May 20, 2008

Mr. Gregory Spencer
Chairman, Financial Statement Audit Network

Subject: Governmentwide Accounts Payable

Dear Mr. Spencer:

The Government Accountability Office (GAO) is required by the Government Management Reform Act of 1994 to audit the Consolidated Financial Statements of the U.S. Government (CFS). Certain material weaknesses in financial reporting and other limitations on the scope of our work have continued to result in conditions that have prevented us from expressing an opinion on the federal government’s accrual basis consolidated financial statements. To assist us in planning future audits, when we anticipate being able to eventually issue an opinion on the accrual basis consolidated financial statements, we have performed and plan to continue performing selected procedures on certain line items and other areas of interest. The purpose of these procedures is to obtain an understanding of selected federal agencies’ accounting and reporting and the audit work being performed in these areas. This letter relates to the fiscal year 2006 accounts payable (A/P) line item. The federal government reported about $58 billion of A/P as of September 30, 2006.

Our procedures regarding A/P focused on 15 federal agencies whose A/P balances were reported in Note 9, Accounts Payable, of the fiscal year 2006 CFS. We reviewed those agencies’ relevant written policies for A/P accounting and reporting, fiscal year

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31 U.S.C. 331(e). The act states that not later than March 31, 1998, and each year thereafter, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, shall annually prepare and submit to the President and the Congress an audited financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the United States Government. The federal government has elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well. Accrual basis consolidated financial statements refers to all of the consolidated financial statements and notes except for those related to the Statement of Social Insurance.

2006 financial statements and closing packages submitted to the Department of the Treasury (Treasury), and the A/P audit documentation prepared by the agencies' offices of the inspectors general and/or the contracted independent public accountants. We discussed our results with the auditors and management officials at the selected federal agencies. We also discussed our results with Office of Management and Budget and Treasury representatives. We considered their comments and incorporated them as appropriate.

We provided a briefing of the results of our work at the April 15, 2008, Financial Statement Audit Network meeting. The purpose of this letter is to transmit that briefing to you as chairman of the Financial Statement Audit Network to distribute as you deem appropriate. The enclosed briefing slides summarize our observations related to

- federal agencies' written A/P policies,
- federal agencies' financial statement disclosure/reporting of A/P,
- federal agencies' A/P reporting to Treasury (closing package),
- A/P reporting guidance, and
- federal agency auditors' A/P cycle memos.

We appreciate the courtesy and cooperation extended to us by agency and auditor staff throughout our work. We look forward to continuing to work with you and other members of the Financial Statement Audit Network to help improve financial management in the federal government. If you have any questions about this letter, please contact me at (202) 512-3406 or engelg@gao.gov.

Sincerely yours,

Gary T. Engel
Director
Financial Management and Assurance

Enclosure
Governmentwide Accounts Payable

Financial Statement Audit Network

April 15, 2008

Briefing Topics

• Background & Objectives
• Scope
• Methodology
• Observations
• A/P Follow-up
Background & Objectives

- **Background:**
  Internal control deficiencies in certain federal agencies’ reporting of accounts payable (A/P) contributed to a material weakness for “Liabilities and Commitments and Contingencies” reported in GAO’s fiscal year 2007 Consolidated Financial Statement (CFS) audit report.

- **Objectives:**
  To obtain a better understanding of agencies’ accounting and reporting for A/P and the audit work performed by agencies’ auditors – in connection with our requirements for auditing the CFS

Scope: Selected Agencies

- DOD - $27.4 billion
- USDA - $4.2 billion
- DHS - $2.8 billion
- AID - $2.3 billion
- Justice - $2.3 billion
- PBGC - $2.2 billion
- USPS - $2.0 billion
- GSA - $2.0 billion
- NASA - $1.7 billion
- Energy - $1.3 billion
- State - $1.3 billion
- Interior - $1.1 billion
- TVA - $1.1 billion
- Labor - $.9 billion
- Education $.9 billion
Methodology

To obtain an understanding of agency A/P policies and auditor procedures, we
- identified relevant criteria,
- sent questionnaires to the auditors of the 15 selected agencies,
- reviewed the selected agencies' financial statements, written policies, and closing packages, and
- reviewed the selected auditors’ cycle memos, audit programs, specific control evaluations (SCE), account risk analyses (ARA), summaries of tests, notices of findings, and other relevant documents regarding A/P.

Observations

- Agency Written Policies
- Agency Financial Statement Disclosure/Reporting
- Agency Reporting to Treasury (Closing Package)
- A/P Reporting Guidance
- Auditor Cycle Memos
Observations
Agency Written Policies - Criteria

Standards for Internal Control in the Federal Government (GAO/AIMD-00-21.3.1, Nov 1999):

- “Control activities, including policies and procedures, help ensure that management’s directives are carried out”
- “internal controls and all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination”

Observations
Agency Written Policies

For most of the 15 selected agencies, we noted that their written policies regarding A/P did not include one or more of the following key elements:

- A/P accounting recognition criteria
- Significant A/P transactions/events
- Estimation policies (for those agencies that were estimating their A/P balances)
- Policies for identifying unrecorded A/P at fiscal year-end

Also, one of the selected agencies did not provide any written policies for A/P accounting and reporting.
Observations
Agency Financial Statement Disclosure/Reporting - Criteria

- The definition of A/P per Statement of Federal Financial Accounting Standard (SFFAS) #1 is “amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities”. A/P is not intended to include liabilities related to ongoing continuous expenses such as employee salary and benefits, which are covered by other current liabilities.

- The definition of A/P per OMB Circular A-136, “Financial Reporting Requirements” is consistent with SFFAS #1. OMB A-136 further states that disclosure of accounting policies should identify and describe the entity’s accounting principles and the methods of applying those principles, including important judgments about recognition and valuation.

Observations
Agency Financial Statement Disclosure/Reporting

Three agencies with significant A/P balances did not disclose
- A/P recognition criteria and/or
- key valuation policies for estimating grants payable.
Observations
Agency Reporting to Treasury (Closing Package) - Criteria

Treasury Financial Manual, Volume I, Part 2, Chapter 4700 (TFM 2-4700), Appendix 1, section 6.1, states that A/P should include:
- Amounts owed to a non-Federal entity for goods and other property ordered and received;
- Services rendered by other than Federal employees;
- Voucher schedule payments transmitted but not yet processed;
- Interest accrued and owed to others; and
- A/P canceled reported by a department.

Observations
Agency Reporting to Treasury (Closing Package) – Criteria (Cont.)

TFM 2-4700 Appendix 1, section 6.8, states that Other Liabilities should include the following:
- Deferred Revenue,
- Accrued Wages & Benefits,
- Gold Certificates,
- Exchange Stabilization Fund,
- Other Debt,
- Deposited Funds and Undeposited Collections,
- Advances from Foreign Governments,
- Carriers Claim Payable,
- Accrued Grant Liability,
- Contractual Services (Obligations),
- Advances from Others,
- Energy Employees Occupational Illness Compensation Act,
- Nuclear Waste Fund,
- and "all other liabilities not classified" here.
Observations
Agency Reporting to Treasury (Closing Package)

None of the selected agencies that included grants payable amounts in A/P reclassified such amounts to Other Liabilities consistent with TFM guidance.

Observations
A/P Reporting Guidance

Consistency of OMB and Treasury Guidance

- TFM 2-4700 is very specific about including certain types of transactions, such as grants payable and interest payable, in Other Liabilities versus A/P.

- There is no specific guidance in OMB A-136 about where to classify grants payable or interest payable.
Observations
Auditor Cycle Memos - Criteria

- Government Auditing Standards state that "auditors must prepare audit documentation in sufficient detail to provide a clear understanding of the work performed, the audit evidence obtained and its source, and the conclusions reached".

- The GAO/PCIE FAM (2007 Exposure Draft) provides specific guidance in section 390.05 on what should be included in the cycle memo. For example, the FAM states that, among other things, a cycle memo should clearly describe the accounting system, identify the cycle transactions for each significant cycle, and identify major controls and agency policies.

Observations
Auditor Cycle Memos

We observed that the following were not always documented:

- Significant transactions – i.e. types of transactions included in A/P
- Significant internal controls and agency policies
  - AP accounting recognition criteria
  - AP and/or grants payable estimation policies (for those agencies that were estimating the majority of their A/P and/or grants payable balances)
**A/P Follow-up**

We plan to follow-up with selected agency auditors regarding the observations we discussed with them during recent agency A/P teleconferences.

**Questions**

Suzanne Murphy, GAO, Assistant Director 404-679-1940
Carolyn Voltz, GAO, Auditor in Charge, 404-679-2088

(198526)
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