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United States Government Accountability Office
Washington, DC 20548

The President
The President of the Senate
The Speaker of the House of Representatives

The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, is required annually to submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.[1] This is (1) our report on the accompanying U.S. government's accrual basis consolidated financial statements for the fiscal years ended September 30, 2008 and 2007, and the 2008, 2007, and 2006 Statements of Social Insurance, and (2) our associated reports on internal control and compliance with significant laws and regulations. As used in this report, accrual basis financial statements refer to all of the consolidated financial statements and notes, except for those related to the Statement of Social Insurance.[2]

The federal government is responsible for (1) preparing annual consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act (FMFIA)[3] are met; and (3) complying with significant laws and regulations. Also, the 24 Chief Financial Officers (CFO) Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with Federal Financial Management Improvement Act of 1996 (FFMIA)[4] requirements. Our objective was to

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[1]The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. 331(e). The federal government has elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well.

[2]The accrual basis consolidated financial statements for the fiscal years ended September 30, 2008 and 2007 consist of the (1) Statements of Net Cost, (2) Statements of Operations and Changes in Net Position, (3) Reconciliations of Net Operating Cost and Unified Budget Deficit, (4) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (5) Balance Sheets, including the related notes to these financial statements. Most revenues are recorded on a modified cash basis. The 2008, 2007, and 2006 Statements of Social Insurance, including the related notes, are also included in the consolidated financial statements. The Statements of Social Insurance do not interrelate to the accrual basis consolidated financial statements.

[3]31 U.S.C. 3512 (c), (d) (commonly referred to as FMFIA). This act requires executive agency heads to evaluate and report annually to the President and the Congress on the adequacy of their internal control and accounting systems and on actions to correct significant problems.

[4]31 U.S.C. 3512 note (Federal Financial Management Improvement Act).

audit the consolidated financial statements for the fiscal years ended September 30, 2008 and 2007. Appendix I discusses the scope and methodology of our work.

Material weaknesses[5] discussed later in our report continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner. We found the following:

- Certain material weaknesses in financial reporting and other limitations on the scope of our work[6] resulted in conditions that continued to prevent us from expressing an opinion on the accompanying accrual basis consolidated financial statements for the fiscal years ended September 30, 2008 and 2007.[7]

- The Statements of Social Insurance for 2008 and 2007[8] are presented fairly, in all material respects, in conformity with GAAP; we disclaim an opinion on the 2006 Statement of Social Insurance.[9]

- The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2008.

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[5]A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

[6]Three major impediments continue to prevent us from rendering an opinion on the accrual basis consolidated financial statements: (1) serious financial management problems at the Department of Defense, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

[7]We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2006 and on the accrual basis consolidated financial statements of the U.S. government for fiscal year 2007.

[8]The valuation date is January 1 for all social insurance programs except the Black Lung program, which valuation date is September 30.

[9]We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance.

- Our work to test compliance with selected provisions of significant laws and regulations in fiscal year 2008 was limited by the material weaknesses and scope limitations discussed in this report.

Significant Matters of Emphasis—The Federal Government's Response to Stabilize Financial Markets and Its Long-Term Fiscal Challenges

Before discussing our disclaimer of opinion on the accrual basis consolidated financial statements for fiscal years 2008 and 2007 and on the 2006 Statement of Social Insurance, and our unqualified opinions on the 2008 and 2007 Statements of Social Insurance, the following key items deserve emphasis in order to put the information contained in the financial statements and the Management's Discussion and Analysis section of the *2008 Financial Report of the United States Government* (*2008 Financial Report*) into context.

The unprecedented actions that the federal government is taking to restore stability to the financial markets will likely have a significant effect on the federal government's financial condition, at least in the short-term, through increased borrowing. In addition, the current recession could significantly affect the federal government's future tax revenues and the value of certain of its assets and liabilities, such as loans and loan guarantees. The ultimate effect of these actions and the recession on the federal government's financial condition are not yet known and will not be fully reflected in the consolidated financial statements and *The Budget of the United States Government* until fiscal year 2009 and beyond. For example, the federal government placed the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) into conservatorship and committed to (1) provide capital of up to $200 billion ($13.8 billion of which was recorded as a liability at September 30, 2008), (2) make short-term loans to the entities, and (3) buy mortgage-backed securities issued by the entities.[10] Also, under the Troubled Asset Relief Program (TARP)[11] established in fiscal year 2009, the federal government may purchase, up to $700 billion,[12] or insure "troubled assets". Substantial purchases have been made thus far under TARP. Further, the federal government borrowed money to increase its cash deposits at the Federal Reserve to support the Federal Reserve's market stabilization actions (as of September 30, 2008, the deposit balance was $300 billion). These and other actions that the federal government has taken to stabilize financial markets and restore the availability of credit for Americans are discussed in the Management Discussion and Analysis section of the *2008 Financial Report* and Notes 2, 4, 8, 20, and 25 of the consolidated financial statements.

[10]The Housing and Economic Recovery Act of 2008 (Pub. L. No. 110-289) authorizes the Department of the Treasury to purchase, for a limited amount of time, any amount of Fannie Mae or Freddie Mac securities, whether debt or equity.
[11]The TARP was established by the Department of the Treasury under authority provided in the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343). The Act requires the U.S. Comptroller General to report every 60 days on a variety of areas associated with oversight of TARP. For the initial 60-day report see GAO, *Troubled Asset Relief Program*, GAO-09-161 (Washington, D.C.: December 3, 2008).
[12]The $700 billion purchase limit is reduced by an amount equal to the difference between the total of the outstanding insured obligations and the balance in the Troubled Assets Insurance Financing Fund.

Currently, policymakers are understandably focused on dealing with stabilizing financial markets and stimulating the economy. However, once these issues are addressed, the nation's new and returning leaders will need to turn their attention to the serious long-term challenges of addressing the federal government's large and growing structural deficits that are driven primarily by rising health care costs and known demographic trends. As discussed in this *2008 Financial Report*, the federal government is on an unsustainable long-term fiscal path. The federal government faces increasing pressures yet a shrinking window of opportunity for phasing in adjustments.

DISCLAIMER OF OPINION ON THE ACCRUAL BASIS CONSOLIDATED FINANCIAL STATEMENTS

Because of the federal government's inability to demonstrate the reliability of significant portions of the U.S. government's accompanying accrual basis consolidated financial statements for fiscal years 2008 and 2007, principally resulting from certain material weaknesses, and other limitations on the scope of our work, described in this report, we are unable to, and we do not, express an opinion on such accrual basis consolidated financial statements.

As a result of these limitations, readers are cautioned that amounts reported in the accrual basis consolidated financial statements and related notes may not be reliable. These material weaknesses and other scope limitations also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and other financial management information—including information used to manage the federal government day to day and budget information reported by federal agencies—that is taken from the same data sources as the accrual basis consolidated financial statements.

We have not audited and do not express an opinion on the Management's Discussion and Analysis, or on Stewardship Information, Supplemental Information, or other information that is not part of the consolidated financial statements and related notes included in the *2008 Financial Report*.

As discussed in Note 21 to the consolidated financial statements, the fiscal year 2007 Balance Sheet and Statement of Operations and Changes in Net Position were both restated to correct certain earmarked activity and balances. Last year, we disclaimed an opinion on the fiscal year 2007 accrual basis consolidated financial statements due to certain material weaknesses and limitations on the scope of our work, including the material weakness related to the preparation of the consolidated financial statements. Given the material weaknesses and scope limitations discussed below, additional restatements may occur in the future.

Limitations on the Scope of Our Work

For fiscal years 2008 and 2007, there were limitations on the scope of our work in addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements. First, the Department of the Treasury

(Treasury) and the Office of Management and Budget (OMB) depend on representations from certain federal agencies to provide their representations to us regarding the U.S. government's consolidated financial statements. Treasury and OMB were unable to provide us with adequate representations regarding the U.S. government's accrual basis consolidated financial statements primarily because of insufficient representations provided to them by the Department of Defense (DOD) for fiscal years 2008 and 2007. Second, the final *2008 Financial Report* and *2007 Financial Report* were not provided in time for us to complete all of our planned audit procedures related to the compilation of these reports.

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual Basis Consolidated Financial Statements

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the accompanying accrual basis consolidated financial statements, as briefly described below. The underlying material weaknesses in internal control, which generally have existed for years, contributed to our disclaimer of opinion on the accrual basis consolidated financial statements. Appendix II describes the material weaknesses in more detail and highlights the primary effects of these material weaknesses on the accompanying accrual basis consolidated financial statements and on the management of federal government operations. The material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements were the federal government's inability to:

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by DOD, were properly reported in the accrual basis consolidated financial statements;

- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;

- support significant portions of the total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain agencies;

- adequately account for and reconcile intragovernmental activity and balances between federal agencies;

- ensure that the federal government's accrual basis consolidated financial statements were (1) consistent with the underlying audited agency financial statements, (2) properly balanced, and (3) in conformity with GAAP; and

- identify and either resolve or explain material differences between certain components of the budget deficit reported in Treasury's records, which are used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of Changes in Cash Balance from Unified Budget and Other Activities, and related amounts reported in federal agencies' financial statements and underlying financial information and records.

Due to the material weaknesses and the additional limitations on the scope of our work discussed above, there may also be additional issues that could affect the accrual basis consolidated financial statements that were not identified.

UNQUALIFIED OPINIONS ON THE STATEMENTS OF SOCIAL INSURANCE FOR 2008 AND 2007

In our opinion, the Statements of Social Insurance for 2008 and 2007 present fairly, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with GAAP. We disclaim an opinion on the 2006 Statement of Social Insurance[13] and have not audited and do not express an opinion on the Statements of Social Insurance for 2005 and 2004, and on other information related to such statements that is included in the accompanying *2008 Financial Report*.

As discussed in Note 23 to the consolidated financial statements, the Statement of Social Insurance presents the actuarial present value of the federal government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs.[14] In preparing the Statement of Social Insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the Statement of Social Insurance and the fact that such assumptions are inherently subject to substantial uncertainty (arising from the likelihood of future changes in general economic, regulatory, and market conditions, as well as other more specific future events, significant uncertainties, and contingencies), there will be differences between the estimates in the Statement of Social Insurance and the actual results, and those differences may be material. The Supplemental Information section of the *2008 Financial Report* includes unaudited information concerning how changes in various assumptions would change the present value of future estimated expenditures in excess of future estimated revenue. As discussed in that section, Medicare projections are very sensitive to changes in the health care cost growth assumption.

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[13]Beginning in fiscal year 2006, the Statement of Social Insurance became a principal financial statement and was audited as part of the applicable federal agencies' financial statements. We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. For fiscal years 2008 and 2007, we designed our audit to provide an opinion on the 2008 and 2007 consolidated Statements of Social Insurance, respectively.

[14]The projection period used for the Social Security, Medicare, and Railroad Retirement social insurance programs is 75 years. For the Black Lung program, the projections are through 2040, when the program is scheduled to terminate.

In addition to the inherent uncertainty that underlies the expenditure projections prepared for all parts of Medicare, the Supplementary Medical Insurance (SMI) Part D projections have an added uncertainty in that they were prepared using very little program experience upon which to base the estimates, and the SMI Part B projections assume significant reductions in physician payments, as required under current law, which may or may not occur. The Congress has overridden scheduled reductions in physician payments calculated for each of the last 6 years, including for 2008, and also for 2009.[15] On December 29, 2007, legislation was enacted to override scheduled reductions in payments for the first half of 2008. On July 15, 2008, the Medicare Improvements for Patients and Providers Act (MIPPA) of 2008 was enacted. Many provisions in the MIPPA affected the Medicare program including payments to providers such as physicians and managed care plans, and beneficiary improvements, such as expanded access to care, enrollment assistance, and increased coverage. It is not possible to anticipate what other actions the Congress might take, either in the near or long-term, to alter the scheduled reductions in physician payments. If scheduled reductions continue to be overridden in the future, actual SMI Part B expenditures could be materially greater than the amounts presented in the 2008 Statement of Social Insurance.

The scheduled future benefits reported in the Statement of Social Insurance are based on benefit formulas in current law. However, consistent with the respective annual Trustees Reports, the Social Security and Medicare programs are not sustainable under current financing arrangements. Also, the law concerning these programs can be changed at any time by the Congress. In fact, payment of Social Security and Medicare Hospital Insurance (Part A) benefits are limited by law to the balances in the respective trust funds. Consequently, future scheduled benefits are limited to future revenues plus existing trust fund assets. As discussed in the Supplemental Information section of the *2008 Financial Report*, the Social Security and Medicare Part A trust funds are projected to be exhausted in 2041 and 2019, respectively, at which time they will be unable to pay the full amount of scheduled future benefits. For Social Security, projected future revenues would be sufficient to pay 78 percent of scheduled benefits in 2041, the year of trust fund exhaustion, and decreasing to 75 percent of scheduled benefits in 2082. Similarly, for Medicare Part A, projected future revenues would be sufficient to pay 78 percent of scheduled benefits in 2019, the year of trust fund exhaustion, and decreasing to 30 percent of scheduled benefits in 2082.

Management's Discussion and Analysis, Supplemental Information, and other information included in the accompanying *2008 Financial Report* contain information directly related to the Statements of Social Insurance. We did not audit and do not express an opinion on this information. However, we compared the information that directly related to the Statements of Social Insurance for consistency with the Statements of Social Insurance and discussed the methods of measurement and presentation of such

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[15]The Medicare, Medicaid, and SCHIP Extension Act of 2007, Pub. L. No. 110-173, § 101(a)(1)(B), overrode the scheduled reductions for the first six months of calendar year 2008 and the Medicare Improvement for Patients and Providers Act of 2008, Pub. L. No. 110-275, § 131 (a)(1), overrode the scheduled reductions for the last six months of calendar year 2008 and all of 2009.

information with Treasury officials. Based on this limited work, we found no material inconsistencies with the Statements of Social Insurance or GAAP.

ADVERSE OPINION ON INTERNAL CONTROL

Because of the effects of the material weaknesses discussed in this report, in our opinion, the federal government did not maintain effective internal control as of September 30, 2008, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, the federal government's internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis. Our adverse opinion on internal control over financial reporting and compliance is based upon the criteria established under FMFIA.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements, which were discussed above, we found the following three other material weaknesses in internal control as of September 30, 2008. These material weaknesses are discussed in more detail in appendix III, including the primary effects of the material weaknesses on the accompanying accrual basis consolidated financial statements and on the management of federal government operations. These other material weaknesses were the federal government's inability to:

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to cost-effectively reduce improper payments,

- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and

- effectively manage its tax collection activities.

Further, we found the following significant deficiencies in internal control as of September 30, 2008, which are discussed in more detail in appendix IV. These significant deficiencies involve the following areas:

- implementing effective credit reform estimation and related financial reporting processes for loans receivable and loan guarantee liabilities at certain federal credit agencies, and

- preparing the Statement of Social Insurance for certain programs.

Due to improvements during fiscal year 2008, (1) control deficiencies related to loans receivable and loan guarantee liabilities, which were reported as a material weakness in fiscal year 2007, are reported as a significant deficiency in fiscal year 2008, and (2) the significant deficiency regarding monitoring and oversight of federal grants and the Medicare Advantage Organizations that was reported in fiscal year 2007 is no longer reported as a significant deficiency.

Individual federal agency financial statement audit reports identify additional control deficiencies, which were reported by agency auditors as either material weaknesses or significant deficiencies at the individual agency level. We do not consider these additional deficiencies to represent material weaknesses or significant deficiencies at the governmentwide level. Also, due to the issues noted throughout this report, additional material weaknesses and significant deficiencies may exist that were not identified and reported.

COMPLIANCE WITH SIGNIFICANT LAWS AND REGULATIONS

Our work to test compliance with selected provisions of significant laws and regulations related to financial reporting was limited by the material weaknesses and scope limitations discussed in this report. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on agencies' compliance with significant laws and regulations. Certain individual agency audit reports contain instances of noncompliance. None of these instances were deemed to be reportable noncompliances with regard to the accompanying consolidated financial statements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with significant laws and regulations.

AGENCY FINANCIAL MANAGEMENT SYSTEMS

To achieve the financial management improvements envisioned by Congress when enacting the CFO Act and FFMIA, federal agencies need to modernize their financial management systems to generate reliable, useful, and timely financial and performance information throughout the year as well as at year-end. The size and complexity of the federal government and the long-standing nature of its financial management systems weaknesses continue to present a formidable management challenge in providing accountability to the nation's taxpayers.

FFMIA requires auditors, as part of the 24 CFO Act agencies' financial statement audits, to report whether those agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's Standard General Ledger at the transaction level. For fiscal years 2008 and 2007, auditors for 14 and 13 of the 24 CFO Act agencies, respectively, reported that the agencies' financial management systems did not substantially comply with one or more of these three FFMIA requirements. Agency heads for the 24 CFO Act agencies also annually report on FFMIA compliance. A fewer number of agency heads (9 in 2008 and 10 in 2007) reported that their agencies' systems were not in substantial compliance with one or more of the three FFMIA requirements. In our report on fiscal year 2000 FFMIA results,[16] we first recommended additional OMB guidance be provided to clarify the meaning of substantial compliance to address these inconsistencies, and have reiterated this recommendation thereafter. We noted that OMB started taking action in our most recent FFMIA report on fiscal year 2007 results,[17] and we will continue to work with OMB on this issue. According to many of the agency auditors' reports, serious financial management systems problems remain. As a result, federal agencies' financial management systems are unable to routinely produce reliable, useful, and timely financial information, which hampers the federal government's ability to effectively administer and oversee its major programs.

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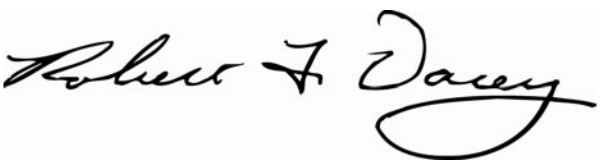
We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.



Robert F. Dacey
Chief Accountant
U. S. Government Accountability Office

December 9, 2008

[16]GAO, *Financial Management: FFMIA Implementation Critical for Federal Accountability*, GAO-02-29 (Washington, D.C.: Oct. 1, 2001).
[17]GAO, *Financial Management: Persistent Financial Management System Issues Remain for Many CFO Act Agencies*, GAO-08-1018 (Washington, D.C.: Sept. 30, 2008).

APPENDIX I

Objectives, Scope, and Methodology

The Government Management Reform Act of 1994 expanded the requirements of the Chief Financial Officers (CFO) Act of 1990 by making the inspectors general of 24 major federal agencies[18] responsible for annual audits of agencywide financial statements prepared by these agencies and GAO responsible for the audit of the U.S. government's consolidated financial statements. The Accountability of Tax Dollars (ATD) Act of 2002[19] requires most other executive branch agencies to prepare and have audited annual financial statements. The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 35 agencies[20] that are significant to the U.S. government's consolidated financial statements. Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 agencies to achieve our joint audit objectives. Our audit approach regarding the accrual basis consolidated financial statements focused primarily on determining the current status of the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements and the other material weaknesses affecting internal control that we had previously reported in our report on the consolidated financial statements for fiscal year 2007.[21] Our work included separately auditing the financial statements of the following significant federal agencies and federal agency components:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2008 and 2007 financial statements.[22] In fiscal years 2008 and 2007, IRS collected about $2.7 trillion in tax payments each year and paid about $426 billion and $292 billion, respectively, in refunds and economic stimulus rebates to taxpayers.[23] For fiscal year 2008, we continued to report material weaknesses that resulted in ineffective internal control. We also reported a significant deficiency. Our tests of IRS's compliance with selected provisions of significant laws and regulations disclosed one area of noncompliance. We also found that IRS's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996.

[18]31 U.S.C. 901(b), 3521(e). The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. 31 U.S.C. 3515(c).
[19]Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002); see 31 U.S.C. 3515.
[20]See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 agencies.
[21]For our report on the U.S. government's consolidated financial statements for fiscal year 2007, see U.S. Department of the Treasury, *Fiscal Year 2007 Financial Report of the United States Government* (Washington, D.C.: Dec. 2007), pp. 159-182, which can be found on GAO's Internet site at www.gao.gov.
[22]GAO, *Financial Audit: IRS's Fiscal Years 2008 and 2007 Financial Statements*, GAO-09-119 (Washington, D.C.: Nov. 10, 2008).
[23]The Economic Stimulus Act of 2008, Pub. L. No. 110-185, §101, 122 Stat. 613, 613-17 (Feb.13, 2008) (*codified at* 26 U.S.C. § 6428), included provisions to help stimulate the economy, such as the 2008 disbursement to eligible taxpayers of recovery rebates (i.e. tax refunds) of up to $600 for individuals and $1,200 for couples, with an additional $300 for each child. Pursuant to the act, IRS disbursed refunds totaling about $94 billion, or about 22 percent of all refunds disbursed by IRS during fiscal year 2008.

- We audited and expressed an unqualified opinion on the Schedules of Federal Debt managed by Treasury's Bureau of the Public Debt (BPD) for the fiscal years ended September 30, 2008 and 2007.[24] For these 2 fiscal years, the schedules reported (1) approximately $5.8 trillion (2008) and $5.0 trillion (2007) of federal debt held by the public;[25] (2) about $4.2 trillion (2008) and $3.9 trillion (2007) of intragovernmental debt holdings;[26] and (3) about $242 billion (2008) and $239 billion (2007) of interest on federal debt held by the public. We reported that as of September 30, 2008, BPD had effective internal control over financial reporting and compliance with laws and regulations relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable BPD noncompliance in fiscal year 2008 with a selected provision of law we tested.

- We audited and expressed unqualified opinions on the fiscal years 2008 and 2007 financial statements of the United States Securities and Exchange Commission (SEC).[27] For fiscal year 2008, we reported that although certain internal controls could be improved, SEC had effective internal control over financial reporting, including safeguarding of assets, and compliance with laws and regulations. We also reported three significant deficiencies in internal control. Further, we reported that there was no reportable noncompliance with selected provisions of laws and regulations we tested.

- We audited and expressed unqualified opinions on the December 31, 2007 and 2006, financial statements of the funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Deposit Insurance Fund (DIF) and the FSLIC Resolution Fund.[28] We reported that as of December 31, 2007, FDIC had effective internal control over financial reporting and compliance with significant laws and regulations.

In addition, we considered the CFO Act agencies' and certain other federal agencies' fiscal years 2008 and 2007 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. Financial statements and audit reports for these agencies provide information about the operations of each of these entities. The agency audit reports also contain details regarding any audit findings and related recommendations for the respective entity. We did not audit, and we do not express an opinion on, any of these individual federal agency financial statements.

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[24]GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2008 and 2007 Schedules of Federal Debt*, GAO-09-44 (Washington, D.C.: Nov. 7, 2008).
[25]The public holding federal debt is comprised of individuals, corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks.
[26]Intragovernmental debt holdings represent federal debt issued by Treasury and held by certain federal government accounts such as the Social Security and Medicare trust funds.
[27]GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2008 and 2007*, GAO-09-173 (Washington, D.C.: Nov. 14, 2008).
[28]GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2007 and 2006 Financial Statements*, GAO-08-416 (Washington, D.C.: Feb. 11, 2008).

We considered the Department of Defense’s (DOD) assertion that DOD management prepared and submitted pursuant to the provisions of the National Defense Authorization Act for Fiscal Year 2002.[29] In accordance with section 1008 of this act, DOD reported that certain major deficiencies related to noncompliant systems and noncompliant processes continued to impact the department’s ability to prepare reliable financial statements. In addition, DOD refers to its ongoing efforts to address related material weaknesses reported by the DOD Inspector General. In the DOD Inspector General’s fiscal year 2008 report on internal control over financial reporting, the Inspector General cited material weaknesses in several areas including (1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; (4) intragovernmental eliminations; and (5) material amounts of unsupported accounting entries needed to prepare DOD’s annual consolidated financial statements.

Because of the significance of the amounts included in the Statement of Social Insurance related to the Social Security Administration (SSA) and the Department of Health and Human Services (HHS), our audit approach regarding the Statement of Social Insurance focused primarily on these two agencies. For each federal agency preparing a Statement of Social Insurance,[30] we considered the agencies’ fiscal years 2008 and 2007 financial statements and the related auditors’ reports prepared by the inspectors general or contracted independent public accountants. We performed sufficient audit work, including internal control and substantive audit procedures, reperformance procedures, and review of the other auditors’ Statement of Social Insurance-related audit work, to support our opinions on the 2008 and 2007 Statements of Social Insurance.

We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and compliance with selected provisions of significant laws and regulations. We considered the limitations on the scope of our work regarding the accrual basis consolidated financial statements in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

[29]Pub. L. No. 107-107, §1008, 115 Stat. 1012, 1204 (Dec. 28, 2001).
[30]These agencies include SSA, HHS, the Railroad Retirement Board, and the Department of Labor.

APPENDIX II

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual Basis Consolidated Financial Statements

The continuing material weaknesses discussed below contributed to our disclaimer of opinion on the federal government's accrual basis consolidated financial statements. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying accrual basis consolidated financial statements, as described below.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that property, plant, and equipment (PP&E) and inventories and related property were properly reported in the accrual basis consolidated financial statements. Most of the PP&E and inventories and related property are the responsibility of DOD. As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued deficiencies in internal control procedures and processes related to PP&E.

Deficiencies in internal control over assets could affect the federal government's ability to fully know the assets it owns, including their location and condition, and its ability to effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets and reliably report asset balances; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including any related to treaties and other international agreements entered into to further the federal government's interests, were complete and properly reported.

Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, deficiencies in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as adversely affect the federal government's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, if disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.

Cost of Government Operations and Disbursement Activity

The previously discussed material weaknesses in reporting assets and liabilities, material weaknesses in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD.

With respect to disbursements, DOD and certain other federal agencies reported continued control deficiencies in reconciling disbursement activity. For fiscal years 2008 and 2007, there was unreconciled disbursement activity, including unreconciled differences between federal agencies' and Treasury's records of disbursements and unsupported federal agency adjustments, totaling billions of dollars, which could also affect the balance sheet.

Unreliable cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required. If disbursements are improperly recorded, this could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in *The Budget of the United States Government* (President's Budget) concerning obligations and outlays.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

Federal agencies are unable to adequately account for and reconcile intragovernmental activity and balances. OMB and Treasury require the chief financial officers (CFO) of 35 executive departments and agencies to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these agencies are required to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts as of the end of the fiscal year.

A substantial number of the agencies did not adequately perform the required reconciliations for fiscal years 2008 and 2007. For these fiscal years, based on trading partner information provided to Treasury through agencies' closing packages, Treasury produced a "Material Difference Report" for each agency showing amounts for certain intragovernmental activity and balances that significantly differed from those of its corresponding trading partners as of the end of the fiscal year. Based on our analysis of the "Material Difference Reports" for fiscal year 2008, we noted that a significant number of CFOs were unable to adequately explain the differences with their trading partners or did not provide adequate documentation to support responses on the CFO Representations. For both fiscal years 2008 and 2007, amounts reported by federal agency trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, a significant number of CFOs cited differing accounting methodologies, accounting errors, and timing differences for their material differences with their trading partners. Some CFOs simply indicated that they were unable to explain the differences with their trading partners with no indication when the differences will be resolved. As a result of the above, the federal government's ability to determine the impact of these differences on the amounts reported in the consolidated financial statements is significantly impaired.

In 2006, OMB issued Memorandum No. M-07-03, *Business Rules for Intragovernmental Transactions* (Nov. 13, 2006), and Treasury issued the Treasury Financial Manual Bulletin No. 2007-03, *Intragovernmental Business Rules* (Nov. 15, 2006). This guidance added criteria for resolving intragovernmental disputes and major differences between trading partners for certain intragovernmental transactions and called for the establishment of an Intragovernmental Dispute Resolution Committee. OMB is currently working with the Chief Financial Officers Council to create the Intragovernmental Dispute Resolution Committee.[31] OMB is also using a "Watch List" that lists federal agencies with large intragovernmental imbalances. The Watch List was developed to facilitate reductions in some of the largest intragovernmental imbalances, bring federal agency reporting into alignment with the Intragovernmental Business Rules, bring the appropriate representatives together from the respective agencies, and document the issues and resolutions.

Treasury is also taking steps to help resolve material differences in intragovernmental activity and balances. For example, Treasury is requiring federal agencies to provide documentation on how and when agencies are resolving certain of their unresolved material differences. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal agency leadership to fully implement the required business rules and continued strong leadership by OMB and Treasury.

Preparation of Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2008, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). In addition, as discussed in our scope limitation section of this report, the final *2008 Financial Report* was not provided in time for us to complete

[31]The U.S. Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies and senior officials of OMB and Treasury who work collaboratively to improve financial management in the U.S. Government.

all of our planned audit procedures related to its compilation. During our fiscal year 2008 audit, we found the following:[32]

- Treasury's process for compiling the consolidated financial statements demonstrated that amounts in the Statement of Social Insurance were consistent with the underlying federal agencies' audited financial statements and that the Balance Sheet and the Statement of Net Cost were also consistent with federal agencies' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process did not ensure that the information in the remaining three principal financial statements were fully consistent with the underlying information in federal agencies' audited financial statements and other financial data.

- At the federal agency level, for fiscal year 2008, auditors for many of the CFO Act agencies reported significant deficiencies regarding agencies' financial reporting processes which, in turn, could affect the preparation of the consolidated financial statements. For example, auditors for several agencies reported that a significant number of adjustments were required to prepare the agencies' financial statements. These and other auditors are also required to separately audit financial information sent by the federal agencies to Treasury through a closing package. In connection with preparing the consolidated financial statements, several auditors reported significant deficiencies regarding the preparation of the closing package and Treasury had to record material adjustments to correct errors found in agencies' audited closing package information.

- To make the fiscal years 2008 and 2007 consolidated financial statements balance, Treasury recorded a net increase of $29.8 billion and a net decrease of $6.7 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Unmatched transactions and balances."[33] An additional net $11 billion and $2.5 billion of unmatched transactions were recorded in the Statement of Net Cost for fiscal years 2008 and 2007, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.

- The federal government could not demonstrate that it had fully identified and reported all items needed to reconcile the operating results, which for fiscal year 2008 showed a net operating cost of $1,009.1 billion, to the budget results, which for the same period showed a unified budget deficit of $454.8 billion.

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[32]Most of the issues we identified in fiscal year 2008 existed in fiscal year 2007, and many have existed for a number of years. In June 2008, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Financial Audit: Material Weaknesses in Internal Control over the Processes Used to Prepare the Consolidated Financial Statements of the U.S. Government*, GAO-08-748 (Washington, D.C.: June 17, 2008).
[33]Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to net operating cost, it reported this amount as a component of net operating cost in the accompanying consolidated financial statements.

- The federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the accrual basis consolidated financial statements. Treasury's elimination of certain intragovernmental activity and balances continues to be impaired by the federal agencies' problems in handling their intragovernmental transactions. As a result, Treasury recorded the net differences in intragovernmental elimination entries as "Unmatched transactions and balances," in order to force the Statements of Operations and Changes in Net Position into balance. As previously discussed, amounts reported for federal agency trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, there are hundreds of billions of dollars of unreconciled differences between the General Fund and federal agencies related to appropriation and other intragovernmental transactions. The ability to reconcile such transactions is hampered because only some of the General Fund is reported in the Department of the Treasury's financial statements.

- Over the past several years, significant actions have been taken to assist in ensuring that financial information required by GAAP is disclosed in the consolidated financial statements. However, Treasury's reporting of certain financial information required by GAAP continues to be impaired. Due to certain material weaknesses noted in this report, for example, commitments and contingencies related to treaties and other international agreements, Treasury is precluded from determining if additional disclosure is required by GAAP in the consolidated financial statements, and we are precluded from determining if the omitted information is material. Further, Treasury's ability to report information in accordance with GAAP will also remain impaired until federal agencies, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, as we have reported in past years, there continue to be undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence that the excluded financial information was immaterial.

- Other internal control deficiencies existed in Treasury's process for preparing the consolidated financial statements, involving inadequate or ineffective (1) policies and procedures, (2) reviews of the financial statements and supporting documentation provided to GAO, and (3) processes for monitoring the preparation of the consolidated financial statements.

- As in previous years, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2008 financial reporting challenges it faced, such as control deficiencies in its process for preparing the consolidated financial statements noted above. We found that personnel at Treasury's Financial Management Service had excessive workloads that required an extraordinary amount of effort and dedication to compile the consolidated financial statements; however, there were not enough personnel with specialized financial reporting experience to help ensure reliable financial reporting by the reporting date. In addition, the federal government does not perform interim compilations at the governmentwide level, which leads to almost all of the compilation effort being performed during a condensed time period at the end of the year.

During fiscal year 2008, Treasury, in coordination with OMB, continued implementing corrective action plans and made progress in addressing certain internal control deficiencies we have previously reported. Until the internal control deficiencies have been fully addressed, the federal government's ability to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, properly balanced, and in conformity with GAAP will be impaired. Resolving some of these internal control deficiencies will be a difficult challenge and will require a strong commitment from Treasury and OMB as they continue to implement their corrective action plans.

Components of the Budget Deficit

Both the Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget and Other Activities report a unified budget deficit for fiscal years 2008 and 2007 of $454.8 billion and $162.8 billion, respectively.[34] The budget deficit is calculated by subtracting actual budget outlays (outlays) from actual budget receipts (receipts).

For several years, we have been reporting material unreconciled differences between the total net outlays reported in selected federal agencies' Statement of Budgetary Resources (SBR) and Treasury's central accounting records used to compute the budget deficit[35] reported in the consolidated financial statements. OMB and Treasury have continued to work with federal agencies to reduce these material unreconciled differences. Such efforts have resulted in significantly reducing the net outlay differences in fiscal year 2008. However, billions of dollars of differences still exist in this and other components of the deficit because the federal government does not have effective processes and procedures for identifying, resolving, and explaining material differences in the components of the deficit between Treasury's central accounting records and information reported in agency financial statements and underlying agency financial information and records. Until these differences are timely reconciled by the federal government, their effect on the accrual basis consolidated financial statements will be unknown.

[34]The budget deficit, receipts, and outlays amounts are reported in Treasury's *Monthly Treasury Statement* and the President's Budget.

[35]See GAO's audit report on its audit of the federal government's fiscal year 2007 financial statements that was incorporated in the *2007 Financial Report of the U.S. Government* published by Treasury. Also, see GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

In fiscal year 2008, we again noted that several agencies' auditors reported internal control deficiencies (1) affecting the agencies' SBRs, and (2) relating to monitoring, accounting, and reporting of budgetary transactions. These control deficiencies could affect the reporting and calculation of the net outlay amounts in the agencies' SBRs. In addition, such deficiencies may also affect the agencies' ability to report reliable budgetary information to Treasury and OMB and may affect the unified budget deficit reported in the accrual basis consolidated financial statements. The unified budget deficit is also reported in Treasury's *Combined Statement of Receipts, Outlays, and Balances*,[36] and in other federal government publications.

[36]Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on agency reporting.

APPENDIX III

Other Material Weaknesses

The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2008. In addition to the material weaknesses discussed in appendix II that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements, we found the following three other material weaknesses in internal control.

Improper Payments

While the federal government, under OMB's leadership, has made significant progress in increasing the number of programs that reported estimates of improper payments, the federal government did not have effective internal controls to determine the full extent to which improper payments occur and to reasonably assure that appropriate actions are taken to cost-effectively reduce improper payments as intended by the Improper Payments Information Act of 2002 (IPIA).[37] Reported federal agencies' estimates of improper payments, based on available information, totaled about $72 billion for fiscal year 2008, which represented about 4 percent of $1.8 trillion of reported outlays for the related programs. The increase from the prior year estimate of $49 billion[38] was primarily attributable to (1) a $5.7 billion increase in the Medicaid program's estimate which now encompasses each of its three components—fee-for-service, managed care, and eligibility; and (2) ten newly reported programs with improper payment estimates totaling about $10 billion. We view these efforts as a positive step to improve transparency over the full magnitude of improper payments.

However, we noted continuing weaknesses related to the federal government's ability to determine the full extent of improper payments, including 2 agencies that had not reported improper payment estimates for 6 risk-susceptible federal programs with total program outlays of about $50 billion (primarily Medicare Part D) for fiscal year 2008 and programs for which risk assessments (to identify the potential risk of improper payments)

[37]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002). The IPIA requires federal executive branch agencies to review all programs and activities, identify those that may be susceptible to significant improper payments, estimate and report the annual amount of improper payments for those programs, and implement actions to cost-effectively reduce improper payments.

[38]In their fiscal year 2008 Performance and Accountability Reports (PAR), selected federal agencies updated their fiscal year 2007 improper payment estimates to reflect changes since issuance of their fiscal year 2007 PARs. These updates decreased the governmentwide improper payment estimate for fiscal year 2007 from $55 billion to $49 billion, primarily because the Department of Health and Human Services (HHS) updated Medicaid's improper payment estimate for fiscal 2007 from $12.9 billion (or 18.45 percent error rate) to about $6.6 billion (or 4.7 percent error rate), a $6.3 billion decrease (or 13.75 percent error rate decrease). HHS reported in its fiscal year 2008 PAR that the $12.9 billion estimate for fiscal year 2007 was preliminary based on two quarters (or six months) of fiscal year 2006 claim payments. In fiscal year 2008, HHS completed its review of fiscal year 2006 claim payments and derived a significantly lower error rate of 4.7 percent or $6.6 billion for fiscal year 2007.

have either not yet been performed or have not been recently updated. In addition, agency auditors reported internal control and systems deficiencies related to (1) testing of payment transactions for improper payments, (2) development of corrective action plans to reduce improper payments, and (3) recovery of improper payments. Also, agency auditors reported a number of control deficiencies that could allow improper payments to occur. For example, in the Department of Transportation's fiscal year *2008 Performance and Accountability Report*, the Office of Inspector General reported that its audits and investigations continue to find oversight and control deficiencies, fraud and abuse, and other ethics issues involving agency officials and contractors, including schemes related to bribery and kickbacks, bid rigging, and over-billing of labor and materials. Also, at the Department of Health and Human Services, the auditor reported control deficiencies related to preventing and detecting errors in Medicare payments. Further, as reported improper payment estimates are not required to be audited, such estimates may not be reliable. Until the federal government has implemented effective controls to determine the full extent to which improper payments occur and to reasonably assure that appropriate actions are taken to cost-effectively reduce improper payments, including making any necessary policy changes, the federal government will not have reasonable assurance that the use of taxpayer funds is adequately safeguarded.

Information Security

Although progress has been made, serious and widespread information security control deficiencies continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. During fiscal year 2008, federal agencies did not consistently implement effective controls to prevent, limit, or detect unauthorized access to computing resources. Specifically, agencies did not always (1) protect information system boundaries; (2) utilize identification and authentication mechanisms; (3) protect sensitive system resources; (4) use audit and monitoring capability, including incident handling; and (5) restrict physical access to information assets. In addition, agencies did not consistently configure network devices and services to prevent unauthorized access and ensure system integrity, such as patching key servers and workstations, in a timely manner; assign incompatible duties to different individuals or groups so that one individual does not control all aspects of a process or transaction; and maintain or test continuity of operations plans for key information systems.

Such information security control deficiencies unnecessarily increase the risk that the reliability and availability of data that are recorded in or transmitted by federal financial management systems could be compromised. A primary reason for these control deficiencies is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control deficiencies, resolving information security problems, and managing information security risks on an ongoing basis. The administration has taken important actions to improve information security, such as issuing extensive guidance on information security and requiring agencies to perform specific actions to protect certain personally identifiable information. However, until agencies effectively and fully implement agencywide information security programs, federal data and systems, including financial information, will remain at risk.

Tax Collection Activities

During fiscal year 2008, material weaknesses and systems deficiencies continued to affect the federal government's ability to effectively manage its tax collection activities. Due to errors and delays in recording taxpayer information, payments, and other activities, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden by causing frustration to taxpayers who either have already paid taxes owed or who owe significantly lower amounts. In addition, deficiencies in control over tax revenue and refunds continue to hamper the federal government's ability to optimize the use of its limited resources to collect unpaid taxes and minimize payment of improper refunds. These control deficiencies are due to the federal government's (1) lack of cost benefit information, and (2) not having fully established and implemented a systematic process for ensuring it is using its resources to maximize its ability to collect what is owed and minimize the disbursements of improper tax refunds. These deficiencies can significantly affect the level of enforcement tax revenue collected and improper refunds disbursed. As a result, the federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.

APPENDIX IV

Significant Deficiencies

In addition to the material weaknesses discussed in appendices II and III, we found two significant deficiencies in internal control described below. In fiscal year 2007, we reported a significant deficiency in monitoring and oversight of federal grants and the Medicare Advantage Organizations. In fiscal year 2008, sufficient improvements were made. Consequently, we no longer consider this area a significant deficiency.

Loans Receivable and Loan Guarantee Liabilities

Federal agencies accounting for the majority of the reported balances for direct loans and loan guarantee liabilities continued to have internal control deficiencies related to their credit reform estimation and related financial reporting processes. However, due to improvements during fiscal year 2008 at the Department of Agriculture and certain of the federal credit agencies, we removed this area from the list of material weaknesses contributing to our disclaimer of opinion 0and consider the remaining control deficiencies to be a significant deficiency. Nevertheless, these issues and the complexities associated with estimating the costs of lending activities significantly increase the risk that misstatements in agency and governmentwide financial statements could occur and go undetected. Further, these control deficiencies can adversely affect the federal government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.

Preparation of the Statement of Social Insurance

Deficiencies were identified in certain controls over spreadsheets used by the Department of Health and Human Services (HHS) to prepare its Statement of Social Insurance, including the lack of robust automated controls over spreadsheet changes that may result in output that varies from management's intentions. HHS contributes the majority of the amounts reported on the consolidated Statement of Social Insurance. Such control deficiencies could result in misstatements to the consolidated Statement of Social Insurance.

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