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FINANCIAL
MANAGEMENT

Federal Financial
Management
Improvement Act
Results for Fiscal Year
1997



**Comptroller General
of the United States**

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September 30, 1998

The Honorable Fred Thompson
Chairman
The Honorable John Glenn
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable Dan Burton
Chairman
The Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform and Oversight
House of Representatives

The inability of many federal agencies to accurately record and report financial management data on both a year-end and interim basis for decision-making purposes has been a serious, longstanding weakness. To help improve federal accounting practices and increase the government's ability to routinely provide reliable financial management information, the Congress enacted the Federal Financial Management Improvement Act (FFMIA) of 1996, Public Law 104-208. Under FFMIA, beginning with the fiscal year ended September 30, 1997, auditors for each of the 24 major departments and agencies named in the Chief Financial Officers (CFO) Act¹ (referred to as CFO agencies) must report whether the agencies' financial management systems comply substantially with three requirements—(1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the U. S. Government Standard General Ledger (SGL)² at the transaction level. Agencies with systems not in substantial compliance with the requirements must prepare remediation plans to bring their systems into substantial compliance, generally within 3 years.³

¹FFMIA also applies to agency components required to be audited under 31 U.S.C. 3521(e). Because this is the first year of FFMIA reporting for the 24 CFO agencies and most agencies issued consolidated audit reports for fiscal year 1997, we focused our review at the agency level. Appendix I contains a list of the 24 CFO agencies and components designated by the Office of Management and Budget for fiscal year 1997.

²The SGL provides a standard chart of accounts and standardized transactions that agencies are to use in all their financial systems.

³If the agency's financial management systems are so deficient that substantial compliance cannot be reached within 3 years, the remediation plan must specify the most feasible date by which the agency will achieve compliance and designate an official responsible for effecting the necessary corrective actions.

To aid congressional oversight and keep the Congress advised on the status of federal financial management, the General Accounting Office (GAO) is required annually to report on FFMIA implementation by October 1. Specifically, our report is to summarize information concerning (1) compliance with FFMIA's requirements, including whether the CFO agencies' financial statements have been prepared in accordance with applicable accounting standards and (2) the adequacy of applicable accounting standards for the federal government.

Results in Brief

In their fiscal year 1997 audit reports, auditors for 19 of 23⁴ CFO agencies reported that the agencies' financial systems did not comply substantially with FFMIA's requirements, primarily due to noncompliance with systems requirements. Auditors reported that the financial systems of 9 of those 19 agencies, including the Departments of Defense, Treasury, and Labor, were noncompliant with all three FFMIA requirements. The serious problems described in the auditors' reports limit the reliability, usefulness, and timeliness of financial information needed to effectively manage government operations. For many agencies, the preparation of financial statements requires considerable reliance on ad hoc programming and analysis of data produced by inadequate financial systems that are not integrated, reconciled, and often require significant adjustments. Therefore, it will take time and concerted effort to raise government financial management systems to the level of quality and reliability envisioned in FFMIA.

Our first-ever audit of the governmentwide consolidated financial statements⁵ indicates that many agencies' financial statements are not yet meeting applicable accounting standards. We were unable to render an opinion on the fiscal year 1997 consolidated financial statements for the government due to significant financial systems weaknesses, problems with fundamental recordkeeping, incomplete documentation, and weak internal controls, including computer controls. Of the 23 CFO agencies for which audit reports have been issued as of August 28, 1998, 10 received unqualified opinions on their fiscal year 1997 financial statements. An additional three agencies received unqualified opinions on statements

⁴The statutory reporting deadline for audit reports discussing the results of the fiscal year 1997 financial statement audits for the CFO agencies was March 1, 1998. As of August 28, the auditor for one agency—Department of State—has not issued its fiscal year 1997 audit report. The agency's auditor indicated that it plans to report that the agency's financial systems did not comply substantially with FFMIA's requirements.

⁵Financial Audit: 1997 Consolidated Financial Statements of the United States Government (GAO/AIMD-98-127, March 31, 1998).

covering portions of their operations.⁶ The remaining 10 agencies received either qualified opinions or disclaimers of opinion.⁷ Agencies generally recognize the extent and severity of their financial management deficiencies, and there are several efforts underway to address these problems across government.

The Federal Accounting Standards Advisory Board (FASAB) has successfully developed a set of accounting standards. FASAB has recommended, and the Office of Management and Budget (OMB) and GAO have issued, two statements of accounting concepts and nine statements of accounting standards tailored to the federal government's unique characteristics and special needs. FASAB is also considering additional accounting matters relevant to financial statements for the federal government, including accounting and reporting for social insurance entitlement programs.⁸

Agencies' efforts to improve financial management are challenged by implementing new accounting standards and updating financial management systems. Several agencies have expressed concerns regarding their ability to effectively implement the accounting requirements,⁹ which became effective in fiscal year 1998. In addition, as the CFO agencies move toward a more effective system of financial management, a significant challenge is the poor status of financial management systems, which were not designed to meet current accounting standards and system requirements.

Further, agencies' progress in implementing new accounting standards and improving reported financial management weaknesses will be affected by competing demands associated with Year 2000 computer conversion

⁶Consolidated agencywide financial statements were not issued for the Office of Personnel Management (OPM) and the Federal Emergency Management Agency (FEMA). Instead, OPM received five opinions, two unqualified and three disclaimers of opinion. In addition, FEMA prepared combined financial statements covering a portion of its operations and received an unqualified opinion. Also, the Department of the Treasury received two opinions, an unqualified opinion on its administrative financial statements and a qualified opinion on its custodial financial statements.

⁷Auditors issue qualified opinions when the financial statements are presented fairly, with exceptions that are specifically disclosed and described. The issuance of a qualified opinion indicates either a departure from the standards or a limitation of audit scope. Disclaimers of opinion are rendered when auditors cannot satisfy themselves as to whether the financial statements are presented fairly.

⁸Social insurance entitlement programs include Medicare, Social Security, and Black Lung Disability.

⁹Some of the new requirements, which were issued in 1995 and 1996, include the application of managerial cost accounting concepts and preparation of the new Statements of Financing and Budgetary Resources.

issues.¹⁰ Agencies are necessarily making Year 2000 compliance a priority, and longer term efforts to address financial management systems are expected to be delayed.

Background

The overall purpose of FFMIA is to ensure that agency financial management systems provide timely, uniform, reliable, and thus more useful financial information. With such information, government leaders will be better positioned to invest scarce resources, reduce costs, oversee programs, and hold agency managers accountable for the way they run government programs. Compliance with federal financial management systems requirements, applicable accounting standards, and the SGL are all necessary to help achieve these goals.

Financial Management System Requirements

The financial management systems policies and standards prescribed for executive agencies to follow in developing, operating, evaluating, and reporting on financial management systems are defined in OMB Circular A-127, Financial Management Systems, which was revised in July 1993. Circular A-127 references the series of publications, entitled Federal Financial Management Systems Requirements, issued by the Joint Financial Management Improvement Program (JFMIP),¹¹ as the primary source of governmentwide requirements for financial management systems. Table 1 lists the publications in the Federal Financial Management System Requirements Series and their issue dates.¹²

¹⁰For the past several decades, information systems have typically used two digits to represent the year, such as "98" for 1998, to conserve electronic data storage and reduce operating costs. In this format, however, 2000 is indistinguishable from 1900 because both are represented as "00." As a result, computer systems or applications that use dates or perform date- or time-sensitive calculations may, if not modified, generate incorrect results beyond 1999.

¹¹JFMIP is a cooperative undertaking of OMB, Treasury, OPM, and GAO working with operating agencies to improve financial management practices throughout the government. The program was initiated in 1948 and was given statutory authorization in the Budget and Accounting Procedures Act of 1950 (31 U.S.C. 3511 (d)).

¹²JFMIP is in the process of updating some of these requirements.

Table 1: Publications in the Federal Financial Management System Requirements Series

Federal Financial Management System Requirements (FFMSR) document	Issue date
FFMSR-0 <u>Framework for Federal Financial Management Systems</u>	January 1995
FFMSR-1 <u>Core Financial System Requirements</u>	September 1995
FFMSR-2 <u>Personnel/Payroll System Requirements</u>	May 1990
FFMSR-3 <u>Travel System Requirements</u>	January 1991
FFMSR-4 <u>Seized/Forfeited Asset System Requirements</u>	March 1993
FFMSR-5 <u>Direct Loan System Requirements</u>	December 1993
FFMSR-6 <u>Guaranteed Loan System Requirements</u>	December 1993
FFMSR-7 <u>Inventory System Requirements</u>	June 1995
FFMSR-8 <u>Managerial Cost Accounting System Requirements</u>	February 1998

Federal Accounting Standards

Federal accounting standards, which agency CFOs use in preparing financial statements and in developing financial management systems, are recommended by FASAB.¹³ FASAB recommends accounting standards after considering the financial and budgetary information needs of the Congress, executive agencies, other users of federal financial information, and comments from the public. The Secretary of the Treasury, the Director of OMB, and the Comptroller General then decide whether to adopt the recommended standards. If they do, the standards are published by OMB and GAO and go into effect. This process has resulted in the issuance of two statements of accounting concepts and nine statements of accounting standards.

The Accounting and Auditing Policy Committee¹⁴ (AAPC) assists in resolving issues related to the implementation of accounting standards. AAPC's efforts result in authoritative guidance for preparers and auditors of federal financial statements in connection with implementation of accounting and auditing standards as well as the reporting and auditing

¹³In October 1990, the Secretary of the Treasury, the Director of OMB, and the Comptroller General established FASAB to recommend a set of generally accepted accounting standards for the federal government. FASAB's mission is to recommend reporting concepts and accounting standards that provide federal agencies' financial reports with understandable, relevant, and consistent information about the financial position, activities, and results of operations of the U.S. government and its components.

¹⁴In 1997, FASAB in conjunction with OMB, Treasury, GAO, the CFO Council, and the President's Council on Integrity and Efficiency, established AAPC. AAPC's mission is to assist the federal government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues within the framework of existing authoritative literature. AAPC serves as a permanent committee sponsored by FASAB.

requirements contained in OMB's form and content and audit bulletins.¹⁵ To date, AAPC has recommended and OMB has issued two technical releases.

The Standard General Ledger

The SGL provides a uniform chart of accounts and pro forma transactions used to standardize federal agencies' financial information accumulation and processing, enhance financial control, and support budget and external reporting, including financial statement preparation. Use of the SGL improves data stewardship throughout the government, enabling consistent reporting at all levels within the agencies and providing comparable data and financial analysis at the governmentwide level. SGL guidance is published in the Treasury Financial Manual. Treasury's Financial Management Service (FMS) is responsible for maintaining the SGL and answering agency inquiries.

Scope and Methodology

In performing our work, we reviewed fiscal year 1997 audit results for the 23 CFO agencies that have issued audited financial statements as of August 28, 1998, and for the governmentwide consolidated financial statements which we audited. We also reviewed OMB's implementation guidance for FFMA and OMB's 1998 Federal Financial Management Status Report & Five-Year Plan. We did not independently verify or test the reliability of the data in OMB's report. Further, we reviewed applicable federal accounting standards. We also interviewed agency management and auditors of the 24 CFO agencies to obtain their views on FFMA implementation. We conducted our work from July through August 1998 at the 24 CFO agencies and OMB in Washington, D.C. in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Acting Director of OMB and the Commissioner of FMS or their designees. The Deputy Controller of OMB's Office of Federal Financial Management provided us with written comments and the Commissioner of FMS provided us with oral comments. These comments are discussed in the "Agency Comments" section, and OMB's comments are reprinted in appendix III.

Fiscal Year 1997 Results

The majority of federal agencies' financial management systems do not meet current accounting standards and systems requirements and cannot, as currently operated, provide uniform and reliable financial information for managing government operations. Audit reports for fiscal year 1997

¹⁵OMB Bulletin 97-01, Form and Content of Agency Financial Statements, and OMB Bulletin 98-08, Audit Requirements for Federal Financial Statements.

agency financial statements disclosed the continuing problems agencies are experiencing with their financial management systems.

In their fiscal year 1997 audit reports, auditors for 19 of 23 CFO agencies reported that the agencies' financial systems did not substantially comply with FFMIAs requirements. Auditors for these 19 agencies reported noncompliance in the area of systems requirements, and auditors for 12 of the 19 agencies also reported noncompliance in the area of accounting standards. In addition, auditors for nine agencies reported that the agencies' systems did not substantially comply with all three requirements of FFMIAs. Auditors for four agencies—the Department of Energy, General Services Administration, National Aeronautics and Space Administration, and National Science Foundation—reported that their agencies' financial systems complied substantially with FFMIAs three requirements.

Table 2 summarizes the auditors' and agencies' determinations of substantial compliance with the requirements of FFMIAs.

Table 2: Summary of Auditors' FFMA Determinations and Agencies' Responses

Agency	Auditor's determination of substantial compliance		Areas of reported substantial noncompliance			Agency's response to auditor's determination ^a	
	Yes	No	Systems requirements	Accounting standards	SGL	Agree	Disagree
Department of Agriculture		•	•	•	•	•	
Department of Commerce		•	•	•	•	•	
Department of Defense		•	•	•	•	•	
Department of Education		•	•			•	
Department of Energy	•					•	
Department of Health and Human Services		•	•			•	
Department of Housing and Urban Development		•	•	•	•	•	
Department of the Interior		•	•			•	
Department of Justice		•	•	•	•	•	
Department of Labor		•	•	•	•	•	
Social Security Administration		•	•				•
Department of Transportation		•	•	•		•	
Department of the Treasury		•	•	•	•	•	
Department of Veterans Affairs		•	•			•	
Agency for International Development		•	•	•	•	•	
Environmental Protection Agency		•	•	•			•
Federal Emergency Management Agency		•	•			•	
General Services Administration	•					•	
National Aeronautics and Space Administration	•					•	
National Science Foundation	•					•	
Nuclear Regulatory Commission		•	•			•	
Office of Personnel Management		•	•	•	•		•
Small Business Administration		•	•	•		•	
Total	4	19	19	12	9	20	3

^aAgreement or disagreement is based on agency comments included in the auditors' reports or interviews with agency management.

A September 9, 1997, OMB memorandum for agency managers and auditors provided guidance for assessing compliance with FFMA requirements for fiscal year 1997. This guidance, with minor revisions, was recently incorporated into OMB's audit bulletin (OMB Bulletin 98-08) and initially

focuses on financial systems essential to meeting financial statement preparation and budgetary reporting requirements.

OMB's guidance provides information on the meaning of substantial compliance and describes indicators that should be used in assessing whether an agency's financial systems are in substantial compliance with FFMA's three requirements. The guidance states that substantial noncompliance in any one of the three requirements results in substantial noncompliance with FFMA. For example, an agency could have an unqualified opinion on its financial statements and no material weaknesses in internal control indicating that the financial statements are prepared in accordance with applicable federal accounting standards, yet have financial management systems that are not in substantial compliance with financial management systems requirements.

As we testified on April 1, 1998,¹⁶ there are serious financial management improvement challenges facing the federal government. Agencies must overcome significant financial systems weaknesses, problems with fundamental recordkeeping, incomplete documentation, and weak internal controls (including computer controls). These problems contributed to agencies' noncompliance with FFMA's requirements. The primary reasons for agencies' financial systems noncompliance with the three requirements of FFMA, which are discussed in detail in the respective audit reports on the agency financial statements, include the following.

1) Primary reasons for noncompliance with financial management systems requirements.

- Ineffective general controls¹⁷ over automated information systems.
- Systems data were not updated or reconciled in a timely manner, resulting in unreliable and incomplete data.
- Systems were not integrated and thus required a manual, untimely process and many adjustments for the preparation of financial statements.

2) Primary reasons for noncompliance with federal accounting standards.

¹⁶U.S. Government's Financial Statements: Results of GAO's Fiscal Year 1997 Audit (GAO/T-AIMD-98-128, April 1, 1998).

¹⁷General controls focus on systems security such as entitywide security program planning and management, access controls, software development and change management controls, separation of duties, system software controls, and service continuity.

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- Inability to properly account for and report billions of dollars of property, plant, and equipment and supplies.
 - Inability to accurately and properly estimate the cost of most federal credit programs and the related loans receivable and loan guarantee liabilities.
 - Inability to estimate the proper amount of various liabilities, including postemployment health benefits for federal employees and veterans compensation benefits.
 - Inability to properly account for basic transactions, especially those between governmental agencies and other entities.
 - Inability to estimate and report material amounts of the costs and liabilities for remedying environmental contamination.

3) Primary reasons for noncompliance with the SGL at the transaction level.

- Core system data could not be reconciled to feeder system data.
- Transaction detail supporting account information was nonexistent or not readily available.
- System financial data were not consistent with the SGL and its posting requirements.

As a result of these weaknesses, government managers are not receiving the timely, uniform, reliable information needed to oversee programs, reduce costs, and help make resource decisions.

Agencies' Determination of Agreement With FFMIA Compliance

Once the auditor of an agency reports on FFMIA compliance, the agency head is responsible for determining, based on a review of the auditor's report and any other relevant information, whether the agency's financial management systems comply substantially with the three requirements.¹⁸ The agency head is required to make this determination no later than 120 days after (1) the receipt of the auditor's report or (2) the last day of the fiscal year following the year covered by the audit, whichever comes first.

Although there are no formal procedures required or in use for making or communicating the agency head's determination, agency comments included in the auditor's report or agency management's comments during interviews are good indicators as to whether the agency head agrees or disagrees with the auditor's assessment of FFMIA compliance. On the basis of agency comments or interviews with agency management, it appears

¹⁸Under the FFMIA process, the auditor's and the agency head's determinations of compliance may differ.

that 20 of the 23 CFO agencies, for which audit reports have been issued, agreed with their auditors' determination—16 agreed that their systems are not in substantial compliance and 4 agreed that their systems are in substantial compliance. The three remaining agencies—the Environmental Protection Agency, the Social Security Administration, and the Office of Personnel Management—are in the process of resolving differences with their auditors. The primary factor contributing to differences between the agencies' and auditors' assessments of FFMA compliance is the interpretation of substantial compliance.

OMB is currently meeting with these agencies to assist them in resolving their differences. According to OMB, if a disagreement cannot be resolved through mediation, the agency head is to send a formal letter stating the disagreement and requesting that the Director of OMB make a decision. Under the act, the Director is to review the differing determinations and report on the findings to the appropriate congressional committees. As of August 28, 1998, OMB had not received any formal letters of disagreement.

Preparation of Agency Remediation Plans

If an agency head determines that the agency's systems are not in substantial compliance, the act requires that the agency head, in consultation with the Director of OMB, establish a remediation plan to bring the systems into substantial compliance with FFMA's requirements. According to subsequent guidance issued by OMB,¹⁹ for fiscal year 1997, agencies are to include remediation plans in their annual agency financial management status report and 5-year plan submitted to OMB by September 14, 1998. Of the 16 agencies that agreed with the auditors' assessment of noncompliance with FFMA, three of these agencies—the departments of Justice and Labor, and the Nuclear Regulatory Commission—have submitted their remediation plans to OMB. As of August 28, 1998, the remaining 13 agencies were in the process of preparing their remediation plans.

Remediation plans are to include corrective actions, intermediate target dates, and resources necessary to achieve substantial compliance with FFMA's requirements within 3 years of the date the noncompliance determination is made. If, with the concurrence of the Director of OMB, the agency head determines that substantial compliance cannot be reached within 3 years, the remediation plan must specify the most feasible date by which the agency will achieve compliance and designate an official responsible for effecting the necessary corrective actions.

¹⁹OMB issued this guidance on July 1, 1998, as part of Circular A-11 guidance.

As we testified on June 18, 1998,²⁰ congressional committees, as part of annual appropriation or oversight hearings, could use the agencies' financial statement audits, reports on compliance with FFMA, and remediation plans to measure the progress agencies are making toward improving financial management. We also discussed the need for the remediation plans to be sufficiently detailed to provide a "road map" for agency management and staff to resolve financial management problems. Agency remediation plans should provide a detailed description of planned actions accompanied by reasonable milestones and also assign accountability for resolving specific financial management issues. Therefore, it is important that agencies determine the actions necessary to effectively resolve problems, prepare timely remediation plans, and monitor the progress made toward improving financial management systems and practices.

Agencies Have Difficulty Providing Information in Accordance With Accounting Standards

We did not express an opinion on the first governmentwide consolidated financial statements because serious deficiencies prevented us and the government from having assurance that it had properly reported large portions of its assets, liabilities, and costs. These deficiencies affect the reliability of the consolidated financial statements and much of the underlying information. They also affect the government's ability to accurately measure the full cost of programs, and effectively and efficiently manage its operations.

Appendix II summarizes the fiscal year 1997 audit opinions for the 23 CFO agencies that have issued audited financial statements as of August 28, 1998. Also, for agencies that did not receive an unqualified opinion, appendix II identifies the year the agency first anticipates obtaining an unqualified opinion, as reported in OMB's 1998 Federal Financial Management Status Report & Five-Year Plan. As shown in appendix II, 10 agencies received an unqualified opinion. Ten other agencies received either qualified opinions or disclaimers of opinion. An additional two agencies, which received more than one audit opinion, received unqualified opinions on financial statements covering a portion of their operations and qualified or disclaimers of opinion on statements for the remaining segments of their operations. One agency that prepared combined statements covering a portion of its operations received an unqualified opinion. Our report on the governmentwide consolidated financial statements and other auditors' reports identified deficiencies that

²⁰Financial Management: Fostering the Effective Implementation of Legislative Goals (GAO/T-AIMD-98-215, June 1998).

show that many agencies have difficulty providing information in accordance with applicable federal accounting standards. The executive branch recognizes the extent and severity of the reported financial management deficiencies and that addressing them will require concerted improvement efforts across government.

Financial management has been designated one of the President's priority management objectives, with the goal of having performance and cost information in a timely, informative, and accurate way, consistent with federal accounting standards. Also, the administration has made a commitment to obtain an unqualified opinion on the fiscal year 1999 governmentwide consolidated financial statements. However, Department of Defense management has indicated that the agency will not be able to obtain an unqualified opinion on its agencywide consolidated financial statements until after fiscal year 2000. This could pose a significant obstacle in achieving the administration's goal.

To help achieve this goal, strategies are being established for many agencies. The President has asked OMB to identify agencies with financial reporting deficiencies and have them prepare agency specific strategies, including milestones, for resolving such deficiencies by September 30, 1999. Initial agency strategy plans were due to OMB by July 31, 1998, and all have been received. We are currently reviewing these strategy plans and will be conducting meetings with agencies to discuss the sufficiency of the plans and make any needed suggestions for improvement. While corrective actions detailed in the strategy plans may fix annual financial statement reporting deficiencies, they may not necessarily fix identified instances of noncompliance with FFMIA's requirements.

Status of Federal Accounting Standards

Using a due process approach, FASAB has developed accounting standards for the federal government. So far, FASAB has recommended and the three principals—OMB, Treasury, and GAO—have approved two statements of accounting concepts²¹ and nine statements of accounting standards with various effective dates ranging from fiscal year 1994 through fiscal year 1998. The concepts and standards, as recommended by FASAB, underpin OMB's guidance to agencies on the form and content of their financial statements and the government's consolidated financial statements. Table

²¹Effective dates do not apply to Statements of Federal Financial Accounting Concepts.

3 provides a list of concepts, standards, and interpretations²² along with their respective effective dates.

Table 3: Statements of Federal Financial Accounting Concepts (SFFAC), Statements of Federal Financial Accounting Standards (SFFAS), Interpretations and Effective Dates

Concepts	
SFFAC No. 1	<u>Objectives of Federal Financial Reporting</u>
SFFAC No. 2	<u>Entity and Display</u>
Standards	
	Effective for fiscal year
SFFAS No. 1	<u>Accounting for Selected Assets and Liabilities</u> 1994
SFFAS No. 2	<u>Accounting for Direct Loans and Loan Guarantees</u> 1994
SFFAS No. 3	<u>Accounting for Inventory and Related Property</u> 1994
SFFAS No. 4	<u>Managerial Cost Accounting Concepts and Standards</u> 1998
SFFAS No. 5	<u>Accounting for Liabilities of the Federal Government</u> 1997
SFFAS No. 6	<u>Accounting for Property, Plant, and Equipment</u> 1998
SFFAS No. 7	<u>Accounting for Revenue and Other Financing Sources</u> 1998
SFFAS No. 8	<u>Supplementary Stewardship Reporting</u> 1998
SFFAS No. 9	<u>Deferral of Required Implementation Date for SFFAS No. 4</u> 1998
Interpretations	
No. 1	<u>Reporting on Indian Trust Funds</u>
No. 2	<u>Accounting for Treasury Judgment Fund Transactions</u>
No. 3	<u>Measurement Date for Pension and Retirement Health Care Liabilities</u>
No. 4	<u>Accounting for Pension Payments in Excess of Pension Expense</u>

Four of the standards, which were issued in 1995 and 1996, are effective for the first time in fiscal year 1998. In addition, FASAB has recommended Statement of Recommended Accounting Standard No. 10, Accounting for Internal Use Software. This Statement is currently before the principals for adoption. After being adopted by the principals, it will go before the Congress for a 45-day congressional review period. FASAB is also considering additional accounting issues:

- Management's Discussion and Analysis;
- Governmentwide Supplementary Stewardship Reporting;
- Amendments to Accounting for Property, Plant, and Equipment; and
- Accounting for Social Insurance.

²²Occasionally, FASAB clarifies existing federal accounting standards by providing interpretations. An interpretation is a document of narrow scope that provides clarifications of original meaning, additional definitions, or other guidance pertaining to an existing standard. Effective dates do not apply to interpretations.

Challenges in Complying With FFMIA Requirements

We previously reported²³ that agencies face significant challenges in fully implementing systems requirements, accounting standards, and the SGL. Agencies made some progress in fiscal year 1997 toward implementing and maintaining financial systems that comply with these requirements. However, agencies have indicated concerns with implementing new accounting requirements imposed by accounting standards which became effective in fiscal year 1998. Moreover, the need to update a significant number of critical systems applications coupled with the government's history of systems development difficulties portends problems in achieving substantial compliance with FFMIA's requirements in the near future, particularly as agencies are struggling to address critical Year 2000 computer conversion issues.

Although the accounting standards were issued several years ago, some agencies are not prepared to address key elements of the requirements that became effective for fiscal year 1998. For example, the managerial cost accounting concepts and standards promulgated in SFFAS No. 4²⁴ are aimed at providing reliable and timely information on the full cost of federal programs, their activities, and outputs. The standard requires agency management to define responsibility segments²⁵ and to measure and report the costs of each segment's outputs. However, management of several agencies have expressed difficulty in linking responsibility segments to general ledger accounts, which is necessary to assign costs to segment outputs.

In addition, the deferred maintenance requirements of SFFAS No. 6 require disclosures related to the condition and the estimated cost to remedy deferred maintenance of property, plant, and equipment. As we reported in January 1998,²⁶ a critical step in developing a deferred maintenance estimate is a complete and reliable inventory of property, plant, and equipment on which to assess maintenance needs. However, in our report on the U.S. government's fiscal year 1997 consolidated financial

²³Financial Management: Implementation of the Federal Financial Management Improvement Act of 1996 (GAO/AIMD-98-1, October 1, 1997).

²⁴FASAB initially proposed that SFFAS No. 4 be effective for fiscal year 1997. FASAB subsequently recommended and the principals adopted SFFAS No. 4 as effective for fiscal year 1998.

²⁵A responsibility segment is a component of a reporting entity that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services. Generally, a responsibility segment's manager reports directly to the entity's top management, and its resources and results of operations can be clearly distinguished from those of other segments of the entity.

²⁶Deferred Maintenance Reporting: Challenges to Implementation (GAO/AIMD-98-42, January 30, 1998).

statements,²⁷ we identified the federal government's inability to properly account for and report billions of dollars of property, plant, and equipment as a material deficiency. The lack of accurate accounting of property, plant, and equipment could impede efforts to implement the deferred maintenance requirements. Moreover, the requirement to disclose deferred maintenance will be a challenge because most agencies do not have experience in generating agencywide estimates of deferred maintenance. Historically, agencies were not required to develop deferred maintenance estimates for financial reporting purposes. Although the 11 agencies responsible for almost 99 percent of property, plant, and equipment²⁸ reported that they have estimated deferred maintenance for budgetary and other purposes, these estimates were generally limited in scope and not independently verified.

Also, SFFAS No. 7 requires a new statement—Statement of Financing—to show how budgetary resources obligated during the period relate to the net cost of operations for that reporting entity. Several agencies have expressed concerns about having the available resources to prepare the Statement. In particular, agencies are concerned that preparing the Statement will require extensive analysis by trained accountants because agency accounting systems have not been modified to support the preparation of the Statement. As a result, some agencies requested that FASAB defer the requirements for the Statement of Financing for 2 years. While FASAB recently decided not to recommend deferral of the Statement, it, along with OMB, GAO, and agency CFOs are working to develop a presentation of required information that will satisfy requirements of the standard with data which can be reasonably developed by agencies' existing systems. Agencies' problems implementing the new accounting standards will be considered as part of fiscal year 1998 FFMIA reporting.

Agencies are further challenged by the condition of many of the government's critical financial systems applications, which are not designed to meet current accounting standards and systems requirements. These systems will need to be replaced or significantly upgraded in the next 5 years. OMB's Federal Financial Management Status Report & Five-Year Plan reveals that as of the end of fiscal year 1997, agencies identified 809 operating financial management system applications that fall into this category. According to OMB, this represents 72 percent of total

²⁷Financial Audit: 1997 Consolidated Financial Statements of the United States Government (GAO/AIMD-98-127, March 31, 1998).

²⁸For our January report on deferred maintenance, we reviewed the plans and progress of 11 agencies toward implementing this standard.

applications in operation. OMB also reports that agencies lack the resources to replace or upgrade some systems that need modernization.

The serious questions that remain in addressing the federal government's Year 2000 readiness further complicate agencies' efforts to improve their financial management systems. We specifically discussed the Year 2000 problem as a high-risk area in our February 1997 high-risk report,²⁹ and have issued guidance³⁰ to help organizations successfully address the issue. To monitor agencies' accountability in addressing the Year 2000 problem in their systems, OMB requires agencies to regularly report on their progress.

We recently reported³¹ that the CFO agencies' progress in addressing Year 2000 computing issues continues at a slow pace. Agencies are appropriately focusing their priorities on Year 2000 compliance issues, and consequently, other efforts to improve financial management systems may be delayed, including efforts to address FFMA noncompliance.

Long-standing problems with agencies' financial management systems decrease the government's ability to produce timely, uniform, and reliable financial information, which is important for formulating budgets, managing government programs, and making difficult policy choices. The federal government's size and complexity and the discipline needed to fix its financial management systems present a significant challenge. It will take time and continued effort to improve federal financial management systems to the level required by FFMA.

Agency Comments

In comments on a draft of this report, the Deputy Controller of OMB's Office of Federal Financial Management generally agreed that our report fairly presented the status of the federal government's implementation of FFMA. The Commissioner of FMS concurred with the report's contents. OMB

²⁹High-Risk Series: Information Management and Technology (GAO/HR-97-9, February 1997).

³⁰Year 2000 Computing Crisis: An Assessment Guide (GAO/AIMD-10.1.14, September 1997), which includes the key tasks needed to complete each phase of a Year 2000 program (awareness, assessment, renovation, validation, and implementation), Year 2000 Computing Crisis: Business Continuity and Contingency Planning (GAO/AIMD-10.1.19, August 1998), which describes the tasks needed to ensure the continuity of agency operations, and Year 2000 Computing Crisis: A Testing Guide (GAO/AIMD-10.1.21, Exposure Draft, June 1998), which discusses the need to plan and conduct Year 2000 tests in a structured and disciplined fashion.

³¹Year 2000 Computing Crisis: Actions Must Be Taken Now to Address Slow Pace of Federal Progress (GAO/T-AIMD-98-205, June 10, 1998) and Year 2000 Computing Crisis: Strong Leadership and Partnerships Needed to Mitigate Risk of Major Disruptions (GAO/T-AIMD-98-262, August 13, 1998).

also offered technical comments, which we have incorporated as appropriate.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, Senate Committee on Governmental Affairs and Subcommittee on Government Management, Information, and Technology, House Committee on Government Reform and Oversight, other interested congressional committees, the Director of OMB, the Secretary of the Treasury, heads of the 24 CFO agencies, and agency CFOs and Inspectors General. Copies will also be made available to others upon request.

This report was prepared under the direction of Gloria L. Jarmon, Director, Health and Human Services Accounting and Financial Management, who may be reached at (202) 512-4476 if you or your staffs have any questions. Major contributors to this letter are listed in appendix IV.

A handwritten signature in black ink that reads "James F. Hinchman". The signature is written in a cursive style with a long, sweeping underline.

James F. Hinchman
Acting Comptroller General

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Table II.1: The 24 CFO Agencies' Fiscal Year 1997 Net Outlays,
Audit Opinions, and Expected Dates to Obtain Unqualified Audit
Opinions

Abbreviations

AAPC	Accounting and Auditing Policy Committee
CFO	Chief Financial Officer
DOD	Department of Defense
EPA	Environmental Protection Agency
FASAB	Federal Accounting Standards Advisory Board
FEMA	Federal Emergency Management Agency
FFMIA	Federal Financial Management Improvement Act of 1996
FFMSR	Federal Financial Management System Requirements
FMS	Financial Management Service
JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget
OPM	Office of Personnel Management
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SGL	Standard General Ledger

Agencies and Components Required to Issue Audited Financial Statements for Fiscal Year 1997

Department of Agriculture
Food and Consumer Service
Forest Service
Rural Development Service

Department of Commerce

Department of Defense
Defense Logistics Agency Working Capital Funds
Defense Security Assistance Agency
Department of the Air Force General Funds
Department of the Air Force Working Capital Funds
Department of the Army General Funds
Department of the Army Working Capital Funds
Department of the Navy General Funds
Department of the Navy Working Capital Funds
Military Retirement Trust Fund
National Defense Stockpile Transaction Trust Fund

Department of Education

Department of Energy

Department of Health and Human Services
Health Care Financing Administration
Indian Health Service

Department of Housing and Urban Development

Department of the Interior

Department of Justice

Department of Labor
Unemployment Trust Fund

Department of State

Social Security Administration

Appendix I
Agencies and Components Required to Issue
Audited Financial Statements for Fiscal Year
1997

Department of Transportation
Federal Aviation Administration
Highway Trust Fund

Department of the Treasury
Bureau of Alcohol, Tobacco, and Firearms
Bureau of Public Debt
Internal Revenue Service
United States Customs Service

Department of Veterans Affairs

Agency for International Development

Environmental Protection Agency

Federal Emergency Management Agency

General Services Administration

National Aeronautics and Space Administration

National Science Foundation

Nuclear Regulatory Commission

Office of Personnel Management
Civil Service Retirement and Disability Fund

Small Business Administration

CFO Agencies' Fiscal Year 1997 Net Outlays, Audit Opinions, and Target Dates

The 1990 CFO Act laid the legislative foundation for the federal government to provide taxpayers, the nation's leaders, and agency program managers with reliable financial information through audited financial statements. Under the CFO Act, as expanded by the Government Management Reform Act of 1994, 24 major agencies, which account for 99 percent of federal outlays, are required to annually prepare organizationwide audited financial statements beginning with those for fiscal year 1996. Table II.1 lists the 24 CFO agencies, their reported fiscal year 1997 net outlays, the audit opinion issued for fiscal year 1997, and the fiscal year for which the agency expects to first receive an unqualified opinion on its financial statements, as reported in OMB's 1998 Federal Financial Management Status Report & Five-Year Plan.

Table II.1: The 24 CFO Agencies' Fiscal Year 1997 Net Outlays, Audit Opinions, and Expected Dates to Obtain Unqualified Audit Opinions

Agency	Reported fiscal year 1997 outlays (in billions)	Fiscal year 1997 audit opinion	Expected date to obtain an unqualified opinion (fiscal year)
Department of Agriculture	\$52.5	Disclaimer	2000
Department of Commerce	3.8	Disclaimer	1999
Department of Defense ^a	261.8	Disclaimer	after 2000
Department of Education	30.0	Unqualified	N/A
Department of Energy	14.5	Unqualified	N/A
Department of Health and Human Services	339.5	Qualified	1999
Department of Housing and Urban Development	27.5	Qualified	1998
Department of the Interior	6.7	Unqualified	N/A
Department of Justice	14.3	Disclaimer	2000
Department of Labor	30.5	Unqualified	N/A
Department of State	5.2	Not available	1999
Department of Transportation	39.8	Disclaimer	1999
Department of the Treasury	379.3		
Administrative Statements		Unqualified	N/A
Custodial Statements		Qualified	1999
Department of Veterans Affairs	39.3	Qualified	1998
Agency for International Development	2.2	Disclaimer	1999
Environmental Protection Agency	6.2	Unqualified	N/A
Federal Emergency Management Agency ^b	3.3	Unqualified	1998
General Services Administration	1.1	Unqualified	N/A
National Aeronautics and Space Administration	14.4	Unqualified	N/A
National Science Foundation	3.1	Qualified	1998

(continued)

Appendix II
CFO Agencies' Fiscal Year 1997 Net Outlays,
Audit Opinions, and Target Dates

Agency	Reported fiscal year 1997 outlays (in billions)	Fiscal year 1997 audit opinion	Expected date to obtain an unqualified opinion (fiscal year)
Nuclear Regulatory Commission	0.1	Unqualified	N/A
Office of Personnel Management	45.4		
Retirement Fund		Unqualified	N/A
Life Insurance Fund		Unqualified	N/A
Revolving Funds		Disclaimer	2000
Health Benefits		Disclaimer	2000
Salaries and Expenses		Disclaimer	2000
Small Business Administration	0.3	Unqualified	N/A
Social Security Administration	393.3	Unqualified	N/A
	\$1,714.1		

^aThe Department of Defense (DOD) is making some progress in meeting the audited financial statement requirements of the CFO Act. However, significant and long-standing deficiencies preclude DOD from expecting an unqualified opinion on its agencywide consolidated financial statements until after fiscal year 2000.

^bFEMA prepared combined financial statements for specified activities and the Disaster Relief Fund. FEMA plans to issue agencywide consolidated financial statements for fiscal year 1998.

Source for reported fiscal year 1997 net outlays: Budget of the United States Government, Fiscal Year 1999.

Comments From the Office of Management and Budget

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



OFFICE OF FEDERAL
FINANCIAL MANAGEMENT

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D. C. 20503

September 17, 1998

Mr. Gene L. Dodaro
Assistant Comptroller General
General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Dodaro:

Thank you for the opportunity to comment on your report on FINANCIAL MANAGEMENT: FFMIA Implementation Results for Fiscal Year 1997. The synergy of OMB and GAO in guiding agencies implementing requirements of the FFMIA will lead to improved financial management systems and contribute towards the Administration's goal of an unqualified opinion on the consolidated financial statements for FY 1999.

OMB generally agrees that the facts presented in this report fairly presents the status of the Federal government's implementation of the FFMIA. However, we would like offer a few comments to clarify and correct some of the information presented.

- In the section Agencies' Determination of Agreement with FFMIA Compliance, it is stated that OMB is currently mediating discussions between the agencies' auditors and agencies' management to resolve their differences (page 17). The statement should read that OMB is currently meeting with these agencies to assist them in resolving differences, not mediating discussions. Until the agency head formally refers a disagreement to the Director of OMB, OMB's role is that of a consultant on FFMIA requirements.
- In the section Results in Brief, the report correctly states that nine accounting standards have been issued (page 4). The section Status of Federal Accounting Standards, states that eight statements of accounting standards have been issued (page 22). This section should be corrected to state nine. Also, in this section at the top of page 24 the paragraph should be modified as follows regarding Standard No. 10:

In addition, FASAB has recommended Statement of Recommended Accounting Standard No. 10, Accounting for Internal Use Software. This Statement is currently before the Principals for adoption. After being adopted by the Principals, it will go before the Congress for a 45 day Congressional review period.

- In the section Fiscal Year 1997 Results, states that FFMIA guidance was recently incorporated into OMB's audit bulletin which initially focuses on financial systems related to the preparation of financial statements (page 13). The FFMIA guidance contained in OMB Bulletin 98-08 addresses all financial management systems essential to meeting financial

Now on p. 11.
See comment 1.

Now on p. 3.
Now on p. 13
Now on p. 14.

See comment 1.

Now on p. 8.
See comment 2.

**Appendix III
Comments From the Office of Management
and Budget**

statement preparation and budgetary reporting requirements. As budgetary reporting requirements encompass more than the information provided in the financial statements this section should be revised to include budgetary reporting requirements. Also, the section as now written uses the word "initially". This would imply there are plans to change focus in the future. OMB believes the focus of the FFMIA is on systems that report the financial results of the Federal government and has no plans to modify this in the future.

- In the section Agencies Have Difficulty Providing Information in Accordance with Accounting Standards, a suggested rewrite for the paragraph beginning at the bottom of page 20 is as follows:

Also, the Administration has made a commitment to gain an unqualified opinion on the consolidated financial statement of the U. S. Government as a whole by fiscal year 1999. Management at 23 of the 24 CFO agencies have committed to gaining an unqualified opinion on their agencywide financial statements by FY 2000. Only the Department of Defense management has indicated that their agency will not be able to meet this date.

- Appendix I includes a list of agencies and components required to issue audited financial statements for fiscal year 1997. This is inaccurate and should be corrected to reflect the list of agencies and components provided in the attachment to this letter.

If you have any questions on these comments please contact Jean Holcombe on (202)395-5048 or Shelia Conley on (202)395-3070.

Sincerely,



Norwood J. Jackson, Jr.
Deputy Controller

Attachment

See comment 1.
Now on p. 13.

See comment 3.

**Appendix III
Comments From the Office of Management
and Budget**

The following are GAO's comments on the Office of Management and Budget's letter of September 17, 1998.

GAO's Comments

1. Report has been modified to reflect OMB's comment.
2. Report has been modified to reflect that OMB's audit bulletin addresses financial systems essential to meeting financial statement preparation and budgetary reporting requirements.
3. Report has been modified to accurately reflect the list of agencies and components OMB provided, but the attachment has not been included.

Major Contributors to This Report

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