accounting information by program in order to link program performance information with the costs incurred.
- DOT accounting systems were unable to provide detailed supporting records for six material financial statement budgetary line items.
- DOT accounting practices did not ensure that the Statement of Financing was properly reconciled.

Other Reportable Conditions

None were reported.

Noncompliance With Laws and Regulations

DOT was not in compliance with

- FFMIA, because (1) PP&E and inventory amounts presented on the Balance Sheet were inaccurate and not supported by financial records, (2) the Departmental Accounting and Financial Information System was not used for preparation of the financial statements, and (3) the cost accounting data needed to effectively evaluate performance against performance goals and outcomes was not available;

- Title 31, United States Code Sections 1108 and 1501, because unliquidated obligations were not reviewed prior to certification; and
- OMB Bulletin 97-01, because performance measures did not provide information about cost-effectiveness and fiscal year financial data were not linked to performance measures.

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