



September 2019

MANAGEMENT REPORT

Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements

GAO Highlights

Highlights of [GAO-19-624](#), a report to agency officials

Why GAO Did This Study

The Secretary of the Treasury, in coordination with the Director of OMB, prepares the *Financial Report of the United States Government*, which contains the CFS. Since GAO's first audit of the fiscal year 1997 CFS, certain material weaknesses and other limitations on the scope of its work have prevented GAO from expressing an opinion on the accrual-based consolidated financial statements. As part of the fiscal year 2018 CFS audit, GAO identified material weaknesses and other continuing control deficiencies in the processes used to prepare the CFS. The purpose of this report is to provide (1) details on new control deficiencies GAO identified related to the processes used to prepare the CFS, along with related recommendations, and (2) the status of corrective actions that Treasury and OMB have taken to address GAO's prior recommendations related to the processes used to prepare the CFS that remained open as of the completion of GAO's audit of the fiscal year 2017 CFS.

What GAO Recommends

GAO is making four new recommendations—three to Treasury and one to both Treasury and OMB—to address the control deficiencies identified during the fiscal year 2018 CFS audit. In commenting on GAO's draft report, Treasury concurred with the four new recommendations and noted its ongoing commitment to improving federal financial reporting. OMB generally agreed with the draft report and noted its continuing commitment to achieving sound financial management across the federal government.

View [GAO-19-624](#). For more information, contact Dawn B. Simpson at (202) 512-3406 or simpsondb@gao.gov.

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Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements

What GAO Found

During its audit of the fiscal year 2018 consolidated financial statements of the U.S. government (CFS), GAO identified control deficiencies in the Department of the Treasury's (Treasury) and the Office of Management and Budget's (OMB) processes used to prepare the CFS. These control deficiencies contributed to material weaknesses in internal control that involve the federal government's inability to

- adequately account for intragovernmental activity and balances between federal entities;
- reasonably assure that the consolidated financial statements are (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in accordance with U.S. generally accepted accounting principles; and
- reasonably assure that the information in the (1) Reconciliations of Net Operating Cost and Budget Deficit and (2) Statements of Changes in Cash Balance from Budget and Other Activities is complete, properly supported, and consistent with the underlying information in the audited entities' financial statements and other financial data.

During its audit of the fiscal year 2018 CFS, GAO identified three new internal control deficiencies.

- Treasury did not have sufficient procedures to analyze and determine whether appropriate disclosures related to new federal accounting standards were included in the draft fiscal year 2018 *Financial Report of the United States Government*.
- Treasury did not have sufficient procedures to properly support and consistently report restatements, reclassifications, and adjustments to beginning net position in the draft fiscal year 2018 *Financial Report of the United States Government*.
- Treasury and OMB did not have adequate processes and procedures for reporting appropriate information regarding legal contingency losses in the fiscal year 2018 CFS.

In addition, GAO found that various other control deficiencies identified in previous years' audits with respect to the processes used to prepare the CFS either were resolved or continued to exist. Specifically, Treasury, in coordination with OMB, implemented corrective actions that resolved the control deficiencies related to two of the 14 recommendations open as of the completion of GAO's fiscal year 2017 CFS audit, and as a result, GAO closed these recommendations. While progress was made, 12 of the 14 recommendations remained open as of March 20, 2019, the date of GAO's report on its audit of the fiscal year 2018 CFS. GAO will continue to monitor the status of corrective actions to address the four new recommendations made in this report as well as the 12 open recommendations from prior years as part of its fiscal year 2019 CFS audit.

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Abbreviations

CFS	consolidated financial statements of the U.S. government
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
<i>Financial Report</i>	<i>Financial Report of the United States Government</i>
OMB	Office of Management and Budget
SCSIA	Statements of Changes in Social Insurance Amounts
SLTFP	Statements of Long-Term Fiscal Projections
SOSI	Statements of Social Insurance
SFFAS	Statement of Federal Financial Accounting Standards
Treasury	Department of the Treasury
U.S. GAAP	U.S. generally accepted accounting principles

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September 4, 2019

The Honorable Steven T. Mnuchin
Secretary of the Treasury

The Honorable Mick Mulvaney
Director
Office of Management and Budget

In our March 2019 report on the results of our audit of the consolidated financial statements of the U.S. government (CFS) as of and for the fiscal years ended September 30, 2018, and 2017,¹ we disclaimed an opinion on the CFS. Since GAO's first audit of the CFS, for fiscal year 1997, certain material weaknesses² in internal control over financial reporting and other limitations on the scope of our work have resulted in conditions that prevented us from expressing an opinion on the federal government's accrual-based consolidated financial statements.³ See appendix II of our report on our audit of the fiscal years 2018 and 2017 CFS for details on these reported material weaknesses. Internal control deficiencies related

¹The CFS as of and for the fiscal years ended September 30, 2018, and 2017, consist of the Statements of Net Cost; Statements of Operations and Changes in Net Position; Reconciliations of Net Operating Cost and Budget Deficit; Statements of Changes in Cash Balance from Budget and Other Activities; Balance Sheets; 2018 and 2017 Statements of Long-Term Fiscal Projections (SLTFP); 2018, 2017, 2016, 2015, and 2014 Statements of Social Insurance (SOSI); and 2018 and 2017 Statements of Changes in Social Insurance Amounts (SCSIA), including the related notes to these financial statements. See GAO, *Financial Audit: Fiscal Years 2018 and 2017 Consolidated Financial Statements of the U.S. Government*, [GAO-19-294R](#) (Washington, D.C.: Mar. 28, 2019).

²A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control 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 and correct, misstatements on a timely basis.

³As used in this report, accrual-based consolidated financial statements refer to all of the consolidated financial statements and notes, except for those related to the SLTFP, SOSI, and SCSIA. Because of significant uncertainties, primarily related to the achievement of projected reductions in Medicare cost growth, we were unable to, and did not, express opinions on the 2018, 2017, 2016, 2015, and 2014 SOSI and the 2018 and 2017 SCSIA. Because of these significant uncertainties and a material weakness in internal control over financial reporting, we were unable to, and did not, express an opinion on the 2018 and 2017 SLTFP.

to several of these material weaknesses were also reported along with related recommendations by other auditors in their audit reports on individual federal entities' financial statements.⁴

Several of these material weaknesses relate to the federal government's processes used to prepare the CFS.⁵ Such material weaknesses involve the federal government's inability to

- adequately account for intragovernmental activity and balances between federal entities;
- reasonably assure that the consolidated financial statements are (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in accordance with U.S. generally accepted accounting principles; and
- reasonably assure that the information in the (1) Reconciliations of Net Operating Cost and Budget Deficit and (2) Statements of Changes in Cash Balance from Budget and Other Activities is complete, properly supported, and consistent with the underlying information in the audited entities' financial statements and other financial data.

The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), prepares the *Financial Report of the United States Government (Financial Report)*, which contains the CFS, on behalf of the federal government.⁶ The purpose of our management report is to provide (1) detailed information on new control deficiencies identified during our fiscal year 2018 audit that relate to the processes used to prepare the CFS, along with related recommendations, and (2) the status of corrective actions that the Department of the Treasury (Treasury) and OMB have taken to address the 14 recommendations relating to the processes used to prepare the CFS that

⁴[GAO-19-294R](#).

⁵Our March 2019 report also discussed material weaknesses and scope limitations that did not relate to the processes used to prepare the CFS but prevented us from expressing an opinion on the federal government's accrual-based consolidated financial statements.

⁶The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of the government, beginning with financial statements prepared for fiscal year 1997. See 31 U.S.C. § 331(e). The consolidated financial statements include the legislative and judicial branches.

were detailed in our previous reports and remained open as of February 7, 2018, the date of our report on the audit of the fiscal year 2017 CFS.⁷

Scope and Methodology

As part of our audit of the fiscal years 2018 and 2017 CFS, we considered the federal government's financial reporting procedures and related internal control. Also, we determined the status of corrective actions Treasury and OMB have taken to address open recommendations relating to their processes to prepare the CFS, detailed in our previous reports that remained open as of the completion of our fiscal year 2017 audit. A full discussion of our scope and methodology is included in our March 2019 report on our audit of the fiscal years 2018 and 2017 CFS.⁸ We have communicated each of the control deficiencies discussed in this report to your staff. We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe that our audit provides a reasonable basis for our findings and recommendations in this report.

Control Deficiencies Identified during Our Fiscal Year 2018 Audit

During our audit of the fiscal year 2018 CFS, we identified three new internal control deficiencies in Treasury's processes used to prepare the CFS. Specifically, we found that (1) Treasury did not have sufficient procedures to analyze and determine whether appropriate disclosures related to new federal accounting standards were included in the draft fiscal year 2018 *Financial Report*; (2) Treasury did not have sufficient procedures to properly support and consistently report restatements, reclassifications, and adjustments to beginning net position reported in the draft fiscal year 2018 *Financial Report*; and (3) Treasury and OMB did not have adequate processes and procedures for reporting appropriate information regarding legal contingency losses in the fiscal year 2018 CFS.

New Federal Accounting Standards

During our fiscal year 2018 CFS audit, we found that Treasury did not have sufficient procedures to analyze and determine whether appropriate disclosures related to new federal accounting standards were included in the draft fiscal year 2018 *Financial Report*. Treasury uses working

⁷GAO, *Management Report: Continued Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements*, [GAO-18-540](#) (Washington, D.C.: July 16, 2018).

⁸[GAO-19-294R](#).

groups, disclosure checklists, and other tools to assist in determining appropriate reporting in accordance with new standards. Treasury's procedures include working with federal entities during the fiscal year to determine the reporting required based on new standards. Treasury presents the new standards for discussion at monthly Central Reporting Team meetings that include financial reporting representatives from federal entities. Treasury also establishes working groups for certain new standards, such as the working group established for the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*,⁹ to work with federal entities on their implementation. Treasury also utilizes a financial reporting disclosure checklist to help determine that all disclosures required by FASAB standards are included in the CFS. Treasury updates this disclosure checklist throughout the fiscal year and completes the checklist as a key focus of the CFS compilation process.

Although Treasury has processes in place for the implementation of new standards, certain disclosures required by new standards were not included in the draft fiscal year 2018 *Financial Report*. For example, the draft fiscal year 2018 *Financial Report* did not include disclosures related to federal government land assets, such as the number of acres held at the end of each reporting period, explanations of federal entities' election to include or exclude land and land rights from their opening balances, and a reference to the component reporting entity's financial report, as required by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*.¹⁰ In addition, the draft fiscal year 2018 *Financial Report* did not include disclosures related to significant component entity amounts included in certain CFS line items that were determined in accordance with Financial Accounting Standards Board (FASB) standards rather than FASAB standards, in accordance with SFFAS 47.¹¹ SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial*

⁹SFFAS 47 was issued on December 23, 2014, and became effective in fiscal year 2018. Earlier implementation was not permitted.

¹⁰SFFAS 50 was issued on August 4, 2016, and became effective beginning in fiscal year 2017 with early implementation permitted. A few entities began implementing SFFAS 50 in fiscal year 2016 and continued implementation in fiscal years 2017 and 2018.

¹¹OMB and Treasury have identified 40 federal entities that were significant to the U.S. government's fiscal year 2018 consolidated financial statements, including the 24 Chief Financial Officers Act of 1990 agencies. See app. A of the *Fiscal Year 2018 Financial Report of the United States Government* for a listing of the 40 entities. [GAO-19-294R](#).

Accounting Standards Board, provides that general purpose federal financial reports prepared in conformity with accounting standards issued by FASB also may be regarded as in conformity with U.S. generally accepted auditing principles (U.S. GAAP). SFFAS 47 permits the consolidation of amounts determined in accordance with FASAB and FASB standards into a single line item without conversion for differences in accounting policies and also provides application guidance that emphasizes the need for disclosures of the different accounting policies and the related amounts to aid financial statement users' understanding of the information provided.

Treasury's disclosure checklist was not updated in sufficient detail for Treasury accountants to identify appropriate disclosures for inclusion in the draft fiscal year 2018 *Financial Report* in accordance with these new federal accounting standards. The updated disclosure checklist used for fiscal year 2018 did not include (1) specific details about disclosures required by SFFAS 50 for land assets, such as the number of acres added or disposed of during the reporting period, and (2) questions to help determine the need for disclosures to communicate the effect on certain CFS line items that include material amounts determined using accounting policies in accordance with FASB standards rather than FASAB standards, as SFFAS 47 allows. Also, Treasury did not calculate in aggregate the amounts that are reported in the CFS on a FASB basis by line item in order to determine line items where the disclosures were needed. We communicated these matters to Treasury officials, who conducted a comprehensive analysis and included disclosures in the final fiscal year 2018 *Financial Report*, as appropriate. In addition, although Treasury established a working group to help implement SFFAS 47, Treasury's procedures did not provide for sufficient consultation with technical experts in interpreting new standards and updating the disclosure checklist to reasonably assure that all requirements related to the new standard were incorporated during implementation. Actively consulting with technical experts, such as members of FASAB, the body designated as the source of U.S. GAAP for federal reporting entities, would help minimize the risk of misinterpreting the standards or presenting and disclosing information in the *Financial Report* that is incorrect, inconsistent, or incomplete.

Standards for Internal Control in the Federal Government states that one of the key objectives of an organization's internal control over financial reporting is to provide reasonable assurance as to the reliability of its

financial reporting, including its financial statements and note disclosures.¹² Accompanying notes are an integral part of financial statements and provide additional disclosures that are necessary to make the financial statements more informative.

Without sufficient procedures for analyzing and determining the appropriate reporting of disclosures required by new federal accounting standards, Treasury cannot reasonably assure that disclosures included in the *Financial Report* are reliable and complete.

Recommendation for Executive Action

We recommend that the Secretary of the Treasury should ensure that the Fiscal Assistant Secretary develops and implements procedures to enhance Treasury's processes for reasonably assuring that the *Financial Report* includes disclosures required by new federal accounting standards, such as conducting an appropriate level of analysis to determine whether disclosures are needed, consulting with technical experts, and including additional details on these requirements in its financial reporting disclosure checklists. (Recommendation 1)

Restatements, Reclassifications, and Adjustments to Beginning Net Position

During our fiscal year 2018 CFS audit, we found that Treasury did not have sufficient procedures to properly support and consistently report restatements, reclassifications, and adjustments to beginning net position in the draft fiscal year 2018 *Financial Report*. Treasury identifies changes to prior year amounts (either restatements or reclassifications) and adjustments to current year beginning net position based on its review of information that significant component entities submit to Treasury and applicable FASAB standards. Treasury also performs procedures to determine the consistency of such reporting with significant component entities' audited financial statements.

Treasury's *Subject Matter Analysis* standard operating procedure includes steps for Treasury's staff to obtain financial information from significant component entities and to prepare the draft *Financial Report*. According to these procedures, Treasury's staff uses third quarter financial data that significant component entities report and other information to obtain a preliminary understanding of potential changes to prior year amounts and adjustments to beginning net position. Treasury's

¹²GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

staff compares these preliminary results to the entities' year-end information and compares beginning net position amounts reported for the current year to ending net position amounts reported the prior year to identify changes to prior year amounts. The staff then prepares a table categorizing such changes as restatements, reclassifications, or adjustments to beginning net position. This table includes a separate line for each of the significant component entities but does not include separate lines for each line item or note disclosure affected. Treasury uses this table to prepare a summary analysis of its conclusions for reporting restatements, reclassifications, and adjustments to beginning net position and related note disclosures presented in the draft *Financial Report*. The subject area manager reviews the results of the procedures that Treasury's staff performed and documented.

Although Treasury's staff followed these procedures for fiscal year 2018, we found that Treasury did not always maintain sufficient support for restatements, reclassifications, and adjustments to beginning net position included in the draft fiscal year 2018 *Financial Report*. For example, Treasury reported an adjustment to beginning net position but did not identify errors made in prior years to support such an adjustment. Treasury also reported that restatements affected the Statement of Changes in Cash Balance from Budget and Other Activities, but supporting documentation provided by Treasury for the draft fiscal year 2018 *Financial Report* did not clearly indicate how this statement was affected by restatements. Treasury included a summary of significant accounting policies in Note 1 to the CFS as required by U.S. GAAP, which contained information about restatements, reclassifications, and adjustments to beginning net position. However, Treasury did not disclose consistent information in related line item notes, such as those for loans receivable and loan guarantee liabilities, federal employee and veteran benefits payable, and funds from dedicated collections in the draft fiscal year 2018 *Financial Report*. Treasury included information in its summary analysis and supporting documentation that was not consistent with information that significant component entities reported. Although Treasury's processes did not identify these inconsistencies, Treasury corrected them in response to our questions.

We found that Treasury did not identify these inconsistencies, in part, because its subject matter review procedures did not include steps for coordinating with Treasury managers of other subject matter areas to reasonably assure consistency and appropriate support for conclusions. Also, although Treasury's process involved preparing a summary of analyses performed, Treasury's process did not include steps or other

tools to reasonably assure that consistent information was communicated in all financial statement line items and note disclosures affected by restatements, reclassifications, and adjustments to net position.

SFFAS 21, *Reporting of Corrections of Errors and Changes in Accounting Principles*, requires that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes and if the effect of an error would be material to the financial statements in either period. If not material, corrections should be made to the beginning balance of cumulative results of operations in the statement of changes in net position. A reclassification is the movement of a prior year amount in comparative financial statements in order to conform to the current year presentation. *Standards for Internal Control in the Federal Government* states that management should (1) design control activities to achieve objectives and respond to risks, such as procedures to help reasonably assure that financial information is completely and accurately reported, and (2) implement control activities, such as documenting responsibilities through policies and procedures. Management should periodically review policies, procedures, and related control activities for continued relevance and effectiveness in achieving objectives.

Without sufficient procedures for reporting restatements, reclassifications, and adjustments to beginning net position, there is an increased risk of presenting information that is inaccurate or incomplete in the *Financial Report*.

Recommendations for Executive Action

We are making the following two recommendations to Treasury:

- The Secretary of the Treasury should ensure that the Fiscal Assistant Secretary enhances existing procedures for Treasury management to perform additional reviews for restatements, reclassifications, and adjustments to beginning net position to reasonably assure that they are properly supported and accurately reported. (Recommendation 2)
- The Secretary of the Treasury should ensure that the Fiscal Assistant Secretary develops and implements steps to reasonably assure that restatements, reclassifications, and adjustments to beginning net position are consistently reported in the *Financial Report*, such as developing a tool that identifies all affected financial statement line items and note disclosures. (Recommendation 3)

Contingencies for Legal Representation Letters

During our fiscal year 2018 CFS audit, we found that Treasury and OMB did not have adequate processes and procedures for reporting appropriate information regarding legal contingency losses in the fiscal year 2018 CFS. Significant component entities are responsible for properly accounting for and reporting legal contingency losses in their entity-level financial statements and submitting this information to Treasury for inclusion in the CFS. For each entity-level financial statement audit, U.S. generally accepted government auditing standards require that component entity auditors obtain written legal representations as part of the audit.¹³ The significant component entities provide interim and final legal representation letters, along with management schedules, to Treasury, the Department of Justice (DOJ), and GAO.¹⁴

According to DOJ's established process, its legal counsel reviews individual cases included in these legal representation letters for which the potential loss exceeds \$500 million individually or in the aggregate for similar cases. DOJ is responsible for preparing and submitting an interim and final government-wide legal representation letter to Treasury and GAO, containing its assessment of the potential litigation losses, including whether there are litigation, claims, or assessments that were not addressed in the significant component entities' legal representation letters that DOJ believes should have been reported or which DOJ believes should have been reported differently.

Treasury's procedures call for it to determine whether the financial statement information that the significant component entities submitted and Treasury used to compile the fiscal year 2018 CFS is consistent with the significant component entities' management schedules, legal representation letters, and the government-wide legal representation letter. For fiscal year 2018, Treasury identified various inconsistencies among the significant component entities' financial statement information, management schedules, and legal representation letters as well as

¹³Legal representation letters describe and evaluate, with respect to matters which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the entity in the form of legal consultation or representation, (1) pending or threatened litigation, claims, and assessments and (2) unasserted claims and assessments that management considers to be probable of assertion and that if asserted would have at least a reasonable possibility of an unfavorable outcome.

¹⁴Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, OMB-19-01 (Washington, D.C.: Oct. 4, 2018), requires that management document in a schedule how the information contained in the legal counsel's response(s) was considered in preparing the financial statements.

inconsistencies between the government-wide legal representation letter and the significant component entities' management schedules and legal representation letters. There may be appropriate reasons for these differences. For example, although management often relies on advice of legal counsel on the likelihood of loss and estimate of the amount or range of potential loss, as reflected in the legal representation letter, management is ultimately responsible for determining whether the loss should be recognized as a liability or disclosed in the notes to the financial statements. As such, management may make a different determination as to the likelihood of loss or estimated loss amounts than those in the legal counsel's assessment. Also, differences between the government-wide legal representation letter and the significant component entities' legal representation letters can occur in situations in which DOJ has more current information on the likelihood of loss and estimated loss amounts.

However, Treasury was not always able to timely determine whether there were appropriate reasons for the differences it identified or whether adjustments were needed to the legal contingency loss information reported in the fiscal year 2018 CFS. Based on our work, we found that certain of these differences required correction in the fiscal year 2018 CFS. For example, Treasury noted that one significant component entity included estimated loss amounts for reasonably possible cases in its management schedule and that such amounts were not reported in the financial information provided to Treasury for consolidation. Because Treasury was unable to timely resolve the issue, the fiscal year 2018 CFS was not appropriately adjusted to include these amounts. Further, DOJ did not provide us the final government-wide legal representation letter as of our audit completion date.

Although Treasury has procedures for reviewing and analyzing the significant component entities' legal contingency loss information and the government-wide legal representation letter, we found that Treasury lacked effective processes and procedures to reasonably assure that appropriate information regarding legal contingency losses was reported in the fiscal year 2018 CFS. Specifically, Treasury did not have sufficient processes and procedures to obtain the needed information in a manner that would facilitate the timely compilation of the legal contingency loss information for inclusion in the fiscal year 2018 CFS or for timely resolving issues identified during its review. For example, as part of Treasury's procedures, it compares the estimated loss amounts for reasonably possible and probable cases included in the significant component entities' management schedules with the financial statement information

that the significant component entities report for inclusion in the fiscal year 2018 CFS. If discrepancies are greater than 10 percent, Treasury's procedures call for significant component entities to provide an explanation. However, because of the extensive amount of time needed to perform this analysis, Treasury was not always able to timely follow up and resolve the differences with the significant component entities.

SFFAS 5, *Accounting for Liabilities of The Federal Government*, as amended by SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation*, contains accounting and reporting standards for loss contingencies, including those arising from litigation, claims, and assessments. An entity should recognize a liability and a related charge to expense for an estimated loss from a loss contingency only when (1) a past event or exchange transaction has occurred, (2) a future outflow or other sacrifice of resources is probable, and (3) the future outflow or sacrifice of resources is measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of possible liability, or a statement that such an estimate cannot be made. OMB Bulletin 19-01 provides guidance to federal agencies on the preparation of legal letters and management schedules, and the Treasury Financial Manual provides federal agencies the legal letter reporting requirements. Also, *Standards for Internal Control in the Federal Government* provides that management should design control activities to achieve objectives and respond to risks. For example, management should design control activities so that financial information is completely and accurately reported.

Until the federal government implements effective processes and procedures to obtain and assess information regarding legal contingency losses, the reliability of amounts and disclosures associated with legal loss contingencies reported in the CFS and the ability to assess their potential effect on the financial condition of the federal government will be limited.

Recommendation for Executive Action

We recommend that the Secretary of the Treasury should ensure that the Fiscal Assistant Secretary, working in coordination with the Controller of OMB, establishes effective processes and procedures to reasonably assure that appropriate information regarding legal contingency losses is reported in the CFS. (Recommendation 4)

Status of Recommendations from Prior Reports

At the completion of our fiscal year 2017 audit, 14 recommendations were open from our prior reports regarding control deficiencies in the processes used to prepare the CFS. During our fiscal year 2018 CFS audit, we found that Treasury, in coordination with OMB, implemented corrective actions that resulted in significant progress in resolving certain of the control deficiencies addressed by our prior recommendations. For two recommendations, the corrective actions resolved the related control deficiencies, and we closed the recommendations.

While progress was made, 12 recommendations from our prior reports remained open as of March 20, 2019, the date of our report on the audit of the fiscal year 2018 CFS. These continuing control deficiencies contributed to the three material weaknesses that relate to the federal government's processes used to prepare the CFS. Consequently, a total of 16 recommendations need to be addressed—12 remaining from prior reports and the four new recommendations we are making in this report.

Appendix I summarizes the status as of March 20, 2019, of the 14 open recommendations from our prior years' reports according to Treasury and OMB, as well as our own assessment and additional comments, where appropriate. Various efforts are under way to address these recommendations. As part of our fiscal year 2019 CFS audit, we will continue to monitor Treasury's and OMB's progress in addressing our recommendations.

Agency Comments and Our Evaluation

Treasury Comments

We provided a draft of this report to Treasury for comment. In its written comments, reproduced in appendix II, Treasury concurred with our four new recommendations. Treasury agreed that new processes and procedures would enhance its internal controls over the processes used to prepare the CFS. It also described actions it will take, and has taken, to address these recommendations as well as certain open recommendations from our prior reports that are summarized in appendix I of this report. Treasury also provided technical comments, which we incorporated as appropriate.

Treasury stated that it implemented process improvements that addressed three of the new recommendations, which resulted from our review of the draft fiscal year 2018 *Financial Report*, prior to the

publication of the final report. These three recommendations are aimed at enhancing Treasury's processes related to (1) including appropriate disclosures required by new federal accounting standards in the *Financial Report* and (2) supporting and consistently reporting restatements, reclassifications, and adjustments to beginning net position. In our report, we acknowledged that Treasury addressed the need for certain additional disclosures related to new federal accounting standards and inconsistencies related to restatements, reclassifications, and adjustments to beginning net position in the final fiscal year 2018 *Financial Report*. However, addressing the specific issues we identified in the draft fiscal year 2018 *Financial Report* does not fully address our recommendations and Treasury did not provide sufficient documentation supporting its efforts to develop and implement or enhance procedures or other steps to reasonably assure that the *Financial Report* is complete and accurate related to these areas. Treasury also stated that it will work on addressing the remaining recommendation.

Regarding five open recommendations from our prior year reports related to treaties and other international agreements, Treasury stated that its existing controls provide reasonable assurance that there are no material misstatements in the *Financial Report* and that it worked with federal entities in fiscal year 2018 to obtain reasonable assurance that proper amounts and disclosures are reported as commitments and contingencies. As noted in appendix I, Treasury established three broad categories to help agencies in classifying treaties and other international agreements with respect to their potential financial implications. The establishment of three standard categories provides some guidance for identifying and reporting treaties and other international agreements; however, as stated in appendix I, we continue to believe further guidance is needed to determine whether additional disclosure in the CFS is required by U.S. GAAP. The guidance should be consistent with FASAB standards and provide procedures for identifying and assessing all treaties and other international agreements for potential contingencies.

Treasury also stated that its efforts to validate the material completeness of budgetary information included in the *Financial Report* and verify the consistency of such information with federal entity reports are sufficient to address the two open recommendations from our prior year reports related to the Reconciliations of Net Operating Cost and Budget Deficit and the Statements of Changes in Cash Balance from Budget and Other Activities (Reconciliation Statements). As noted in appendix I, Treasury has improved its process by documenting its detailed analyses related to the accrual-based and cash-based effects of federal entities' transactions

included in net operating cost and the budget deficit and by continuing to identify items needed to prepare the Reconciliation Statements. However, as noted in appendix I, we continue to believe additional work is needed to (1) reconcile line items to audited federal entity financial statements and (2) determine the appropriate presentation for the reconciling items, which could affect the line items included.

Treasury stated that it appreciates our perspective and will continue to focus its efforts on cost-beneficial solutions to resolve the material conditions that preclude having an opinion rendered on the CFS. Treasury also indicated that it plans to work with GAO as it fulfills its commitment to improving federal financial reporting. As part of our fiscal year 2019 CFS audit, we will determine the status of corrective actions to address the four new recommendations made in this report and the 12 remaining open recommendations from our prior year reports.

OMB Comments

We provided a draft of this report to OMB for comment. In oral comments, OMB staff in the Office of Federal Financial Management stated that OMB generally agreed with the draft report and Treasury's written response. OMB noted that the current administration is committed to continuing to work with Treasury and federal agencies to achieve sound financial management across the federal government.

This report contains three recommendations to the Secretary of the Treasury and one recommendation to the Secretary of the Treasury, working in coordination with the Controller of OMB. The head of a federal entity is required by 31 U.S.C. § 720, to submit a written statement on actions taken or planned on our recommendations to the Senate Committee on Homeland Security and Governmental Affairs and to the House Committee on Oversight and Reform, the congressional committees with jurisdiction over the programs and activities that are the subject of our recommendations, and GAO not later than 180 days after the date of this report. A written statement must also be sent to the Senate and House Committees on Appropriations with the entity's first request for appropriations made more than 180 days after the date of this report. Please send your statement of actions to me at simpsondb@gao.gov.

We are sending copies of this report to appropriate congressional committees, the Fiscal Assistant Secretary of the Treasury, the Controller of the Office of Management and Budget's Office of Federal Financial Management, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov/>.

We acknowledge and appreciate the cooperation and assistance that Treasury and OMB staff members provided during our audit. If you or your staffs have any questions or wish to discuss this report, please contact me at (202) 512-3406 or simpsondb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff members who made major contributions to this report are listed in appendix III.



Dawn B. Simpson
Director
Financial Management and Assurance

Appendix I: Status of GAO's Prior Recommendations Related to the Processes Used to Prepare the CFS

Table 1 shows the status of GAO's prior year recommendations related to the processes used to prepare the consolidated financial statements of the U.S. government. The abbreviations used are defined in the legend at the end of the table.

Table 1: Status of GAO's Prior Recommendations Related to the Processes Used to Prepare the CFS

Count	No.	Recommendation ^a	Status of recommendation ^b	
			Per Treasury and OMB	Per GAO
GAO-04-45 (results of the fiscal year 2002 audit)				
1	02-37	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that federal agencies develop a detailed schedule of all major treaties and other international agreements that obligate the U.S. government to provide cash, goods, or services, or that create other financial arrangements that are contingent on the occurrence or nonoccurrence of future events (a starting point for compiling these data could be the State Department's Treaties in Force). (Preparation material weakness)	Treasury and OMB established three broad categories (Commitment to Spend Money, Potential Obligation to Spend Money, and No Commitment to Spend Money) for treaties and other international agreements with respect to their potential financial implications. In fiscal year 2017, it was confirmed that the relevant financial obligations were included in the applicable financial statements and notes for two of the three categories. In fiscal year 2018, Treasury and OMB established government-wide processes and also relied on management representations from the federal entities to reach reasonable assurance, for the third category, that all material financial obligations or possible material loss exposures were properly reported in the <i>Financial Report</i> .	Open. The establishment of three standard categories provides some guidance for identifying and reporting treaties and other international agreements, but further guidance is needed to determine whether additional disclosure in the CFS is required by U.S. generally accepted accounting principles (U.S. GAAP). The guidance should be consistent with Federal Accounting Standards Advisory Board (FASAB) standards and provide procedures for identifying and assessing all treaties and other international agreements for potential contingencies.

**Appendix I: Status of GAO's Prior
Recommendations Related to the Processes
Used to Prepare the CFS**

Count	No.	Recommendation ^a	Status of recommendation ^b	
			Per Treasury and OMB	Per GAO
2	02-38	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that federal agencies classify all such scheduled major treaties and other international agreements as commitments or contingencies. (Preparation material weakness)	See the status of recommendation No. 02-37.	Open. See the status of recommendation No. 02-37.
3	02-39	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that federal agencies disclose in the notes to the CFS amounts for major treaties and other international agreements that have a reasonably possible chance of resulting in a loss or claim as a contingency. (Preparation material weakness)	See the status of recommendation No. 02-37.	Open. See the status of recommendation No. 02-37.
4	02-40	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that federal agencies disclose in the notes to the CFS amounts for major treaties and other international agreements that are classified as commitments and that may require measurable future financial obligations. (Preparation material weakness)	See the status of recommendation No. 02-37.	Open. See the status of recommendation No. 02-37.

**Appendix I: Status of GAO's Prior
Recommendations Related to the Processes
Used to Prepare the CFS**

Count	No.	Recommendation ^a	Status of recommendation ^b	
			Per Treasury and OMB	Per GAO
5	02-41	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that federal agencies take steps to prevent major treaties and other international agreements that are classified as remote from being recorded or disclosed as probable or reasonably possible in the CFS. (Preparation material weakness)	See the status of recommendation No. 02-37.	Open. See the status of recommendation No. 02-37.
6	02-129	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to ensure that the note disclosure for stewardship responsibilities related to the risk assumed for federal insurance and guarantee programs meets the requirements of Statement of Federal Financial Accounting Standards (SFFAS) No. 5, Accounting for Liabilities of the Federal Government, paragraph 106, which requires that when financial information pursuant to Financial Accounting Standards Board standards on federal insurance and guarantee programs conducted by government corporations is incorporated in general purpose financial reports of a larger federal reporting entity, the entity should report as required supplementary information what amounts and periodic change in those amounts would be reported under the "risk assumed" approach. (Preparation material weakness)	Treasury and OMB worked with entity subject matter experts on a FASAB task force, which ultimately resulted in the fiscal year 2017 issuance of SFFAS 51, Insurance Programs. The standard rescinded the Insurance and Guarantees section in SFFAS 5 (paras. 97-121) and will become effective for fiscal year 2019 reporting.	Open.
GAO-07-805 (results of the fiscal year 2006 audit)				
7	06-6	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, working in coordination with the Controller of OMB's Office of Federal Financial Management, to establish effective processes and procedures to ensure that appropriate information regarding litigation and claims is included in the government-wide legal representation letter. (Preparation material weakness)	Treasury and OMB performed the analysis on the existing schedules to the legal representation letters and determined that material items were reported appropriately in fiscal years 2017 and 2018. Treasury and OMB will continue to work with the Department of Justice to meet the requirement to complete the government-wide legal representation letter by the end of the audit period.	Open.

**Appendix I: Status of GAO's Prior
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Used to Prepare the CFS**

Count	No.	Recommendation ^a	Status of recommendation ^b	
			Per Treasury and OMB	Per GAO
GAO-08-748 (results of the fiscal year 2007 audit)				
8	07-9	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB's Office of Federal Financial Management, to develop and implement effective processes for monitoring and assessing the effectiveness of internal control over the processes used to prepare the CFS. (Preparation material weakness)	Treasury designed and implemented an effective internal control review for the CFS compilation processes.	Closed.
GAO-13-540 (results from the fiscal year 2012 audit)				
9	12-04	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, working in coordination with the Controller of OMB's Office of Federal Financial Management, to establish and implement effective procedures for reporting amounts in the CFS budget statements that are fully consistent with the underlying information in significant federal entities' audited financial statements and other financial data. (Reconciliation statements material weakness)	Throughout fiscal year 2018, Treasury made significant progress to remediate this audit recommendation. Treasury continued establishing and implementing effective procedures for reporting amounts in the Reconciliation Statements that were fully consistent with the underlying information in significant federal entities' audited financial statements and other financial data.	Open. Treasury documented its detailed analyses related to the accrual-based and cash-based effects of federal entities' transactions included in net operating cost and the budget deficit. However, additional work is needed to reconcile line items to audited federal entity financial statements.
10	12-05	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, working in coordination with the Controller of OMB's Office of Federal Financial Management, to establish and implement effective procedures for identifying and reporting all items needed to prepare the CFS budget statements. (Reconciliations statements material weakness)	Treasury finalized work on establishing and implementing effective procedures for identifying and reporting all items needed to prepare the Reconciliation Statements. Treasury focused on updating and finalizing documentation of the explanations for all reconciling items on the Reconciliation Statements.	Open. Treasury continued to identify items needed to prepare the Reconciliation Statements. However, additional work is needed in determining the appropriate presentation for the reconciling items, which could affect the line items included.

**Appendix I: Status of GAO's Prior
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Used to Prepare the CFS**

Count	No.	Recommendation ^a	Status of recommendation ^b	
			Per Treasury and OMB	Per GAO
GAO-14-543 (results from the fiscal year 2013 audit)				
11	13-06	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, working in coordination with the Controller of OMB, to establish and implement policies and procedures for accounting for and reporting all significant General Fund activity and balances, obtaining assurance on the reliability of the amounts, and reconciling the activity and balances between the General Fund and federal entities. (Intragovernmental material weakness)	Treasury has worked for the past few years to develop the infrastructure to support the Schedules of the General Fund of the U.S. Government. In addition, Treasury developed an accounting model and reporting format for the General Fund. Additionally, Treasury created a method for federal agencies to identify and report their activity with the General Fund that would facilitate entity reconciliation of intragovernmental activity with the General Fund. Treasury continues to work on obtaining the audit assurance on the activity and balances.	Open.
12	13-07	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, working in coordination with the Controller of OMB, to establish a formalized process to require the performance of additional audit procedures specifically focused on intragovernmental activity and balances between federal entities to provide increased audit assurance over the reliability of such information. (Intragovernmental material weakness)	As a result of multiple initiatives over the past few years, Treasury and OMB have observed a significant decrease in intragovernmental differences related to unreconciled transactions submitted by federal entities. Therefore, Treasury and OMB have determined that at this time there is not a justified need for the additional cost and burden on federal entities of implementing additional audit procedures specifically focused on intragovernmental activity and balances.	Open. In fiscal year 2018, there were tens of billions of dollars of unreconciled intragovernmental differences. A formalized process requiring that auditors perform additional audit procedures focused on intragovernmental activity and balances would help to address these unreconciled transactions.
GAO-17-524 (results from the fiscal year 2016 audit)				
13	16-02	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to develop and implement a sufficient process for working with federal entities to reduce or resolve the need for significant adjustments to federal entity data submitted for the CFS. (Preparation material weakness)	Treasury developed and implemented a process to reduce the need for significant adjustments to federal entity data. With this process in place, the number of adjustments has decreased each year since 2016.	Closed.

**Appendix I: Status of GAO's Prior
Recommendations Related to the Processes
Used to Prepare the CFS**

Count	No.	Recommendation ^a	Status of recommendation ^b	
			Per Treasury and OMB	Per GAO
14	16-03	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, working in coordination with the Controller of OMB, to improve corrective action plans for (1) treaties and international agreements, (2) additional audit procedures for intragovernmental activity and balances, and (3) the Reconciliation Statements so that they include sufficient information to address the control deficiencies in these areas effectively. (Preparation material weakness)	Treasury believes that its current remediation plan, including its various corrective action plans (CAP), is comprehensive, appropriate, and effective, with robust and ongoing monitoring processes in place. In addition, Treasury's plan already contains multiple CAPs intended to (1) more precisely assess and monitor treaty and international agreement activity, (2) increase the quality of intragovernmental data, and (3) enhance the controls and analysis supporting the Reconciliation Statements. Treasury will continue to work with OMB and the federal entity community to effectively implement existing corrective actions, while being mindful of the potential burden placed on entities commensurate with additional processes.	Open. The CAPs in these three areas did not include sufficient steps to effectively address related control deficiencies involving the processes used to prepare the CFS.

Legend:

CFS = consolidated financial statements of the U.S. government
Financial Report = Financial Report of the United States Government
 General Fund = General Fund of the U.S. Government
 OMB = Office of Management and Budget
 Treasury = Department of the Treasury

Sources: GAO, Treasury, and OMB. | GAO-19-624

^aThe recommendations in our prior reports related to material weaknesses in the following areas:

Intragovernmental: The material weakness relates to the federal government's inability to adequately account for intragovernmental activity and balances between federal entities.

Preparation: The material weakness relates to the federal government's inability to reasonably assure that the consolidated financial statements are (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in accordance with U.S. GAAP.

Reconciliation statements: The material weakness relates to the federal government's inability to reasonably assure that the information in the (1) Reconciliations of Net Operating Cost and Budget Deficit and (2) Statements of Changes in Cash Balance from Budget and Other Activities is complete, properly supported, and consistent with the underlying information in the audited entities' financial statements and other financial data.

^bThe status of the recommendations listed in app. I is as of March 20, 2019, the date of our report on the audit of the fiscal year 2018 CFS.

Appendix II: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 16, 2019

Ms. Dawn B. Simpson
Director, Financial Management and Assurance
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Simpson:

Thank you for the opportunity to comment on the Government Accountability Office's (GAO) draft Management Report (Report) on the Fiscal Year (FY) 2018 audit, GA0-19-624, MANAGEMENT REPORT, *Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements (CFS)*.

We continue to appreciate GAO's perspective and look forward to continuing to build on our significant progress to enhance the auditability of the *Financial Report of the U.S. Government (Financial Report)*. Since FY 2013, Treasury's efforts have yielded closure of 60 percent of outstanding prior year recommendations. Consistent with management's commitment to ensuring the reliable reporting of the Government's financial position, Treasury will continue to focus its efforts on cost-beneficial solutions that we believe will yield the desired outcome—*i.e.*, sufficiently resolving the material conditions precluding the full audit of the *Financial Report*.

The draft Report identifies four new audit recommendations concerning three new internal control deficiencies in the preparation of the FY 2018 *Financial Report*. Treasury agrees that new processes and procedures would enhance these internal controls. Three of the four new recommendations resulted from GAO's review of the draft FY 2018 *Financial Report*. Treasury implemented process improvements addressing three of these recommendations prior to the publication of the final FY 2018 *Financial Report*. Treasury will work on the remaining recommendation for the FY 2019 *Financial Report*.

Additionally, we are pleased with the closure of two outstanding recommendations from the prior years' report, including a long-outstanding item dating back as far as FY 2007. The remaining recommendations emphasize and articulate the three critical material weaknesses identified in the audit: (1) intragovernmental activity and balances; (2) preparation of the CFS; and (3) reconciliations of budget deficit to net operating cost and changes in cash balance.

Notably, the Schedules of the General Fund of the U.S. Government for FY 2018, prepared by Treasury, were audited for the first time by GAO. Although the inaugural audit resulted in a disclaimer of opinion, Treasury has continued to make significant enhancements in: (a) improving the accounting for and reporting of General Fund activity and balances; and (b) reducing the

**Appendix II: Comments from the Department
of the Treasury**

intragovernmental elimination differences between the General Fund and its trading partners by over \$800 billion during FY 2018. This first audit is a significant milestone as the lack of distinct and detailed accounting for the General Fund has been a long-standing issue contributing to all three of the aforementioned material weaknesses.

In addition, Treasury's efforts in recent years have significantly strengthened internal controls intended to address the preparation material weakness. In FY 2018, Treasury worked with federal entities to obtain reasonable assurance that proper amounts and disclosures are reported as commitments and contingencies related to treaties and other international agreements to ensure compliance with generally accepted accounting principles. GAO did not close these audit recommendations and requested additional procedures be implemented. Treasury agrees controls can continue to be enhanced in this area but believes the existing controls are sufficient to provide reasonable assurance that there are no material misstatements in the *Financial Report* related to this matter.

Finally, Treasury recognizes the audit of the General Fund of the U.S. Government is needed to fully address the material weakness related to reconciliations of budget deficit to net operating cost and changes in cash balance. However, with the great strides made in validating material completeness of budgetary information included in the *Financial Report*, as well as the consistency of that information with agency reports, Treasury believes two additional open audit recommendations have also been satisfied. Specifically, Treasury documented the accrual-based and cash-based effects on the net operating cost and budget deficit. The work in FY 2018 focused on: (a) identifying and reporting all the items in the Reconciliation Statements; and (b) reasonably assuring that the information in these statements were consistent with the federal entities audited financial statements.

In conclusion, we appreciate GAO's partnership and continued support. Thank you again for the opportunity to review and comment on the draft Report. We look forward to working with you and your staff as we fulfill our ongoing commitment to improve federal financial reporting.

Sincerely,



Amy B. Edwards
Deputy Assistant Secretary
Accounting Policy and Financial
Transparency

cc: Timothy F. Soltis

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Dawn B. Simpson, (202) 512-3406 or simpsondb@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made major contributions to this report: Carolyn M. Voltz and Paul F. Foderaro (Assistant Directors), LaTasha L. Freeman (Auditor-in-Charge), Youssef R. Amrani, Maria Hasan, W. Stephen Lowrey, Fabian J. Mendive, Maria M. Morton, and Kristine A. Papa.

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