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H.R. 4685, THE ACCOUNTABILITY OF TAX DOLLARS ACT OF 2002

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 4685

TO AMEND TITLE 31, UNITED STATES CODE, TO EXPAND THE TYPES OF FEDERAL AGENCIES THAT ARE REQUIRED TO PREPARE AUDITED FINANCIAL STATEMENTS

MAY 14, 2002

Serial No. 107–193

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H.R. 4685, THE ACCOUNTABILITY OF TAX DOLLARS ACT OF 2002

TUESDAY, MAY 14, 2002

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:01 p.m., in room 2247, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Putnam, Schakowsky, and Kanjorski.

Staff present: J. Russell George, staff director and chief counsel; Bonnie Heald, deputy staff director; Henry Wray, senior counsel; Rosa Harris, GAO detailee; Justin Paulhamus, clerk; David McMillen, minority professional staff member; and Jean Gosa, minority clerk.

Mr. HORN. This hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order. We're here today to examine H.R. 4685, the Accountability of Tax Dollars Act of 2002, introduced by Representative Patrick Toomey from Pennsylvania. Mr. Toomey will present the merits of his bill as our first witness. This legislation would extend the requirement of annual audits to all Federal agencies with total annual budget authority of $25 million or more.

Since fiscal year 1996, the Chief Financial Officers Act, as amended, has required the 24 major departments and agencies in the executive branch to prepare annual financial statements and have them audited. Although few of these Federal agencies can provide reliable and useful information on a day-to-day basis, the act's requirement for audited financial statements has clearly brought agencies closer toward providing that sorely needed information.

Few agencies dispute the benefits of the audit process. Last year, the General Accounting Office surveyed 26 non-Chief Financial Officers Act agencies and found that 21 of the 26 believe that it is beneficial to have audited financial statements.

Our second panel of witnesses will include a representative of the General Accounting Office, who will discuss that survey. In addition, the panel will include representatives from four of the 26 agencies that would be affected by the legislation. We also have a written statement from the chairman of the Securities and Ex-

change Commission which, without objection, will be included in the hearing record.

I welcome all of our guests today and I look forward to your testimony.

[The prepared statement of Hon. Stephen Horn and the text of H.R. 4685 follow:]

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Opening Statement
Representative Steve Horn, R-CA
Chairman, Government Efficiency, Financial Management and Governmental Relations
May 14, 2002

This hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

We are here today to examine H.R. 4685, the "Accountability of Tax Dollars Act of 2002," introduced by Representative Patrick Toomey from Pennsylvania. Mr. Toomey will present the merits of his bill as our first witness. This legislation would extend the requirement of annual audits to all federal agencies with total annual budget authority of $25 million or more.

Since fiscal year 1996, the Chief Financial Officers Act, as amended, has required the 24 major departments and agencies in the executive branch to prepare annual financial statements and have them audited. Although few of these federal agencies can provide reliable and useful information on a day-to-day basis, the act's requirement for audited financial statements has clearly brought agencies closer toward providing that sorely needed information.

Few agencies dispute the benefits of the audit process. Last year, the General Accounting Office surveyed 26 non-CFO Act agencies and found that 21 of the 26 believe that it is beneficial to have audited financial statements.

Our second panel of witnesses will include a representative of the General Accounting Office who will discuss that survey. In addition, the panel will include representatives from four of the 26 agencies that would be affected by the legislation. We also have a written statement from the chairman of the Securities and Exchange Commission, which without objection will be included in the hearing record.

I welcome all of our witnesses today, and I look forward to your testimony.

I

107TH CONGRESS
2D SESSION

H. R. 4685

To amend title 31, United States Code, to expand the types of Federal agencies that are required to prepare audited financial statements.

IN THE HOUSE OF REPRESENTATIVES

MAY 8, 2002

Mr. TOOMEY (for himself, Mr. KANJORSKI, Mr. SOUDER, Mr. KERNS, Mrs. CUBIN, Mr. TANCREDO, Mr. SCHAFFER, and Mr. CANTOR) introduced the following bill; which was referred to the Committee on Government Reform

---

A BILL

To amend title 31, United States Code, to expand the types of Federal agencies that are required to prepare audited financial statements.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Accountability of Tax Dollars Act of 2002".

SEC. 2. AMENDMENTS RELATING TO AUDITING REQUIREMENT FOR FEDERAL AGENCY FINANCIAL STATEMENTS.

(a) IN GENERAL.—Section 3515 of title 31, United States Code, is amended—

(1) in subsection (a)—

(A) by striking "Not later" and inserting "(1) Except as provided in paragraph (2), not later";

(B) by striking "each executive agency identified in section 901(b) of this title" and inserting "each covered executive agency";

(C) by striking "1997" and inserting "2003"; and

(D) by adding at the end the following:

"(2) A covered executive agency is not required to prepare an audited financial statement under this section for any fiscal year for which the total amount of budget authority available to the agency is less than $25,000,000.";

(2) in subsection (b) by striking "an executive agency" and inserting "a covered executive agency";

(3) in subsection (c) and (d) by striking "executive agencies" each place it appears and inserting "covered executive agencies"; and

(4) by adding at the end the following:

"(e) The term 'covered executive agency'—

"(1) means an executive agency that is not required by another provision of Federal law to prepare and submit to the Congress and the Director of the Office of Management and Budget an audited financial statement for each fiscal year, covering all accounts and associated activities of each office, bureau, and activity of the agency; and

"(2) does not include a corporation, agency, or instrumentality subject to chapter 91 of this title.".

(b) WAIVER AUTHORITY.—

(1) IN GENERAL.—The Director of the Office of Management and Budget may waive the application of all or part of section 3515(a) of title 31, United States Code, as amended by this section, for financial statements required for the first 2 fiscal years beginning after the date of the enactment of this Act for an agency described in paragraph (2) of this subsection.

(2) AGENCIES DESCRIBED.—An agency referred to in paragraph (1) is any covered executive agency (as that term is defined by section 3515(e) of title 31, United States Code, as amended by this subsection (a) of this section) that is not an executive

1 agency identified in section 901(b) of title 31,
2 United States Code.

○

Mr. HORN. And we will first have the gentleman from Pennsylvania, Mr. Toomey, explain his proposal.

STATEMENT OF THE HON. PATRICK J. TOOMEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. TOOMEY. Thank you very much, Chairman Horn. I appreciate you conducting this hearing today.

Specifically, I want to thank you for two things: one, for giving me the opportunity to testify on H.R. 4685, the Accountability of Tax Dollars Act, and for taking an interest in the bill.

I'd also like to thank you for your leadership in the need to improve financial management practices of Federal agencies and for making agencies more accountable to taxpayers.

I first introduced the Accountability of Tax Dollars Act in the 106th Congress as a good government measure to combat waste, fraud and abuse at Federal agencies. I recently reintroduced this legislation with bipartisan support, including the support of one subcommittee member, Mr. Kanjorski of Pennsylvania, as an original cosponsor. I decided to introduce legislation when I learned, to my surprise, that many Federal agencies are simply not required by law to prepare audited financial statements, even though this is a fundamental part of good management and oversight.

So why do we need this bill? Well, first, oversight of Federal agencies is certainly a fundamental responsibility of Congress, and it's a responsibility we should not shirk. But to carry out that responsibility, we need to see audited financial statements that can be relied upon.

Second, we also have a responsibility to the taxpayers to monitor how their tax dollars are spent, but also to enable them to see how their tax money's being spent and to ensure that it is spent most efficiently.

Third, required audited financial statements is really a reasonable standard of oversight. In fact, Federal law currently requires publicly held private companies with budgets of a lot less than $25 million, which is the threshold in my bill, to file audited financial statements with the SEC. Ironically, the SEC itself does not have to prepare their own statement.

At my request, the GAO did a survey of agencies who are not required to prepare audited financial statements in order to determine several things: first, whether $25 million is a cost-effective threshold for requiring audits; second, what degree of effort would be required for agencies to comply with that requirement; and finally, whether non-CFO agencies that voluntarily conduct these audits have realized any benefits for doing so.

The GAO survey say that overall the surveyed agencies reported they either achieved significant benefits or they anticipate achieving such benefits from auditing financial statements. Twenty-one of the 26 agencies reported that Federal agencies should, in their opinion, have their financial statements audited. All of the surveyed agencies that have voluntarily audited reported significant benefits from those audits, including enhancing accountability, identifying inefficiencies and weaknesses, improving internal con-

trols, meeting statutory requirements and monitoring assets and liabilities.

I think one of the most convincing results of the GAO survey was that 13 of the 14 agencies who do not currently prepare audited financial statements reported that the absence of a statutory requirement was a primary reason that they do not do so. The list of agencies not required to audit financial statements includes some very large agencies charged with significant regulatory fiduciary responsibilities, including the Federal Communications Commission, the Securities and Exchange Commission, and the National Labor Relations Board.

As the members of this committee know, the Chief Financial Officers [CFO] Act currently requires the 24 major agencies and departments to prepare and audit financial statements annually. This information provides Congress with valuable insight into the agencies' financial systems and, most importantly, performance results. H.R. 4685, the Accountability of Tax Dollars Act of 2002, would simply extend the CFO requirements currently imposed on the major agencies to all Federal agencies with gross budget authority of at least $25 million. The agencies that would be covered by this bill have a combined annual budget of roughly $20 billion, a significant amount of money that, frankly, should be accounted for more rigorously.

Now, understanding that some of the agencies will be required to fully implement the requirements of the CFO Act, H.R. 4685 gives the OMB Director discretion for the first 2 years of implementation to waive application of all or part of the requirements.

In our current climate of budget constraints, a Federal agency should being able to demonstrate measurable outcomes in the budget process. Audits make agency transactions public, so an agency can be evaluated on how well their programs performed and whether the public received the benefits they're intended to. And frankly, rewarding success can only be achieved with complete and accurate financial information available. I believe H.R. 4685 would take us one step closer to achieving this goal of proper oversight.

I'd like to thank the GAO and Gary Engel, in particular, who is testifying today for their work on this issue. I relied on their expertise and insight regarding the benefits of the audit process for affected agencies when crafting the bill. I also look forward to the testimony of the representatives of the agencies who would be covered by this bill, including the experience of those agencies that have voluntarily submitted to audits in the past and achieved good results.

Again, thank you for bringing attention to this bill and for giving me the chance to make my presentation. I'd be happy to answer any questions you might have.

[The prepared statement of Hon. Patrick J. Toomey follows:]

Rep. Patrick J. Toomey (R-PA)
Testimony before the House Subcommittee on
Government Efficiency, Financial Management,
and Intergovernmental Relations

May 14, 2002

H.R. 4685, The Accountability of Tax Dollars Act

I would like to thank Chairman Horn, Ranking Member Schakowsky, and the other members of the subcommittee for being here today. Mr. Chairman, I would like to thank you for two things today.

First, thank you for giving me the opportunity to testify about H.R. 4685, the Accountability of Tax Dollars Act, and for taking an interest in the bill. Second, I'd like to thank you for your leadership on the need to improve financial management practices at federal agencies and make agencies more accountable to taxpayers.

I first introduced The Accountability of Tax Dollars Act in the 106th Congress as a good government measure to combat waste, fraud, and abuse at federal agencies. I recently reintroduced this legislation with bipartisan support. I decided to introduce legislation when I learned, to my surprise, that many federal agencies are not required by law to prepare audited financial statements, even though this is a fundamental part of good management and oversight.

Why do we need this bill? First, oversight of federal agencies is a fundamental responsibility of Congress, and we should not shirk this responsibility. We need to review agency financial statements that can be relied upon. Second, we also have a responsibility to the taxpayers to monitor how their tax dollars are spent and guarantee that their money is used efficiently.

Third, requiring audited financial statements is a reasonable standard of oversight. In fact, the Securities and Exchange Act requires publicly held private companies with budgets significantly lower than the $25 million threshold in my bill to file audited financial statements with the Securities and Exchange Commission (SEC) who, ironically, do not have to prepare their own.

At my request, the U.S. General Accounting Office (GAO) did a survey of agencies not currently required to audit financial statements in order to determine whether $25 million is a cost-effective threshold for requiring audits, what degree

of effort would be required for agencies to implement the requirement, and whether agencies that voluntarily audit have realized benefits.

The GAO survey stated that, overall, the surveyed agencies reported they either achieved significant benefits or anticipated achieving such benefits from auditing financial statements. Specifically, 21 of the 26 surveyed agencies reported that federal agencies should have their financial statements audited.

All of the surveyed agencies that have voluntarily audited reported significant benefits from those audits like enhancing accountability, identifying inefficiencies and weaknesses, improving internal controls, meeting statutory requirements, and monitoring assets and liabilities. One of the most convincing results of the GAO survey was that 13 of the 14 agencies who do not prepare audited financial statements reported that the absence of a statutory requirement was a primary reason for not auditing.

The list of agencies not required to audit financial statements includes large agencies charged with significant regulatory and fiduciary responsibilities, like the Federal Communications Commission and the Securities and Exchange Commission.

The Chief Financial Officers (CFO) Act currently requires the 24 major agencies and departments to prepare and audit financial statements annually. This information provides Congress with valuable insight into agencies' financial systems and, most importantly, performance results.

H.R. 4685, The Accountability of Tax Dollars Act of 2002, would extend the CFO Act requirements currently imposed on the major agencies to all federal agencies with gross budget authority of $25 million. The agencies that would be covered by this bill have a combined annual budget of roughly $20 billion, a significant amount of money that should be accounted for more rigorously.

Understanding that some effort at the agencies will be required to fully implement the requirements of the CFO Act, H.R. 4685 gives the Director of the Office of Management and Budget the discretion for the first two years of implementation to waive application of all or part of the requirements.

In our current climate of budget constraints, a federal agency should be able to demonstrate measurable outcomes in the budget process. Audits make agency transactions public so an agency can be evaluated on how well their programs performed and whether the public received any benefit. Rewarding success can only be achieved with complete and accurate financial information. I believe H.R 4685 takes us one step closer to achieving this goal.

I want to thank GAO for their work looking into this issue. I relied on their expertise and insight regarding the benefits of the audit process for affected agencies when crafting H.R. 4685.

I also look forward to the testimony of the representatives of agencies who would be covered by this bill, including the experience of those agencies that have voluntarily submitted to audits in the past, and achieved good results.

Thank you again for bringing attention to The Accountability of Tax Dollars Act, and for giving me a chance to discuss the bill.

United States General Accounting Office
Washington, DC 20548

December 14, 2001

The Honorable Patrick J. Toomey
House of Representatives

Subject: Survey Results of Selected Non-CFO Act Agencies' Views on Having Audited Financial Statements

Dear Mr. Toomey:

This letter summarizes the information we provided during a November 30, 2001, briefing to your office. Based on your April 30, 2001, letter to the Comptroller General and subsequent discussions with your office, we conducted a survey of 26 agencies that are not subject to the Chief Financial Officers Act of 1990 (CFO Act). The CFO Act, as expanded by the Government Management Reform Act of 1994, requires 24 major executive branch departments/agencies to prepare annual financial statements and have them audited. Of the 26 non-CFO Act agencies that we surveyed, 12 agencies have prepared and had their financial statements audited within the past 5 years.

The objectives of the survey were to determine the

- benefits achieved or anticipated by the surveyed agencies from preparing financial statements and having them audited;
- degree of effort or anticipated effort for the surveyed agencies to prepare financial statements and have them audited;
- factors, including budget authority, that should be considered in determining whether agencies should prepare financial statements and have them audited; and
- surveyed agencies' views about whether, in general, agencies should have their financial statements audited.

The enclosed briefing slides summarize the survey responses as provided to you in the November 30, 2001, briefing. The attachment to the briefing slides lists, by surveyed agency, the amounts of assets, liabilities, revenue, and expenses that the agencies reported to the Department of the Treasury for fiscal year 2000, as well as certain agency baseline information, such as budget authority, the number of offices, and agency functions. Pages 13 and 14 of the enclosure discuss the scope and methodology of our work. Where appropriate, we discussed certain responses to the questionnaire with agency officials, but we did not independently verify the information provided by the respondents. In addition, we sent agency-specific data presented in the slides to the respective agencies for their review. We performed our

work from June 2001 through November 2001 in accordance with U.S. generally accepted government auditing standards.

Results in Brief

All 26 of the surveyed agencies responded to our survey. Overall, the surveyed agencies reported that they either achieved significant benefits or would anticipate achieving such benefits from having audited financial statements. The level of effort to prepare financial statements and prepare for an audit of such statements varied significantly with the size and other characteristics of the agencies. In determining whether agencies should prepare financial statements and have them audited, respondents identified a combination of factors that should be considered, including budget authority, key financial statement amounts, and the type of agency operations. For example, the surveyed agencies reported that an agency's fiduciary responsibilities and risks associated with the agency's operations were the most important factors to consider. Irrespective of the importance of such factors, 21 of the 26 agencies reported that federal agencies, in general, should have their financial statements audited.

Benefits Achieved or Anticipated by the Surveyed Agencies From Preparing Financial Statements and Having Them Audited

The 12 surveyed agencies that have had their financial statements audited generally reported significant benefits from those audits. The most significant benefits cited are enhancing accountability and identifying inefficiencies and weaknesses. Other significant benefits included improving internal control, enhancing the public's perception of the agency, meeting statutory requirements, and monitoring assets and liabilities. The 14 surveyed agencies that have not had audited financial statements reported that they would anticipate benefits from such audits, but to a much less extent than the achieved benefits reported by the 12 surveyed agencies that have had their financial statements audited.

We asked these 12 audited agencies whether the benefits of their first audit and subsequent audits outweighed the costs and whether their audits were more or less beneficial than expected. Half of the 12 agencies responded that the benefits achieved outweighed the costs for the first audit, and about three-fourths of the agencies responded that the benefits achieved outweighed the costs for subsequent audits. Ten of the 12 agencies (83 percent) responded that their audits were more beneficial than or about as beneficial as expected.

Degree of Effort or Anticipated Effort for the Surveyed Agencies to Prepare Financial Statements and Have Them Audited

For the 12 surveyed agencies that have had their financial statements audited, the reported level of effort to prepare financial statements and to prepare for an audit varied significantly with the size and other characteristics of the agencies. For example, the reported number of staff days to prepare for the first audit ranged from 50 to 750 days, and the estimated fiscal year 2000 audit costs ranged from $11,000 to $350,000. Frequently reported steps that these agencies had taken to prepare for their

first and subsequent audits are (1) improving or replacing financial management systems, (2) hiring additional financial management personnel, (3) training financial management personnel, and (4) performing significant manual procedures (for first audits).

For the 14 surveyed agencies that have not had their financial statements audited, the most frequently cited anticipated steps needed to prepare for a first audit are (1) hiring consultants, (2) training financial management personnel, and (3) requesting additional funding.

Factors That Should Be Considered in Determining Whether Agencies Should Prepare Financial Statements and Have Them Audited

According to the 26 surveyed agencies, the most important factors that should be considered in determining whether agencies should have audited financial statements are (1) whether the agency has fiduciary responsibilities and (2) risks associated with the agency's operations. The surveyed agencies believe that of equal importance to the amount of budget authority an agency receives are the amounts of an agency's assets and liabilities. Other important factors include whether the agency receives nongovernmental funding and the amounts of an agency's revenue and expenses.

Of the 14 surveyed agencies that have not had their financial statements audited, 13 reported that the absence of a statutory requirement to do so was a reason that they have not had such audits. Other reasons cited by 6 of the 14 agencies include an insufficient number of financial management personnel and insufficient funding.

General Views About Whether Agencies Should Have Their Financial Statements Audited

Twenty-one of the 26 surveyed agencies, including all 12 agencies that have had their financial statements audited, reported that, in general, agencies should have their financial statements audited. The remaining 5 surveyed agencies, which had budget authority ranging from about a quarter of a million dollars to a third of a billion dollars, expressed the opposite point of view.

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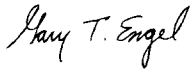
The factors that the surveyed agencies considered to be important in determining the need for having audited financial statements, such as fiduciary responsibilities, risks associated with the agency's operations, and the magnitude of budget authority and key financial statement amounts, are generally consistent with our views. Our long-standing position has been that the preparation and audit of financial statements contribute to reliable, timely, and useful financial information. Such information is important in helping management ensure accountability, measure and control costs, and make timely and fully informed decisions. Preparing audited financial statements also leads to improvements in internal control and financial management systems. Hence, we view much of the effort to prepare financial statements and have them audited as an integral part of effective financial management.

We are sending copies of this letter to the surveyed agencies, the Chief Financial Officer, Executive Office of the President, the Director of the Office of Management and Budget, and interested congressional committees. Copies will also be made available to others upon request. This letter will also be available on GAO's home page at http://www.gao.gov.

If you or your staff have any questions regarding this letter, please contact me at (202) 512-3406 or Kent Bowden, Assistant Director, at (202) 512-5270. Other key contributors to this assignment were Kimberly Graham, Casey Keplinger, Stanley Kostyla, and LaShawnda Wilson.

Sincerely yours,



Gary T. Engel
Director
Financial Management and Assurance

Enclosure

Enclosure

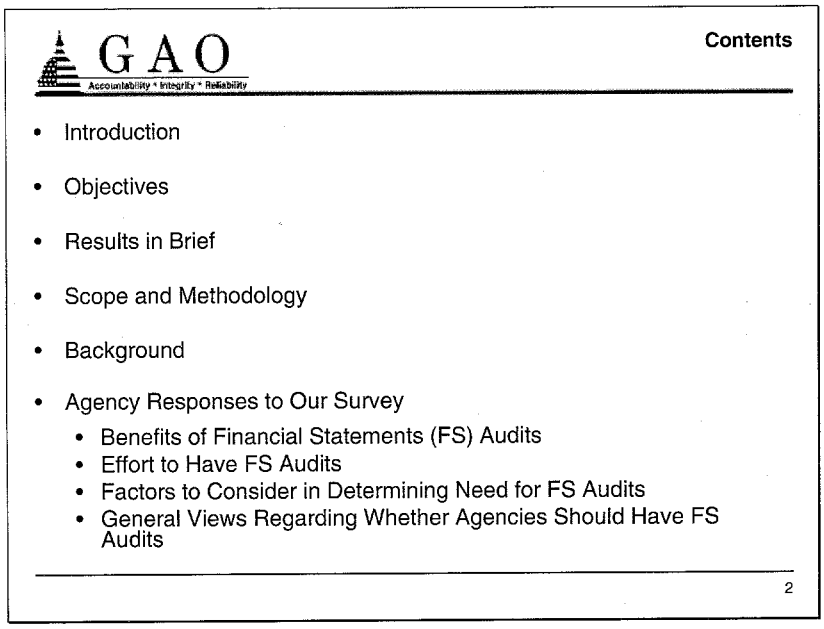
Briefing to the Honorable Patrick J. Toomey

Survey Results of Selected Non-CFO Act Agencies' Views on Having Audited Financial Statements

Briefing to the Honorable Patrick J. Toomey
House of Representatives

November 30, 2001

Enclosure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• General Views Regarding Whether Agencies Should Have FS Audits
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Enclosure

Introduction

- The Chief Financial Officers Act of 1990 (CFO Act), as amended, requires 24 major executive departments/agencies to prepare financial statements annually and have them audited.
- We selected 26 agencies that are not subject to the CFO Act, as amended. We obtained relevant data from these agencies and surveyed them regarding their views on having audited financial statements. Of the 26 agencies that we surveyed:
  - 12 agencies have prepared and had their financial statements audited within the past 5 years, and
  - 14 agencies have not done so.

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Objectives

Based on your letter and subsequent discussions with your staff, we surveyed selected non-CFO Act agencies to determine the

- benefits achieved or anticipated by the surveyed agencies from preparing financial statements and having them audited;
- degree of effort or anticipated effort for the surveyed agencies to prepare financial statements and have them audited;
- factors, including budget authority, that the surveyed agencies believe should be considered in determining whether agencies should prepare financial statements and have them audited; and
- surveyed agencies' views about whether, in general, agencies should have their financial statements audited.

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Results in Brief
Benefits of FS Audits

- The 12 surveyed agencies that have had their financial statements audited generally reported significant benefits from those audits. The most significant benefits are enhancing accountability and identifying inefficiencies and weaknesses. Other significant benefits include improving internal control; enhancing the public's perception of the agency; meeting statutory requirements; and monitoring assets, liabilities, and net position.

- The 14 surveyed agencies that have not had audits of their financial statements reported anticipated benefits for such audits, but to a much less extent than the achieved benefits reported by the 12 agencies that have had their financial statements audited.

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Results in Brief
Effort to Have FS Audits

- The level of effort required by the 12 surveyed agencies that have had their financial statements audited to prepare financial statements and to prepare for an audit varied significantly with the size and other characteristics of the agencies.
  - The number of staff days to prepare for the first audit ranged from 50 to 750 days, and the estimated FY 2000 audit costs ranged from $11,000 to $350,000.
  - Steps taken to prepare for the first and subsequent audits varied significantly. Such steps included performing significant manual procedures, improving or replacing financial management systems, hiring additional financial management personnel, and training financial management personnel.
- The most frequently anticipated steps to be taken to prepare for the first audit, as reported by the 14 surveyed agencies that have not had their financial statements audited, are hiring consultants, training financial management personnel, and requesting additional funding. Other anticipated steps reported include reorganizing business processes and performing significant manual procedures.

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Enclosure

Results in Brief
Factors to Consider
in Determining Need for FS Audits

- According to the 26 surveyed agencies, the most important factors that should be considered in determining whether agencies should have audited financial statements are (1) whether the agency has fiduciary responsibilities and (2) risks associated with the agency's operations. Of equal importance to the amount of budget authority an agency receives are the amounts of agency assets and liabilities. Other important factors include whether the agency receives nongovernmental funding and the amounts of agency revenue and expenses.

- Of the 14 surveyed agencies that have not had their financial statements audited, 13 reported that the absence of a statutory requirement to do so was a reason that they have not had such audits. Other reasons cited by 6 of the 14 agencies for not having their financial statements audited include an insufficient number of financial management personnel and insufficient funding.

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Results in Brief
General Views of Surveyed Agencies
Regarding Whether Agencies Should Have FS Audits

- 21 of the 26 surveyed agencies, including the 12 agencies that have had their financial statements audited, reported that, in general, agencies should have their financial statements audited.

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Scope and Methodology

To accomplish our objectives, we:

- Identified 28 executive branch entities that, based on previous work (1) were not subject to the CFO Act, as amended, (2) had budget authority of at least $10 million,[1] and, (3) with one exception,[2] were not required by statute to have their financial statements audited. As agreed with your office, we did not include the Central Intelligence Agency Retirement Fund or the Executive Office of the President (EOP)[3] in the scope of our survey, leaving 26 agencies for our survey.

[1]In August 2000, we provided your staff a list of these 28 agencies as requested. Each of the agencies had budget authority for fiscal year (FY) 1999 of at least $10 million.

[2]The legislation establishing one of the agencies, the U.S. Institute of Peace, requires that the Institute's financial statements be annually audited under private sector auditing standards.

[3]Public Law 106-58, Treasury and General Government Appropriations Act, 2000, established the position of Chief Financial Officer (CFO) for EOP. The CFO, who was appointed in August 2001, and his staff, have informed us that EOP plans to address financial systems needs, have its auditability assessed, and then have financial statements audits.

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Enclosure

Scope and Methodology

- Obtained and reviewed certain documents that relate to the 26 selected executive branch agencies, including audited financial statements, where available.
- Developed, pretested, and used a questionnaire to survey the 26 agencies, and summarized their responses. Because many of the survey questions requested the agencies' views, the agencies' responses to those questions represent their perspectives and judgments. We discussed certain responses with agency officials, but did not independently verify the reliability of the information provided.
- Sent agency-specific data presented in the slides to the respective agencies for their review.
- Performed our work from June 2001 through November 2001 in accordance with U.S. generally accepted government auditing standards.

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Background

Key Legislation Requiring FS Audits

- Securities Exchange Act of 1934 - Requires publicly held private sector companies to file annual audited financial statements with the Securities and Exchange Commission.
- Chapter 91 of Title 31, United States Code, commonly called the Government Corporation Control Act - Requires government corporations, such as the Export-Import Bank of the United States, to have their annual financial statements audited.
- Single Audit Act of 1984, as amended - Requires each nonfederal entity that expends a total amount of federal awards equal to or in excess of $300,000 in any fiscal year to have either a single audit or a program-specific audit made for such fiscal year.
- Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994 - Requires 24 major executive branch departments/agencies to prepare financial statements annually and have them audited.
- Agency-specific legislation - Requires certain agencies, such as United States Postal Service, to have their annual financial statements audited.

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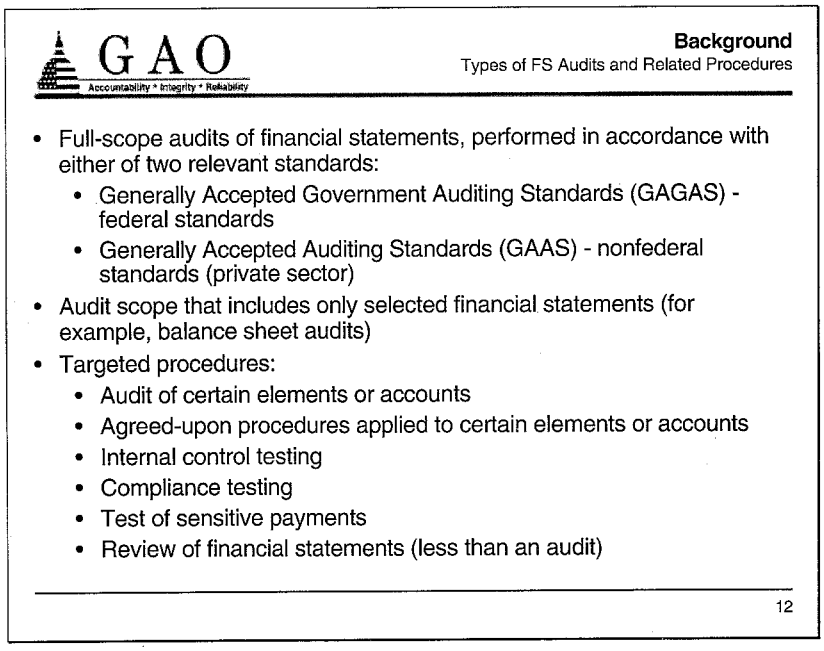
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Background
Types of FS Audits and Related Procedures
• Full-scope audits of financial statements, performed in accordance with either of two relevant standards:
• Generally Accepted Government Auditing Standards (GAGAS) - federal standards
• Generally Accepted Auditing Standards (GAAS) - nonfederal standards (private sector)
• Audit scope that includes only selected financial statements (for example, balance sheet audits)
• Targeted procedures:
• Audit of certain elements or accounts
• Agreed-upon procedures applied to certain elements or accounts
• Internal control testing
• Compliance testing
• Test of sensitive payments
• Review of financial statements (less than an audit)
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Background
Agency Information

- The 26 executive branch agencies we surveyed are generally independent agencies that have commissions or boards appointed by the President.
- 2 of the 26 surveyed agencies each received more budget authority than the CFO Act agency with the least budget authority for FY 2000 (Nuclear Regulatory Commission - $465 million).
- 12 of the 26 agencies have had their financial statements audited within the past 5 years (these agencies are subsequently referred to in this briefing as agencies that have had their financial statements audited). For FY 2000, 7 of these audits were conducted under GAGAS, 3 were conducted in accordance with GAAS, and 2 agencies did not have such audits for FY 2000.
- Only the 10 agencies that had their financial statements audited for FY 2000 prepared financial statements for that year. The remaining 16 agencies did not do so.

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Background
Surveyed Agencies

Have Had FS Audits

Defense Nuclear Facilities Safety Board[1]
Farm Credit System Insurance Corporation
Federal Communications Commission
Federal Housing Finance Board
Federal Mediation and Conciliation Service
Federal Trade Commission
International Trade Commission[2]
Office of Navajo and Hopi Indian Relocation
Railroad Retirement Board
U.S. Court of Appeals for Veterans Claims[3]
U.S. Holocaust Memorial Museum
U.S. Institute of Peace

Have Not Had FS Audits

Commodity Futures Trading Commission
Consumer Product Safety Commission
Equal Employment Opportunity Commission[4]
Federal Election Commission
Federal Labor Relations Authority
Institute of Museum and Library Services
Merit Systems Protection Board
National Archives and Records Administration[5]
National Endowment for the Arts
National Endowment for the Humanities
National Labor Relations Board
National Transportation Safety Board[4]
Securities and Exchange Commission
Selective Service System

[1]Defense Nuclear Facilities Safety Board has balance-sheet-only audits every 3 to 5 years, most recently for FY 1997. It did not prepare FY 2000 FS.

[2]International Trade Commission discontinued audits of its financial statements, effective for FY 1999. It did not prepare FY 2000 FS.

[3]U.S. Court of Appeals for Veterans Claims' first audit was of its FY 2000 FS.

[4]Equal Employment Opportunity Commission and National Transportation Safety Board have indicated that they plan to have FS audits within the next 5 years.

[5]National Archives and Records Administration has annual FS audits of three trust and revolving funds.

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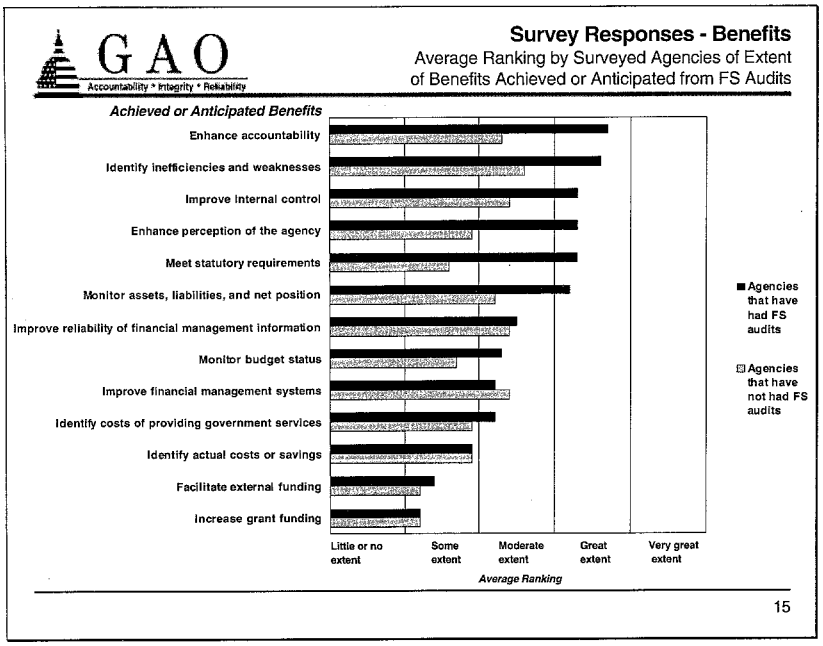
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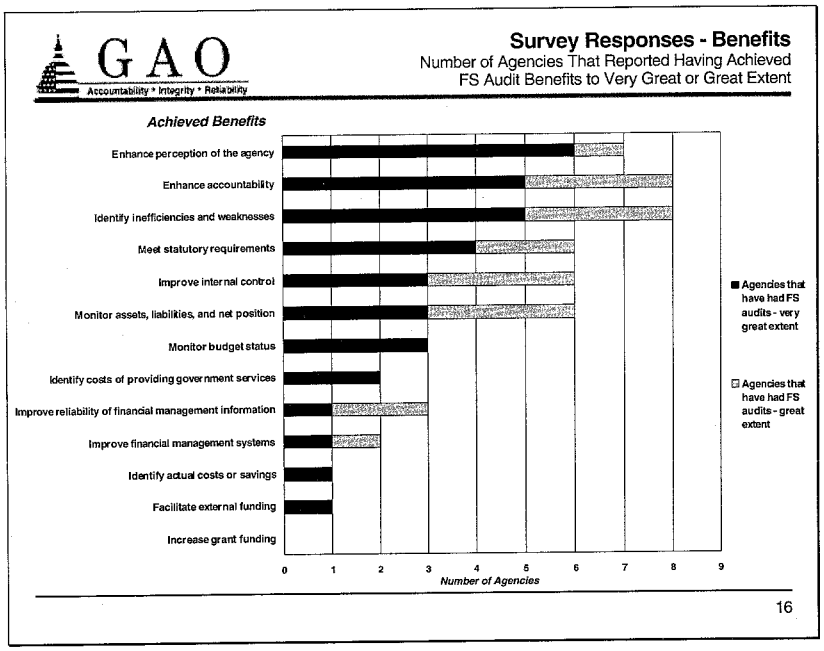
Survey Responses - Benefits
Average Ranking by Surveyed Agencies of Extent of Benefits Achieved or Anticipated from FS Audits
Achieved or Anticipated Benefits
Enhance accountability
Identify inefficiencies and weaknesses
Improve internal control
Enhance perception of the agency
Meet statutory requirements
Monitor assets, liabilities, and net position
Improve reliability of financial management information
Monitor budget status
Improve financial management systems
Identify costs of providing government services
Identify actual costs or savings
Facilitate external funding
Increase grant funding
Agencies that have had FS audits
Agencies that have not had FS audits
Little or no extent
Some extent
Moderate extent
Great extent
Very great extent
Average Ranking
15

Enclosure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Survey Responses - Benefits
Number of Agencies That Reported Having Achieved
FS Audit Benefits to Very Great or Great Extent
Achieved Benefits
Enhance perception of the agency
Enhance accountability
Identify inefficiencies and weaknesses
Meet statutory requirements
Improve internal control
Monitor assets, liabilities, and net position
Monitor budget status
Identify costs of providing government services
Improve reliability of financial management information
Improve financial management systems
Identify actual costs or savings
Facilitate external funding
Increase grant funding
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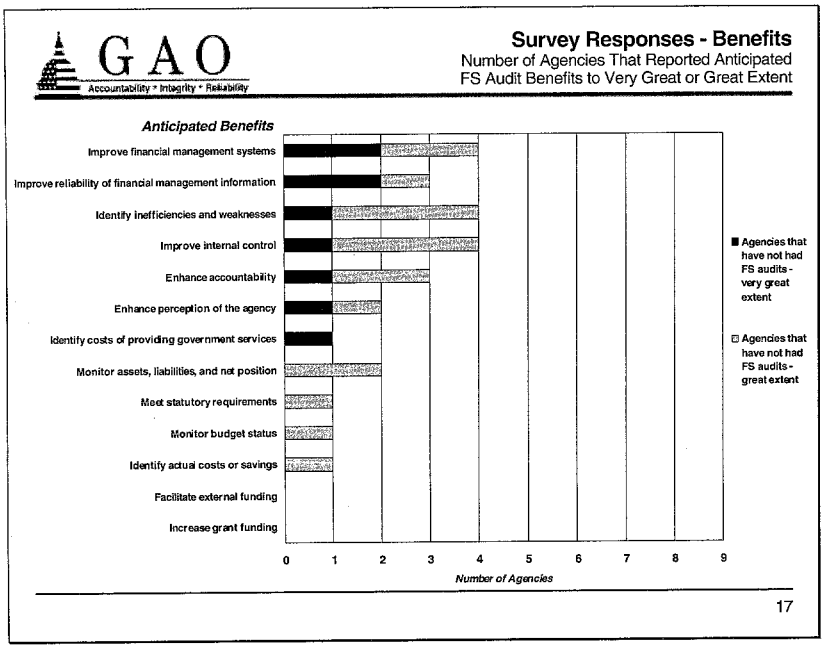
Number of Agencies
Agencies that have had FS audits - very great extent
Agencies that have had FS audits - great extent
16

Enclosure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Survey Responses - Benefits
Number of Agencies That Reported Anticipated
FS Audit Benefits to Very Great or Great Extent
Anticipated Benefits
Improve financial management systems
Improve reliability of financial management information
Identify inefficiencies and weaknesses
Improve internal control
Enhance accountability
Enhance perception of the agency
Identify costs of providing government services
Monitor assets, liabilities, and net position
Meet statutory requirements
Monitor budget status
Identify actual costs or savings
Facilitate external funding
Increase grant funding
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Number of Agencies
Agencies that have not had FS audits - very great extent
Agencies that have not had FS audits - great extent
17

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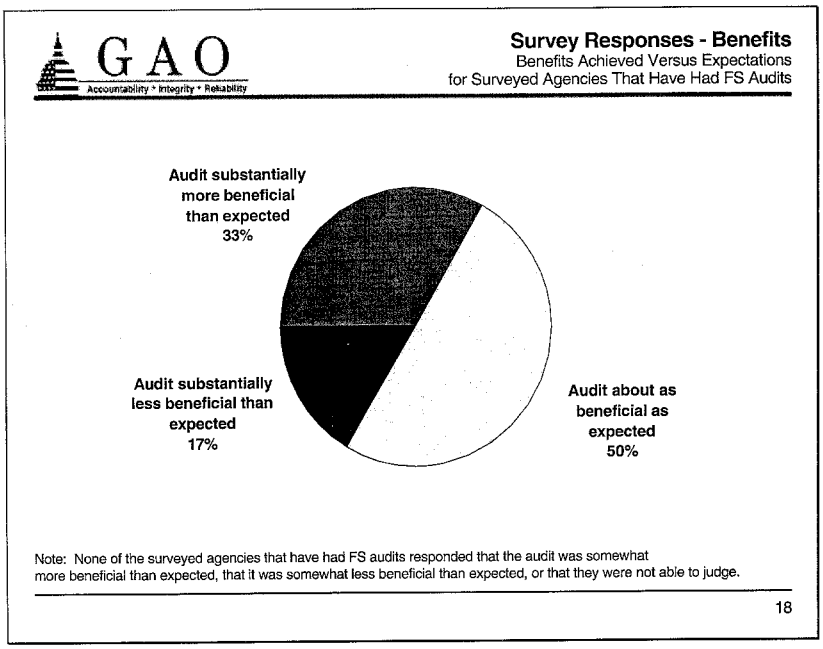
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Survey Responses - Benefits
Benefits Achieved Versus Expectations
for Surveyed Agencies That Have Had FS Audits
Audit substantially more beneficial than expected 33%
Audit substantially less beneficial than expected 17%
Audit about as beneficial as expected 50%
Note: None of the surveyed agencies that have had FS audits responded that the audit was somewhat more beneficial than expected, that it was somewhat less beneficial than expected, or that they were not able to judge.
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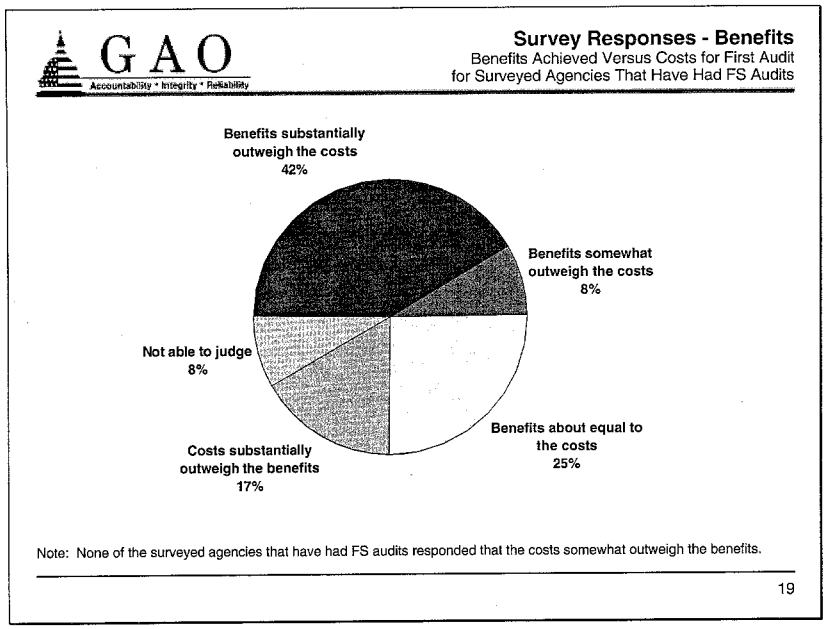
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Survey Responses - Benefits
Benefits Achieved Versus Costs for First Audit
for Surveyed Agencies That Have Had FS Audits
Benefits substantially outweigh the costs 42%
Benefits somewhat outweigh the costs 8%
Not able to judge 8%
Benefits about equal to the costs 25%
Costs substantially outweigh the benefits 17%
Note: None of the surveyed agencies that have had FS audits responded that the costs somewhat outweigh the benefits.
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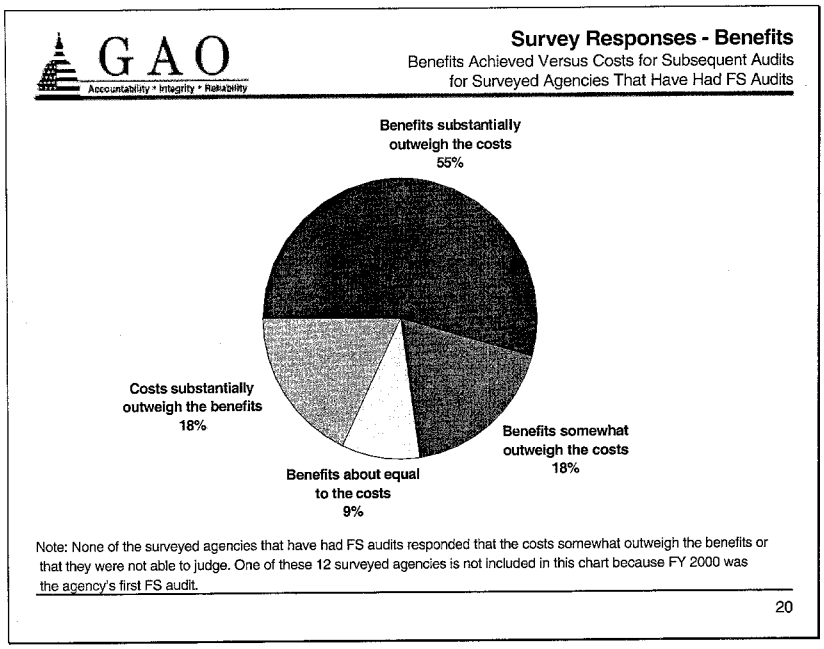
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Survey Responses - Benefits
Benefits Achieved Versus Costs for Subsequent Audits
for Surveyed Agencies That Have Had FS Audits
Benefits substantially outweigh the costs 55%
Benefits somewhat outweigh the costs 18%
Benefits about equal to the costs 9%
Costs substantially outweigh the benefits 18%
Note: None of the surveyed agencies that have had FS audits responded that the costs somewhat outweigh the benefits or that they were not able to judge. One of these 12 surveyed agencies is not included in this chart because FY 2000 was the agency's first FS audit.
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Survey Responses - Effort

Reported Level of Effort for Surveyed Agencies That Had Their First FS Audit Within the Past 5 Years

Agencies that had their first FS audit within the past 5 years					
Range of budget authority[1]	Number of agencies	Calendar weeks to prepare for first audit		Staff days to prepare for first audit	
Less than $25 million	1		4		50
$25 million to $150 million	2	(agency 1)	24	(agency 1)	120
		(agency 2)	52	(agency 2)	180
Greater than $6 billion	1		26		750

[1]Budget authority data was obtained from the FY 2002 President's Budget. None of the surveyed agencies that have had FS audits had FY 2000 budget authority between $150 million and $6 billion.

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Survey Responses - Effort

Reported Level of Effort for Surveyed Agencies That Have Had FS Audits

Agencies that have had FS audits[1]		Typical number of calendar weeks to prepare financial statements			Typical number of staff days to prepare financial statements		
Range of budget authority[2]	Number of agencies	Low	High	Average	Low	High	Average
Less than $25 million	3	1	4	2.7	5	80	33.3
$25 million to $150 million	4	3	6	4.1	17.5	40	29.4
Greater than $6 billion	2	8	10	9	50	120	85

[1]3 of the agencies that have had FS audits did not provide a response.
[2]Budget authority data was obtained from the FY 2002 President's Budget. None of the surveyed agencies that have had FS audits had FY 2000 budget authority between $150 million and $6 billion.

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Survey Responses - Effort

Reported Audit and Related Costs for Surveyed Agencies That Had FY 2000 FS Audits

Range of budget authority[1]	Number of agencies that had FY 2000 FS audits[2]	Estimated costs of FS audits performed by contractor or Office of Inspector General			Other estimated costs related to FS audits		
		Low	High	Average	Low	High	Average
Less than $25 million	4	$11,000	$54,512	$29,525	$0	$9,300	$2,325
$25 million to $150 million	4	$26,000	$100,000	$54,000	$0	$15,000	$5,750
Greater than $6 billion	2	$220,000	$350,000[3]	$285,000	$2,000	$1,218,000[3]	$610,000

[1]Budget authority data was obtained from the FY 2002 President's Budget. None of the surveyed agencies that have had FS audits had FY 2000 budget authority between $150 million and $6 billion.

[2]2 of the 12 surveyed agencies that have had FS audits, International Trade Commission and Defense Nuclear Facilities Safety Board, did not have FS audits for FY 2000.

[3]The surveyed agency that reported FS audit costs of $350,000 also reported related costs of $1,218,000 for consultants to assist the agency in preparing for the FS audit. This agency reported that it took each of the steps described on the following slide during its first or subsequent year audits.

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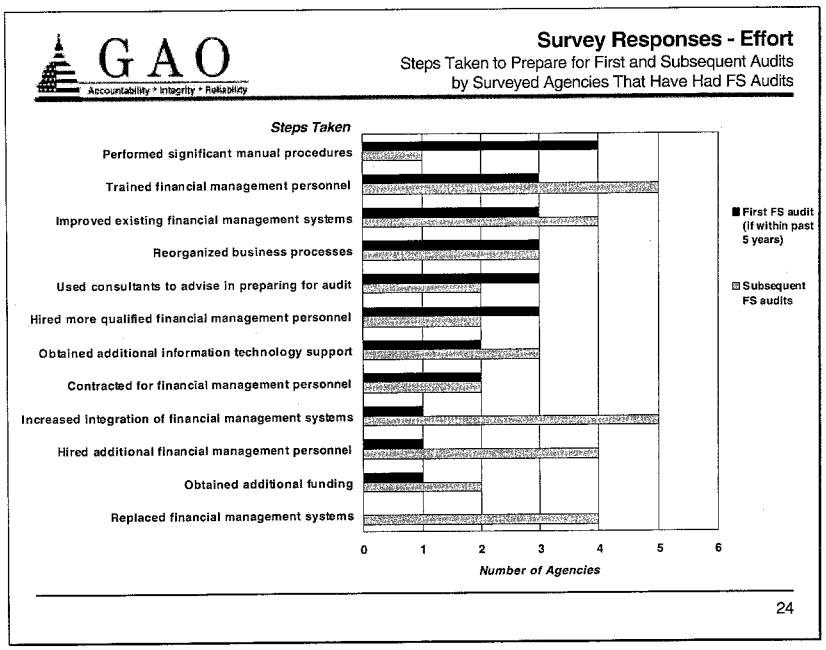
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Survey Responses - Effort
Steps Taken to Prepare for First and Subsequent Audits
by Surveyed Agencies That Have Had FS Audits
Steps Taken
Performed significant manual procedures
Trained financial management personnel
Improved existing financial management systems
Reorganized business processes
Used consultants to advise in preparing for audit
Hired more qualified financial management personnel
Obtained additional information technology support
Contracted for financial management personnel
Increased integration of financial management systems
Hired additional financial management personnel
Obtained additional funding
Replaced financial management systems
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Number of Agencies
First FS audit (if within past 5 years)
Subsequent FS audits
24

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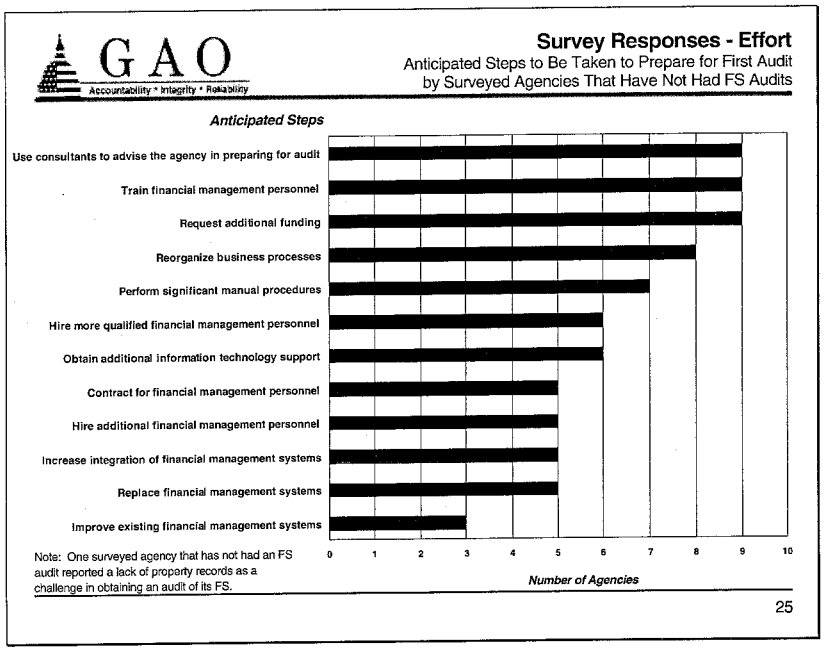
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Survey Responses - Effort
Anticipated Steps to Be Taken to Prepare for First Audit
by Surveyed Agencies That Have Not Had FS Audits
Anticipated Steps
Use consultants to advise the agency in preparing for audit
Train financial management personnel
Request additional funding
Reorganize business processes
Perform significant manual procedures
Hire more qualified financial management personnel
Obtain additional information technology support
Contract for financial management personnel
Hire additional financial management personnel
Increase integration of financial management systems
Replace financial management systems
Improve existing financial management systems
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Number of Agencies
Note: One surveyed agency that has not had an FS audit reported a lack of property records as a challenge in obtaining an audit of its FS.
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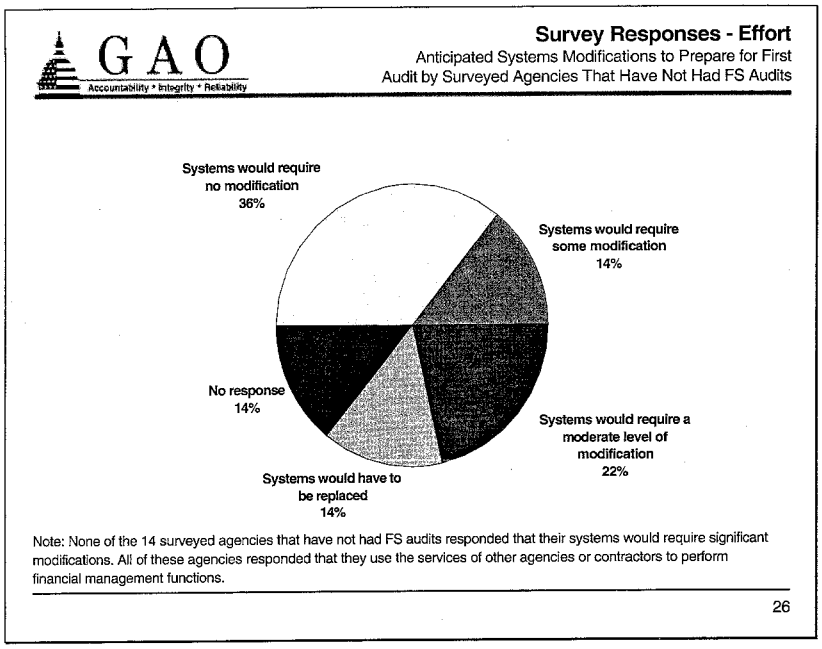
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Survey Responses - Effort
Anticipated Systems Modifications to Prepare for First Audit by Surveyed Agencies That Have Not Had FS Audits
Systems would require no modification 36%
Systems would require some modification 14%
Systems would require a moderate level of modification 22%
Systems would have to be replaced 14%
No response 14%
Note: None of the 14 surveyed agencies that have not had FS audits responded that their systems would require significant modifications. All of these agencies responded that they use the services of other agencies or contractors to perform financial management functions.
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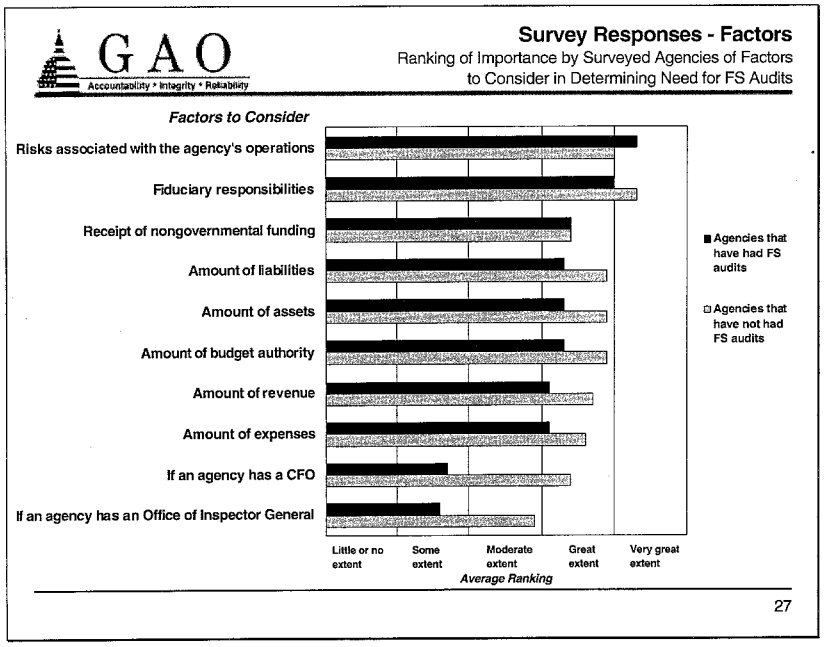
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Survey Responses - Factors
Ranking of Importance by Surveyed Agencies of Factors to Consider in Determining Need for FS Audits
Factors to Consider
Risks associated with the agency's operations
Fiduciary responsibilities
Receipt of nongovernmental funding
Amount of liabilities
Amount of assets
Amount of budget authority
Amount of revenue
Amount of expenses
If an agency has a CFO
If an agency has an Office of Inspector General
Agencies that have had FS audits
Agencies that have not had FS audits
Little or no extent
Some extent
Moderate extent
Great extent
Very great extent
Average Ranking
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Survey Responses - Factors

Examples Provided by Surveyed Agencies of Other Factors to Consider in Determining Need for FS Audits

- In addition to the factors listed on slide 27, agencies cited other factors, including the following, that should be considered in determining whether agencies, in general, should prepare and have audited financial statements:
  - Mission of the agency
  - Value that customers would derive from audited financial statements
  - Whether an agency's funding consists primarily of salaries and expense appropriations versus business-type appropriations

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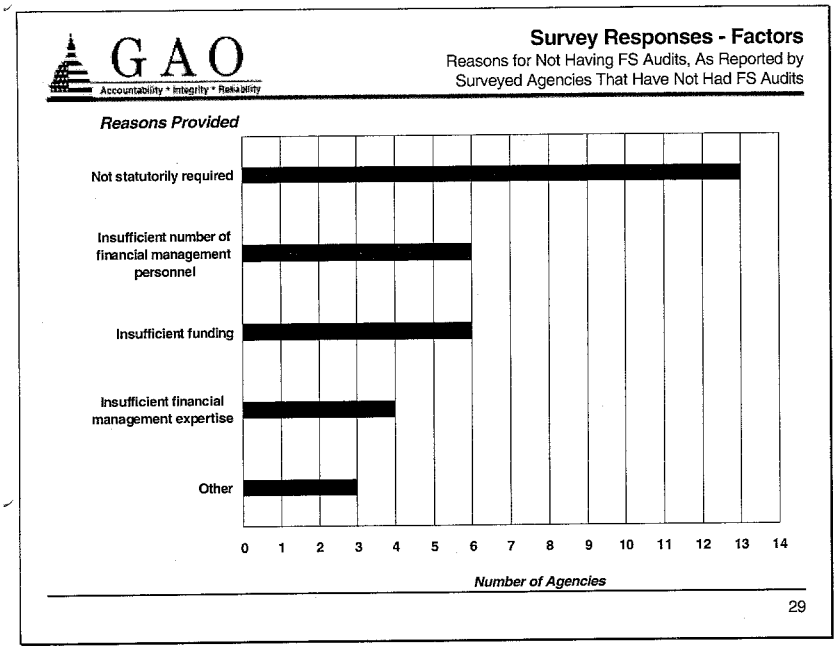
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Survey Responses - Factors
Reasons for Not Having FS Audits, As Reported by Surveyed Agencies That Have Not Had FS Audits
Reasons Provided
Not statutorily required
Insufficient number of financial management personnel
Insufficient funding
Insufficient financial management expertise
Other
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14
Number of Agencies
29

Enclosure

Survey Responses - General Views

General Views of Surveyed Agencies
Regarding Whether Agencies Should Have FS Audits

- 21 of the 26 surveyed agencies responded that agencies, in general, should have their financial statements audited. These agencies consisted of
  - all 12 agencies that have had their financial statements audited and
  - 9 of the 14 agencies that have not had their financial statements audited.

- 5 surveyed agencies responded that agencies, in general, should not have their financial statements audited.
  - These agencies had budget authority ranging from about a quarter of a million dollars to a third of a billion dollars.
  - These agencies reported that the reasons that their particular agencies have not had their financial statements audited were as follows:
    - All 5 agencies reported that such audits were not statutorily required,
    - 4 of the agencies reported that they had insufficient funding, and
    - 3 of the agencies reported that they had an insufficient number of financial management personnel.

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Attachment

FY 2000 Financial Data as Reported by Agencies to Treasury
Agencies That Have Had FS Audits

Agency	Budget authority[1]	Percent	Total Assets	Percent	Total Liabilities	Percent	Total Revenue	Percent	Total Expenses	Perce
Railroad Retirement Board	$9,183	56	$22,703.1	57	$3,977.6	29	$9,330.2	54	$8,678.5	
Federal Communications Commission	6,795	42	15,360.8	38	9,306.0	68	7,580.9	44	9,408.3	
Federal Trade Commission	126	1	227.3	1	218.4	2	126.8	1	143.7	
Farm Credit System Insurance Corporation	83	1	1,601.7	4	167.9	1	101.4	1	12.7	
International Trade Commission	44	0	6.7	0	5.4	0	46.0	0	46.3	
Federal Mediation and Conciliation Service	39	0	10.2	0	6.9	0	41.2	0	40.6	
U.S. Holocaust Memorial Museum	33	0	0.9	0	0.2	0	2.6	0	2.7	
Federal Housing Finance Board[2]	19	0	6.6	0	3.8	0	19.1	0	18.9	
Defense Nuclear Facilities Safety Board	17	0	10.2	0	2.8	0	0.0	0	17.4	
U.S. Institute of Peace	13	0	0.8	0	0.7	0	0.0	0	12.9	
U.S. Court of Appeals for Veterans Claims	11	0	10.4	0	2.5	0	11.5	0	11.4	
Office of Navajo and Hopi Indian Relocation	8	0	11.0	0	2.0	0	14.1	0	14.1	
Total	**$16,371**	**100**	**$39,949.7**	**100**	**$13,694.2**	**100**	**$17,273.8**	**100**	**$18,407.5**	**10**

[1] FY 2000 budget authority data was obtained from the FY 2002 President's Budget.
[2] The amounts reported for Federal Housing Finance Board are from their audited financial statments and not from data reported to Treasury.
Note: All dollar amounts are in millions. The individual percentages do not total to 100 percent due to rounding. The percentages less than one are portrayed as zero in this chart.

Enclosure

FY 2000 Financial Data as Reported by Agencies to Treasury
Agencies That Have Not Had FS Audits

Agency	Budget authority[1]	Percent	Total Assets	Percent	Total Liabilities	Percent	Total Revenue	Percent	Total Expenses	Percent
Securities and Exchange Commission	$382	20	$2,790.0	71	$123.3	15	$3,638.7	74	$363.9	20
National Archives and Records Administration	323	17	252.8	6	345.4	42	280.6	6	311.5	17
Equal Employment Opportunity Commission	282	15	42.1	1	17.7	2	65.9	1	67.6	4
National Labor Relations Board	205	11	47.7	1	49.8	6	8.8	0	213.4	11
Institute of Museum and Library Services	190	10	225.5	6	0.3	0	187.0	4	187.2	10
National Endowment for the Humanities	118	6	99.8	3	1.7	0	116.3	2	116.0	6
National Endowment for the Arts	102	5	106.4	3	2.8	0	111.1	2	108.5	6
National Transportation Safety Board	82	4	34.0	1	4.7	1	—[2]	—[2]	—[2]	—[2]
Commodity Futures Trading Commission	63	3	261.2	7	251.6	30	312.6	6	310.9	17
Consumer Product Safety Commission	52	3	19.1	0	14.9	2	57.0	1	58.1	3
Federal Election Commission	38	2	11.5	0	3.4	0	41.1	1	41.5	2
Merit System Protection Board	29	2	7.3	0	4.2	1	31.1	1	31.1	2
Federal Labor Relations Authority	24	1	4.0	0	4.2	1	23.9	0	24.2	1
elective Service System	24	1	15.5	0	3.8	0	21.2	0	22.5	1
Total	**$1,914**	**100**	**$3,916.9**	**100**	**$827.8**	**100**	**$4,695.3**	**100**	**$1,856.4**	**100**

[1] FY 2000 budget authority data was obtained from the FY 2002 President's Budget.
[2] National Transportation Safety Board did not report data for revenue and expenses to Treasury.
Note: All dollar amounts are in millions. The individual percentages do not total to 100 percent due to rounding. The percentages less than one are portrayed as zero in this chart.

Enclosure

Agency Baseline Information as Reported by Agencies That Have Had FS Audits

Agency	FY 2000 budget authority (in millions)	FY 2000 total full time equivalents	Number of offices	CFO or equivalent?	Statutory Office of Inspector General?	Audit in accordance with GAGAS or GAAS?	Agency Functions: Buy/lease real estate	Provide insurance	Make loans or loan guarantees	Make grants	Assess fines and penalties	Provide services for a fee	Maintain retail operations	Other fiduciary/custodial functions
road Retirement Board	$9,183	1,154	60	Yes	Yes	GAGAS		X			X	X		X
eral Communications Commission	6,795	1,950	4	Yes	Yes	GAGAS	X		X		X	X		X
eral Trade Commission	126	1,007	9	Yes	Yes	GAGAS					X	X		X
n Credit System Insurance Corporation	83	10	1	Yes	No	GAGAS		X			X			
rnational Trade Commission	44	354	1	Yes	Yes	GAGAS[1]	X				X	X		
eral Mediation and Conciliation Service	39	288	71	Yes	No	GAGAS				X		X		
. Holocaust Memorial Museum	33	458	5	Yes	No	GAAS							X	X
eral Housing Finance Board	19	107	1	Yes	Yes	GAGAS					X			
ense Nuclear Facilities Safety Board	17	96	7	Yes	No	GAAS[2]								
. Institute of Peace	13	65	1	No	No	GAAS				X				
. Court of Appeals for Veterans Claims	11	88	1	Yes	No	GAGAS				X		X		X
of Navajo and Hopi Indian Relocation	8	60	3	Yes	No	GAAS								
	$16,371	5,637	164											
rage	$1,364	470	14											

ernational Trade Commission discontinued audits of its financial statements, effective for FY 1999. It did not prepare FY 2000 FS.
fense Nuclear Facilities Safety Board has balance sheet only audits every 3 to 5 years, most recently for FY 1997. It did not prepare FY 2000 FS.
e: FY 2000 budget authority data was obtained from the FY 2002 President's Budget.

Enclosure

Agency Baseline Information as Reported by Agencies That Have Not Had FS Audits

Agency	FY 2000 budget authority (in millions)	FY 2000 total full time equivalents	Number of offices	CFO or equivalent?	Statutory Office of Inspector General?	FY 2000 FS prepared?	Agency Functions: Buy/lease real estate	Provide insurance	Make loans or loan guarantees	Make grants	Assess fines and penalties	Provide services for a fee	Maintain retail operations	Other fiduciary/custodial functions
ies and Exchange Commission	$382	3,037	14	No	Yes	No	X				X	X		
al Archives and Records Administration	323	2,362	28	Yes	Yes	No	X			X		X	X	
Employment Opportunity Commission	282	2,924	52	Yes	Yes	No						X		X
al Labor Relations Board	205	1,976	52	Yes	Yes	No								X
e of Museum and Library Services	190	45	1	Yes	No[1]	No				X				
al Endowment for the Humanities	118	170	1	Yes	Yes	No				X		X		
al Endowment for the Arts	102	155	1	Yes	Yes	No				X				X
al Transportation Safety Board	82	425	11	Yes	No[1]	No						X		
odity Futures Trading Commission	63	546	6	Yes	Yes	No	X				X	X		
ner Product Safety Commission	52	480	43	Yes	Yes	No					X	X		
l Election Commission	38	357	2	Yes	Yes	No					X			
ystems Protection Board	29	234	11	Yes	No[2]	No								
abor Relations Authority	24	198	8	Yes	Yes	No						X		
ve Service System	24	165	5	Yes	No[1]	No								
	$1,914	**13,074**	**235**											
ge	**$137**	**934**	**17**											

te of Museum and Library Services, National Transportation Safety Board, and Selective Service System use the services of another agency's Office of or General.

Systems Protection Board's General Counsel acts as its Inspector General for investigating fraud, waste, and abuse. The agency also uses the services of agency's Office of Inspector General.

Y 2000 budget authority data was obtained from the FY 2002 President's Budget.

(191004)

Mr. HORN. Thank you very much. I will ask two questions and then we'll have the statement of the ranking member.

How was the $25 million threshold determined?

Mr. TOOMEY. That was a subjective process, admittedly. I think it must be necessarily so. If we applied the audited financial standard to every agency, I think a case could be made that for very small budget authorities, it might be more onerous and more costly to comply with than the benefits that would be accrued from having that.

We discussed this with the folks at GAO. We looked at their report, and thought that $25 million was an appropriate point to make that cutoff. As I mentioned in my testimony, any publicly traded company with a security registered on the SEC is required to comply with this; and of course, many of them have smaller annual sales volumes. But we thought this was an appropriate level.

Mr. HORN. Was a cost-benefit analysis performed in determining the dollar threshold for the audits?

Mr. TOOMEY. I would refer to the GAO study on this. They did take that into account and considered the costs that they have estimated, the range of costs that would accrue in compliance. It is difficult, admittedly, to know—to quantify the benefits, in part because in some cases we may not know yet what we might find when financial statements are properly audited.

Mr. HORN. Did you have any questions, as well as your statement?

Ms. SCHAKOWSKY. Thank you, Mr. Chairman.

I think there are some questions implicit in my opening remarks, so maybe you'd like to, or not, respond to that.

I want to thank you, Mr. Chairman. The bill before us today is a reasonable effort to require financial audits in those agencies not currently required to do so. As the chairman has often pointed out, the current law requires audits of 95 percent of the Federal authority. It is not clear to me how much of the remaining 5 percent would be covered by this bill.

I do, however, have a few concerns about this bill that I hope we can address before the bill comes before us to be marked up. First, there is an issue of resources both for these agencies that have an Inspector General and for those that do not. These additional audits will not be free, and with the changes in audit practices following the Enron disaster, audits are more expensive than ever.

The bill before us today does not address either the financial or personnel resources necessary to carry out the functions it requires. Without adequate resources, this bill will force the Inspectors General to divert funds that would otherwise be used for investigations of fraud, waste and abuse. It would be unfortunate if the unintended consequence of this bill was to weaken the efforts to prevent the fraud, waste and abuse of government funds.

I, too, want to raise a question about the $25 million threshold in the bill. With time, it seems to me nearly all agencies will be above this threshold. If that is the intent, then we should just include those agencies today. If the intent is to exempt small agen-

cies, then we probably should build in some correction for inflation.

I want to thank you, Mr. Toomey, and all the witnesses who have agreed to testify today. I look forward to hearing their comments.

[The prepared statement of Hon. Janice D. Schakowsky follows:]

STATEMENT OF THE HONORABLE JAN SCHAKOWSKY
AT THE HEARING ON
H.R. 4685

May 14, 2002

Thank you Mr. Chairman. The bill before us today is a reasonable effort to require financial audits in those agencies not currently required to do so. As the Chairman has often pointed out, the current law requires audits of 95% of the federal authority. It is not clear to me how much of the remaining five percent would be covered by this bill.

I do, however, have a few concerns about this bill that I would hope we can address before the bill comes before us to be marked-up. First, there is an issue of resources, both for those agencies that have an Inspector General and for those that do not. These additional audits will not be free, and with the changes in audit practices following the Enron disaster, audits are more expensive than ever before.

The bill before us today does not address either the financial or personnel resources necessary to carry out the functions it requires. Without adequate resources, this bill will force the Inspectors General to divert funds that would otherwise be used for investigations of fraud, waste, and abuse. It would be unfortunate if the unintended consequence of this bill was to weaken the efforts to prevent the fraud, waste, and abuse of government funds.

I am also concerned about the 25 million dollar threshold in the bill. With time, nearly all agencies will be above this threshold. If that is the intent, then we should just include those agencies today. If the intent is to exempt small agencies, then we should build in some correction for inflation.

I would like to thank the witnesses who have agreed to testify today, and I look forward to hearing their comments.

Mr. TOOMEY. If I could just respond to the points. I think you certainly raised legitimate concerns.

I would point out, as to the cost of doing this, the Federal Government imposes a very comparable requirement on all publicly traded companies. We require that financial statements be audited if you're going to list your securities with the SEC on an exchange. That includes companies that have much lower annual budgets than $25 million. It seems that if it's reasonable to require this, for the benefit of private investors, it's reasonable to have this taxpayer requirement. Although in my bill we don't set a strenuous threshold because we do have the $25 million cutoff.

Whether that's an appropriate level in the future, it's something that could be addressed at a later date. If inflation were to boost budget levels to the point where most or all were above that level, then it might very well justify reconsideration.

Ms. SCHAKOWSKY. Let me just say beacuse it's worthy doesn't mean the money appears. I know that I have a number of worthy things on my agenda, as well, and if you compared them to the private sector, they would also be comparable. But the question of resources, of personnel, of dollars is still an issue I think, if we're responsible, we're going to have to consider.

Thank you. I appreciate it.

Mr. TOOMEY. If I could make just one other comment, and that is to observe that the many agencies do voluntarily audit their financial statements; although they're not required by law. The overwhelming majority of them believe that it is beneficial to the agency to do so. So that's their point of view.

Mr. HORN. Mr. Putnam.

Mr. PUTNAM. I have no questions at this time, Mr. Chairman. Thank you.

Mr. HORN. Delighted to have you.

Mr. PUTNAM. Mr. Toomey is on the right track.

Mr. TOOMEY. Thank you, sir.

Mr. HORN. Now, you're certainly welcome to come up here. There's five witnesses we're going to hear from, and if you have the time, just——

Mr. TOOMEY. I very much appreciate the invitation, Mr. Chairman, but I have a conflict in my schedule which does not allow me to do so. Thank you for inviting me to be here today and for giving me the chance to testify.

Mr. HORN. Thank you very much for coming.

Now we'll get to the five members of panel two. As you know, we ask that the oath be affirmed by our witnesses and that the people who are assistants to you also be affirmed and take the oath.

We're now taking Mr. Engel, Mr. Reger, Mrs. Doone, Mr. Zirkel, and Mr. Brachfeld. Raise your right hand. The clerk will get those names.

[Witnesses sworn.]

Mr. HORN. The clerk will note five at the table and about two or three behind the table.

So let us start the agenda with Gary T. Engel as the Director, Financial Management and Assurance of the U.S. General Accounting Office. We will go down the line and have the various Members here ask questions.

So Mr. Engel, proceed.

STATEMENTS OF GARY T. ENGEL, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE; MARK A. REGER, CHIEF FINANCIAL OFFICER, FEDERAL COMMUNICATIONS COMMISSION; ALISON L. DOONE, DEPUTY STAFF DIRECTOR FOR MANAGEMENT, FEDERAL ELECTION COMMISSION; FREDERICK J. ZIRKEL, INSPECTOR GENERAL, FEDERAL TRADE COMMISSION; AND PAUL BRACHFELD, INSPECTOR GENERAL, NATIONAL ARCHIVES AND RECORDS ADMINISTRATION

Mr. ENGEL. Thank you, Mr. Chairman.

Mr. HORN. Your statements automatically go in the record when I call on you. We'd obviously like you to give a summary of them in 5 minutes or so.

Mr. ENGEL. Yes, sir.

Mr. HORN. Thank you, Mr. Engel, for coming.

Mr. ENGEL. Thank you, Mr. Chairman and members of the subcommittee. Good afternoon.

I'm pleased to be here today to discuss the proposed Accountability of Tax Dollars Act of 2002, H.R. 4685. We agree with the thrust of the proposed amendment to extend the financial management audit requirements of the CFO Act to additional Federal agencies.

GAO's long-standing position has been that the preparation and audit of financial statements are important to agencies' development of reliable, timely and useful financial information. For agencies already covered by the CFO Act, financial statement audits have been the primary catalyst to increasing the reliability of financial data, improving financial information and enhancing accountability.

In connection with work we did at the request of Congressman Toomey in 2001, GAO surveyed 26 Federal agencies not covered by the CFO Act to find out their views on having financial statement audits. Twelve of these agencies had had financial statement audits in the past 5 years. Overall, the surveyed agencies reported that they had either achieved significant benefits or expected to achieve such benefits from having their financial statements audited.

As the exhibit shows, and you should have a document in front of you, the most significant benefit cited by the 12 agencies that had had financial statement audits were enhancing accountability and identifying inefficiencies and weaknesses. Other significant benefits including improving internal control and enhancing public perception of the agency.

The 14 surveyed agencies that had not had their financial statements audited reported they would anticipate benefits from audits, but to a much lesser extent than the achieved benefits reported by the 12 audited agencies. Half of the 12 audited agencies reported that the benefits of their first audits outweighed the costs. And about three-fourths reported that the benefits achieved outweighed the costs of subsequent audits.

According to the size and other characteristics of the agencies, the level of effort to prepare financial statement audits for the 12 audited agencies reported varied. The reported number of staff

days to prepare for the first audit ranged from 50 to 750 days, and estimated fiscal year 2000 audit costs ranged from $11,000 to $350,000.

The 26 surveyed agencies responded that the most important factors to consider in determining whether agencies should have financial statement audits are: one, whether the agency has fiduciary responsibilities; two, risks associated with the agency's operations, 13 of the 14 unaudited agencies said that the absence of a statutory audit requirement was a reason for them not having audits.

Other reasons cited by six of the 14 agencies included an insufficient number of financial management personnel and insufficient funding. Twenty-one of the 26 surveyed agencies, including all 12 that had audits, said that, in general, agencies should have financial statement audits.

I would now like to offer two points for consideration. First, using the fixed dollar threshold to trigger the audit requirement has the benefit of simplicity. Over time, however, agencies could move above or below this dollar threshold, depending upon annual changes in their budget authority. Also, as mentioned earlier, because of inflation the number of entities that would meet this threshold are likely to increase.

One way to deal with these issues and still employ a dollar threshold would be to give OMB the authority to add or exclude agencies based in part on the factors identified during our survey.

My second point involves the waiver that the proposed legislation would authorize OMB to grant to agencies for the first 2 fiscal years beginning after the date of enactment. We support this waiver provision, and we would support making a similar waiver available to OMB for agencies that do not initially meet, but subsequently do meet the audit threshold.

The importance of having financial audits goes far beyond obtaining an unqualified opinion. The preparation and audit of financial statements contributes to reliable, timely and useful financial information which helps management ensure accountability, measure and control of their costs, will allow timely and fully informed decisions.

Preparing audited financial statements also leads to improvements in internal controls and financial management systems. Therefore, we view much of the effort involved in preparing financial statements and having them audited as an integral part of effective financial management.

Mr. Chairman, this concludes my summary remarks. Again, we agree with the thrust of the proposed bill and stand ready to assist the subcommittee with the language and concepts in H.R. 4685. I would be pleased to answer any questions that you or other members of the subcommittee may have.

[The prepared statement of Mr. Engel follows:]

United States General Accounting Office

GAO

Testimony

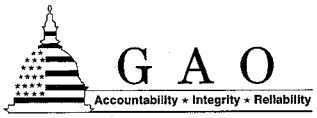
Before the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at 2:00 p.m.
Tuesday, May 14, 2002

FINANCIAL MANAGEMENT

Extending the Financial Statements Audit Requirement of the CFO Act to Additional Federal Agencies

Statement of Gary T. Engel
Director, Financial Management and Assurance



GAO-02-740T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to assist the Subcommittee in its consideration of H.R. 4685, a bill to amend title 31 of the United States Code to expand the number of federal agencies that are required to prepare audited financial statements. As currently proposed, the Chief Financial Officers (CFO) Act audit requirement[1] would be expanded to executive branch agencies that have budget authority of $25 million or more and are not already required to have financial statements audits.[2] Agencies subject to CFO Act audit requirements are also subject to the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).[3] FFMIA builds on the CFO Act by emphasizing the need for agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions on an ongoing basis.

Our remarks today are based on work we did at the request of Representative Patrick J. Toomey, who has introduced H.R. 4685, on the views of 26 surveyed executive branch agencies not covered by the CFO Act on having audited financial statements[4] and on our past and ongoing audit work at various CFO Act agencies.

We agree with the thrust of the proposed amendment in H.R. 4685 to expand the number of federal agencies that are required to prepare audited financial statements. Our longstanding position has been that the preparation and audit of financial statements increase accountability and transparency and are an important tool in the development of reliable, timely, and useful financial information for day-to-day management and oversight. Preparing audited financial statements also leads to improvements in internal control and financial management systems. The views expressed by the 26 selected agencies in our survey are generally

[1]The CFO Act of 1990, as expanded by the Government Management Reform Act of 1994, requires 24 major executive branch departments and agencies to prepare annual financial statements and have them audited (31 U.S.C. 3515).

[2]The requirement would not apply to executive agencies already required by statute to have audited financial statements or to corporations, agencies, or instrumentalities subject to chapter 91 of title 31 of the United States Code.

[3]31 U.S.C. 3512 note (2000).

[4]U.S. General Accounting Office, *Survey Results of Selected Non-CFO Act Agencies' Views on Having Audited Financial Statements*, GAO-02-281R (Washington, D.C.: Dec. 14, 2001).

consistent with our views on the bill and generally support the position that agencies should have audited financial statements. For the existing CFO Act agencies, the preparation and audit of financial statements have been the primary catalyst for increasing the reliability of financial data, improving financial operations, and enhancing accountability.

Summary of Survey Results

The 26 non–CFO Act agencies we surveyed are generally independent agencies that have commissions or boards appointed by the President.[5] The objectives of the survey were to determine the

- benefits achieved or anticipated by the surveyed agencies from preparing financial statements and having them audited;
- degree of effort or anticipated effort for the surveyed agencies to prepare financial statements and have them audited;
- factors, including budget authority, that should be considered in determining whether agencies should prepare financial statements and have them audited; and
- surveyed agencies' views about whether, in general, agencies should have their financial statements audited.

As shown in table 1, 12 of the 26 surveyed agencies have had financial statements audits within the past 5 years, and 14 have not. (See app. I for information about the 26 surveyed agencies, including baseline and financial information.)

[5]We selected the 26 agencies by identifying 28 executive branch entities that (1) were not subject to the CFO Act, as amended, (2) had budget authority for fiscal year 1999 of at least $10 million, and (3) with one exception, were not required by law to have their financial statements audited. As agreed with the study's requester, we did not include two of the entities—the Central Intelligence Agency Retirement Fund and the Executive Office of the President—in the scope of our survey, leaving 26 agencies for our survey.

Table 1: Surveyed Agencies

Have had financial statements audits	Have not had financial statements audits
Defense Nuclear Facilities Safety Board [a]	Commodity Futures Trading Commission
Farm Credit System Insurance Corporation	Consumer Product Safety Commission
Federal Communications Commission	Equal Employment Opportunity Commission [d]
Federal Housing Finance Board	Federal Election Commission
Federal Mediation and Conciliation Service	Federal Labor Relations Authority
Federal Trade Commission	Institute of Museum and Library Services
International Trade Commission [b]	Merit Systems Protection Board
Office of Navajo and Hopi Indian Relocation	National Archives and Records Administration [e]
Railroad Retirement Board	National Endowment for the Arts
U.S. Court of Appeals for Veterans Claims [c]	National Endowment for the Humanities
U.S. Holocaust Memorial Museum	National Labor Relations Board
U.S. Institute of Peace	National Transportation Safety Board [d]
	Securities and Exchange Commission
	Selective Service System

[a]The Defense Nuclear Facilities Safety Board has balance-sheet-only audits every 3 to 5 years, most recently for fiscal year 1997. It did not prepare fiscal year 2000 financial statements.

[b]The International Trade Commission discontinued audits of its financial statements, effective for fiscal year 1999. It did not prepare fiscal year 2000 financial statements.

[c]The U.S. Court of Appeals for Veterans Claims' first audit was of its fiscal year 2000 financial statements.

[d]The Equal Employment Opportunity Commission and the National Transportation Safety Board have indicated that they plan to have financial statements audits within the next 5 years.

[e]The National Archives and Records Administration has annual financial statements audits of three trust and revolving funds.

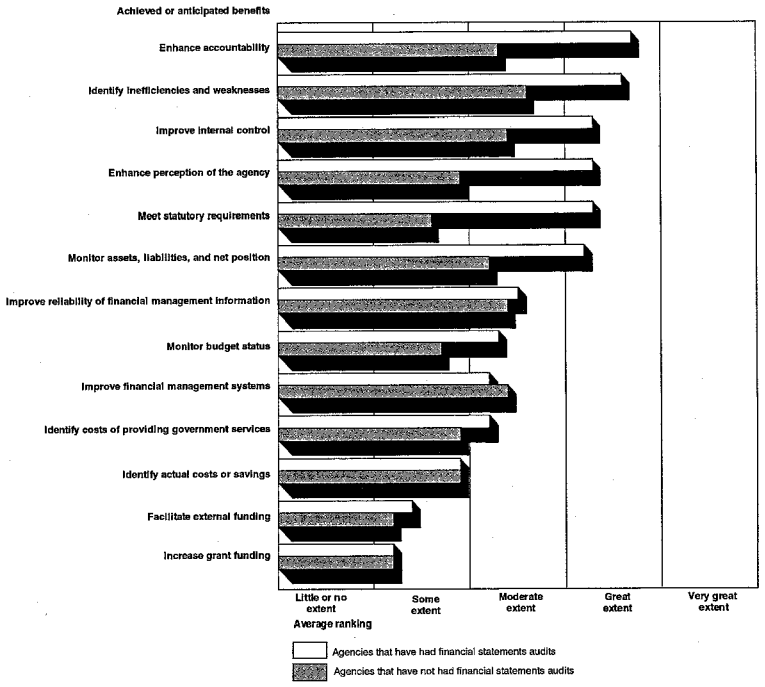
Overall, the surveyed agencies reported that they either achieved significant benefits or would anticipate achieving such benefits from having audited financial statements. The level of effort to prepare financial statements and prepare for an audit of the statements varied significantly with the size and other characteristics of the agencies. In determining whether agencies should prepare financial statements and have them audited, respondents identified a number of factors that should be considered, including budget authority, key financial statement amounts, and the type of agency operations. For example, the surveyed agencies reported that the fiduciary responsibilities of the agency and the risks associated with the agency's operations were the most important factors to

consider. Twenty-one of the 26 surveyed agencies responded that federal agencies, in general, should have audited financial statements.

Achieved or Anticipated Benefits of Having Audited Financial Statements

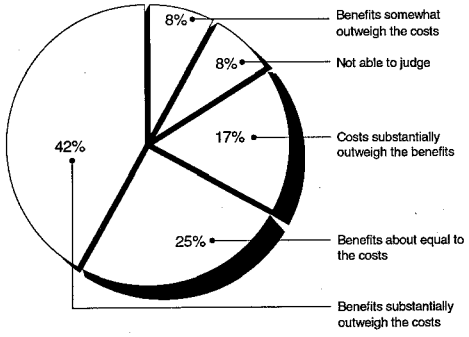
The 12 surveyed agencies that have had their financial statements audited generally reported significant benefits from those audits. As shown in figure 1, the most significant benefits cited were enhancing accountability and identifying inefficiencies and weaknesses. Other significant benefits included improving internal control, enhancing the public's perception of the agency, meeting statutory requirements, and monitoring assets and liabilities. The 14 surveyed agencies that have not had audited financial statements reported that they would anticipate benefits from such audits, but to a much lesser extent than the achieved benefits reported by the 12 surveyed agencies that have had their financial statements audited.

Figure 1: Average Ranking by Surveyed Agencies of Extent of Benefits Achieved or Anticipated from Financial Statements Audits



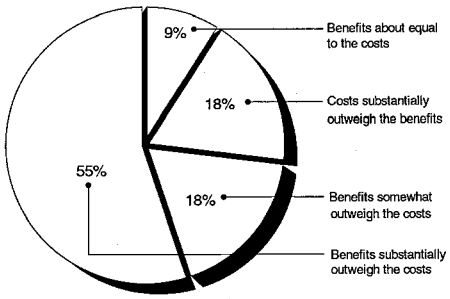
We asked the 12 audited agencies whether the benefits of their first audit and subsequent audits outweighed the costs and whether their audits were more or less beneficial than expected. As shown in figures 2 and 3, half of the 12 agencies responded that the benefits achieved outweighed the costs of the first audit, and about three-fourths of the agencies responded that the benefits achieved outweighed the costs of subsequent audits.

Figure 2: Benefits Achieved Versus Costs for First Audit for Surveyed Agencies That Have Had Financial Statements Audits



Note: None of the surveyed agencies that have had financial statements audits responded that the costs somewhat outweigh the benefits.

Figure 3: Benefits Achieved Versus Costs for Subsequent Audits for Surveyed Agencies That Have Had Financial Statements Audits



Note: None of the surveyed agencies that have had financial statements audits responded that the costs somewhat outweigh the benefits or that they were not able to judge. One of these 12 surveyed agencies is not included in this chart because fiscal year 2000 was the agency's first financial statements audit.

Ten of the 12 agencies (83 percent) responded that their audits were more beneficial than or about as beneficial as they had expected.

Degree of Effort or Anticipated Effort to Prepare Financial Statements and Have Them Audited

For the 12 surveyed agencies that have had their financial statements audited, the reported level of effort to prepare financial statements and to prepare for an audit varied significantly with the size and other characteristics of the agencies. For example, the reported number of staff days to prepare for the first audit ranged from 50 to 750 days, and, as shown in table 2, the estimated fiscal year 2000 audit costs ranged from $11,000 to $350,000.

Table 2: Reported Audit and Related Costs for Surveyed Agencies That Had Fiscal Year 2000 Financial Statements Audits

Range of budget authority[a]	Number of agencies that had fiscal year 2000 financial statements audits[b]	Estimated costs of financial statements audits performed by contractor or Office of Inspector General			Other estimated costs related to financial statements audits		
		Low	High	Average	Low	High	Average
Less than $25 million	4	$11,000	$54,512	$29,525	$0	$9,300	$2,325
$25 million to $150 million	4	$26,000	$100,000	$54,000	$0	$15,000	$5,750
Greater than $6 billion	2	$220,000	$350,000[c]	$285,000	$2,000	$1,218,000[c]	$610,000

[a]Budget authority data were obtained from the Fiscal Year 2002 President's Budget. None of the surveyed agencies that have had financial statements audits had fiscal year 2000 budget authority between $150 million and $6 billion.

[b]Two of the 12 surveyed agencies that have had financial statements audits, the International Trade Commission and the Defense Nuclear Facilities Safety Board, did not have financial statements audits for fiscal year 2000.

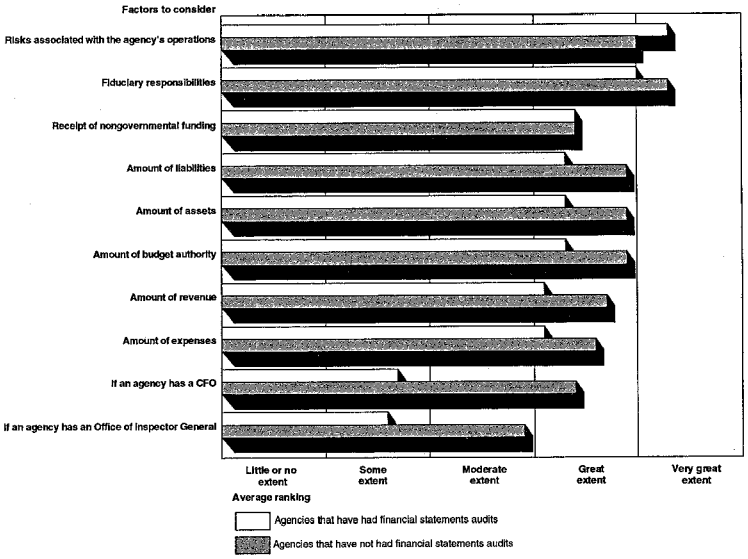
[c]The surveyed agency that reported financial statements audit costs of $350,000 also reported related costs of $1,218,000 for consultants to assist the agency in preparing for the financial statements audit.

Frequently reported steps that these agencies had taken to prepare for their first and subsequent audits are (1) improving or replacing financial management systems, (2) hiring additional financial management personnel, (3) training financial management personnel, and (4) performing significant manual procedures (for first audits).

Factors to Consider in Determining Whether Agencies Should Have Financial Statements Audits

As figure 4 shows, the 26 surveyed agencies responded that the most important factors that should be considered in determining whether agencies should have audited financial statements are (1) whether the agency has fiduciary responsibilities and (2) risks associated with the agency's operations. The surveyed agencies said that the amounts of an agency's assets and liabilities are of equal importance to the amount of budget authority an agency has. Other important factors include whether the agency receives nongovernmental funding and the amounts of an agency's revenues and expenses.

Figure 4: Ranking of Importance by Surveyed Agencies of Factors to Consider in Determining Need for Financial Statements Audits



Of the 14 surveyed agencies that have not had their financial statements audited, 13 reported that the absence of a statutory requirement to do so was a reason they have not had such audits. Other reasons cited by 6 of the 14 agencies include an insufficient number of financial management personnel and insufficient funding.

Surveyed Agencies' General Views about Whether Agencies Should Have Financial Statements Audits

Twenty-one of the 26 surveyed agencies, including all 12 that have had their financial statements audited, reported that, in general, agencies should have their financial statements audited. The remaining 5 surveyed agencies, whose budget authority ranged from about $250,000 to about $325 million, expressed the opposite view.

Other Considerations

Using a fixed-dollar threshold to determine which agencies should be subject to the audit requirement has the benefit of simplicity. Over time, however, entities could move above and below the threshold depending on annual changes in their budget authority. Also, through inflation, the number of entities that meet the dollar threshold would likely increase. One way to deal with this issue and still incorporate a dollar threshold is to provide the Office of Management and Budget (OMB), through the proposed legislation, the authority to add agencies that fall below or exclude agencies that meet the threshold based in part on the other factors identified in our survey. OMB could then be required to report to the Congress on the reasons for a change to any agency's status with respect to the financial statements audit requirement.

The proposed legislation does not specifically provide for a phase-in period for an agency to implement the audit requirement, but it does provide that OMB may waive this requirement for the first 2 fiscal years beginning after the date of enactment. We support this waiver provision and would support making a similar waiver available to OMB for agencies that do not initially meet, but at a subsequent date do meet, the dollar audit threshold.

Conclusions

In closing, I would like to reiterate our support for the thrust of H.R. 4685 to expand financial statements audit requirements beyond the current 24 CFO Act agencies. The importance of having financial statements audits goes far beyond obtaining an unqualified opinion. The preparation and audit of financial statements contribute to reliable, timely, and useful financial information, and such information is important in helping management ensure accountability, measure and control costs, and make timely and fully informed decisions. Preparing audited financial statements also leads to improvements in internal control and financial management systems. Hence, we view much of the effort involved in preparing financial statements and having them audited as an integral part of effective financial management.

Mr. Chairman, this concludes my statement. We welcome any questions that you or other members of the Subcommittee may have.

Contact

If you have any questions about this testimony, please contact me at (202) 512-3406. I can be reached by e-mail at *engelg@gao.gov*. Other key contributors to this testimony were Kent Bowden, Casey Keplinger, LaShawnda Wilson, and Esther Tepper.

Appendix I

Information on the 26 Surveyed Agencies

The following tables provide financial and other baseline information about the 26 surveyed agencies. The tables generally contain information provided by the agencies, which we did not independently verify.

Table 3: Fiscal Year 2000 Financial Data as Reported to Treasury by Surveyed Agencies That Have Had Financial Statements Audits

Agency	Budget Authority[a]	Percent	Total Assets	Percent	Total Liabilities	Percent	Total Revenue	Percent	Total Expenses	Percent
Railroad Retirement Board	$9,183	56	$22,703.1	57	$3,977.6	29	$9,330.2	54	$8,678.5	47
Federal Communications Commission	6,795	42	15,360.8	38	9,306.0	68	7,580.9	44	9,408.3	51
Federal Trade Commission	126	1	227.3	1	218.4	2	126.8	1	143.7	1
Farm Credit System Insurance Corporation	83	1	1,601.7	4	167.9	1	101.4	1	12.7	0
International Trade Commission	44	0	6.7	0	5.4	0	46.0	0	46.3	0
Federal Mediation and Conciliation Service	39	0	10.2	0	6.9	0	41.2	0	40.6	0
U.S. Holocaust Memorial Museum	33	0	0.9	0	0.2	0	2.6	0	2.7	0
Federal Housing Finance Board[b]	19	0	6.6	0	3.8	0	19.1	0	18.9	0
Defense Nuclear Facilities Safety Board	17	0	10.2	0	2.8	0	0.0	0	17.4	0
U.S. Institute of Peace	13	0	0.8	0	0.7	0	0.0	0	12.9	0
U.S. Court of Appeals for Veterans Claims	11	0	10.4	0	2.5	0	11.5	0	11.4	0
Office of Navajo and Hopi Indian Relocation	8	0	11.0	0	2.0	0	14.1	0	14.1	0
Total	**$16,371**	**100**	**$39,949.7**	**100**	**$13,694.2**	**100**	**$17,273.8**	**100**	**$18,407.5**	**100**

[a]Fiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.

[b]The amounts reported for Federal Housing Finance Board are from their audited financial statments and not from data reported to Treasury.

Note: All dollar amounts are in millions. The individual percentages do not total to 100 percent due to rounding. The percentages less than one are portrayed as zero in this chart.

Table 4: Fiscal Year 2000 Financial Data as Reported to Treasury by Surveyed Agencies That Have Not Had Financial Statements Audits

Agency	Budget Authority[a]	Percent	Total Assets	Percent	Total Liabilities	Percent	Total Revenue	Percent	Total Expenses	Percent
Securities and Exchange Commission	$382	20	$2,790.0	71	$123.3	15	$3,638.7	74	$363.9	20
National Archives and Records Administration	323	17	252.8	6	345.4	42	280.6	6	311.5	17
Equal Employment Opportunity Commission	282	15	42.1	1	17.7	2	65.9	1	67.6	4
National Labor Relations Board	205	11	47.7	1	49.8	6	8.8	0	213.4	11
Institute of Museum and Library Services	190	10	225.5	6	0.3	0	187.0	4	187.2	10
National Endowment for the Humanities	118	6	99.8	3	1.7	0	116.3	2	116.0	6
National Endowment for the Arts	102	5	106.4	3	2.8	0	111.1	2	108.5	6
National Transportation Safety Board	82	4	34.0	1	4.7	1	—[b]	—[b]	—[b]	—[b]
Commodity Futures Trading Commission	63	3	261.2	7	251.6	30	312.6	6	310.9	17
Consumer Product Safety Commission	52	3	19.1	0	14.9	2	57.0	1	58.1	3
Federal Election Commission	38	2	11.5	0	3.4	0	41.1	1	41.5	2
Merit System Protection Board	29	2	7.3	0	4.2	1	31.1	1	31.1	2
Federal Labor Relations Authority	24	1	4.0	0	4.2	1	23.9	0	24.2	1
Selective Service System	24	1	15.5	0	3.8	0	21.2	0	22.5	1
Total	**$1,914**	**100**	**$3,916.9**	**100**	**$827.8**	**100**	**$4,895.3**	**100**	**$1,856.4**	**100**

[a]Fiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.

[b]National Transportation Safety Board did not report data for revenue and expenses to Treasury.

Note: All dollar amounts are in millions. The individual percentages do not total to 100 percent due to rounding. The percentages less than one are portrayed as zero in this chart.

Table 5: Baseline Information as Reported by Surveyed Agencies That Have Had Financial Statements Audits

Agency	Fiscal year 2000 budget authority (in millions)	Fiscal year 2000 total full time equivalents	Number of offices	CFO or equivalent?	Statutory Office of Inspector General?	Audit in accordance with GAGAS or GAAS?	Agency Functions: Buy/lease real estate	Provide insurance	Make loans or loan guarantees	Make grants	Assess fines and penalties	Provide services for a fee	Maintain retail operations	Other fiduciary/quasi-social functions
Railroad Retirement Board	$9,183	1,154	60	Yes	Yes	GAGAS		X			X	X		X
Federal Communications Commission	6,795	1,950	4	Yes	Yes	GAGAS	X		X		X	X		X
Federal Trade Commission	126	1,007	9	Yes	Yes	GAGAS					X	X		X
Farm Credit System Insurance Corporation	83	10	1	Yes	No	GAGAS		X			X			
International Trade Commission	44	354	1	Yes	Yes	GAGAS[a]	X				X	X		
Federal Mediation and Conciliation Service	39	288	71	Yes	No	GAGAS				X		X		
U.S. Holocaust Memorial Museum	33	458	5	Yes	No	GAAS							X	X
Federal Housing Finance Board	19	107	1	Yes	Yes	GAGAS					X			
Defense Nuclear Facilities Safety Board	17	96	7	Yes	No	GAAS[b]								
U.S. Institute of Peace	13	65	1	No	No	GAAS				X				
U.S. Court of Appeals for Veterans Claims	11	88	1	Yes	No	GAGAS				X		X		X
Office of Navajo and Hopi Indian Relocation	8	60	3	Yes	No	GAAS								
Total	**$16,371**	**5,637**	**164**											
Average	**$1,364**	**470**	**14**											

[a]International Trade Commission discontinued audits of its financial statements, effective for fiscal year 1999. It did not prepare fiscal year 2000 financial statements.

[b]Defense Nuclear Facilities Safety Board has balance sheet only audits every 3 to 5 years, most recently for fiscal year 1997. It did not prepare fiscal year 2000 financial statements.

Notes: Fiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.
GAGAS (generally accepted government auditing standards) are public sector auditing standards; GAAS (generally accepted auditing standards) are private sector auditing standards.

Table 6: Baseline Information as Reported by Surveyed Agencies That Have Not Had Financial Statements Audits

Agency	Fiscal year 2000 budget authority (in millions)	Fiscal year 2000 total full time equivalents	Number of offices	CFO or equivalent?	Statutory Office of Inspector General?	Fiscal year 2000 financial statements prepared?	Agency Functions: Buy/lease real estate	Provide insurance	Make loans or loan guarantees	Make grants	Assess fines and penalties	Provide services for a fee	Maintain retail operations	Other fiduciary/custodial functions
Securities and Exchange Commission	$382	3,037	14	No	Yes	No	X				X	X		
National Archives and Records Administration	323	2,362	28	Yes	Yes	No	X			X		X	X	
Equal Employment Opportunity Commission	282	2,924	52	Yes	Yes	No						X		X
National Labor Relations Board	205	1,976	52	Yes	Yes	No								X
Institute of Museum and Library Services	190	45	1	Yes	No[a]	No			X					
National Endowment for the Humanities	118	170	1	Yes	Yes	No			X		X			
National Endowment for the Arts	102	155	1	Yes	Yes	No			X					X
National Transportation Safety Board	82	425	11	Yes	No[a]	No					X			
Commodity Futures Trading Commission	63	546	6	Yes	Yes	No	X			X	X			
Consumer Product Safety Commission	52	480	43	Yes	Yes	No				X	X			
Federal Election Commission	38	357	2	Yes	Yes	No				X				
Merit Systems Protection Board	29	234	11	Yes	No[b]	No								
Federal Labor Relations Authority	24	198	8	Yes	Yes	No					X			
Selective Service System	24	165	5	Yes	No[a]	No								
Total	**$1,914**	**13,074**	**235**											
Average	**$137**	**934**	**17**											

[a]Institute of Museum and Library Services, National Transportation Safety Board, and Selective Service System use the services of another agency's Office of Inspector General.

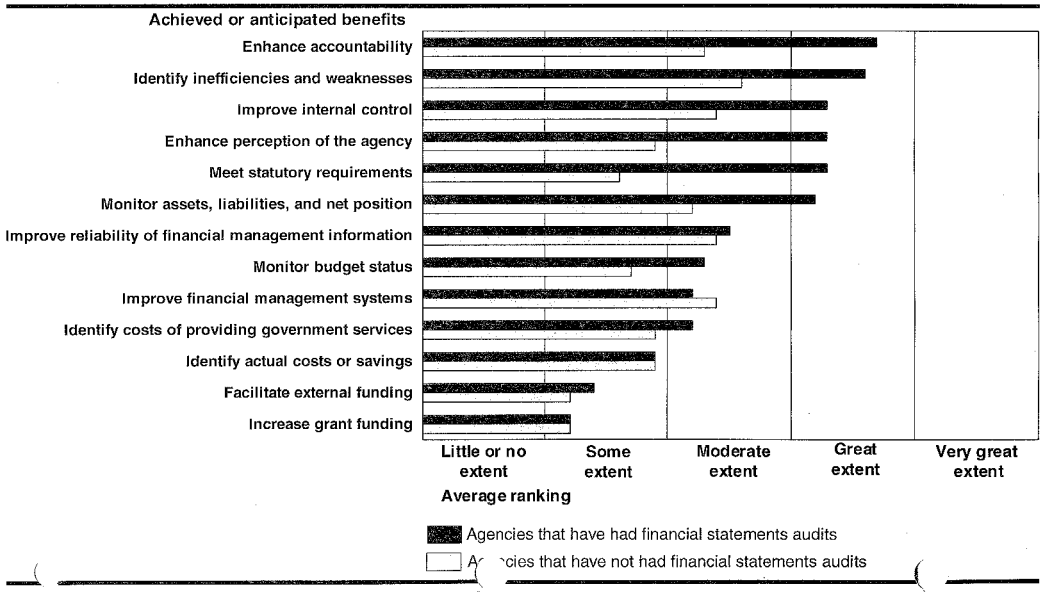
[b]Merit Systems Protection Board's General Counsel acts as its Inspector General for investigating fraud, waste, and abuse. The agency also uses the services of another agency's Office of Inspector General.

Note: Fiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.

GAO

Accountability * Integrity * Reliability

Average Ranking by Surveyed Agencies of Extent of Benefits Achieved or Anticipated from FS Audits



Mr. HORN. All right. We will move to Mark A. Reger, the Chief Financial Officer for the Federal Communications Commission.

Mr. REGER. Mr. Chairman and members of the Government Reform Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, I appreciate your invitation to testify concerning the Federal Communications Commission's experience with compiling its auditable annual financial statements.

I serve as the Chief Financial Officer for the FCC. The FCC is committed to using the taxpayer's money responsibly and to facilitating financial integrity and complete financial reporting.

Let me begin by describing the Commission's financial situation, which is different from many other small independent agencies. We are an agency of 1,975 people. Our appropriated budget is rather small, $26.3 million in direct appropriations for fiscal year 2002 with a total budget of $245 million.

We generate 89 percent of that budget by our collection of statutorily mandated regulatory fees. We also collect approximately $25 million from statutorily mandated licensing fees. Those, however, are not the only moneys included in our financial portfolio. We also administer the auction of radio spectrum and oversee the administration of other funds.

For example, in fiscal year 2001, the Commission collected over $17.8 billion in auction receipts, managed a loan portfolio valued at just over $5.9 billion, and oversaw the administration of a fund which an annually collects and disburses $4 billion.

These additional programs substantially increase the level of sophistication of our accounts. It became apparent to us that we needed to improve our financial recordkeeping process to reflect this increased sophistication.

On its own motion, in 1998, the FCC initiated efforts to compile auditable financial statements. We were not required to do so by the Chief Financial Officers Act of 1990, but nonetheless began efforts to prepare financial statements and subject them to an audit, as would have been required under the CFO Act.

Subsequently, in September 1998, the U.S. Treasury Department directed the FCC to prepare certain auditable information for inclusion in the Treasury's annual financial statements. Treasury had directed the FCC to pursue the compilation of auditable statements because of the financial implications of the spectrum auction program on total receipts recorded in the consolidated U.S. Government statements and the value of the auctions' loan portfolio to asset values in those same statements.

As a result of both the Commission's efforts and Treasury's directive, the FCC compiled its first generally accepted accounting principles balance sheet and accompanying notes for fiscal year 1999. With that action complete, we generated a full set of CFO Act-compliant financial statements for fiscal year 2000 and subjected them to an audit.

We enlisted the aid of two professional accounting firms to assist in these efforts. One firm provided credit subsidy information concerning the Commission's auction loan portfolio, which had not previously been treated under the provisions of credit reform, and assisted the limited finance staff in actually compiling the statements. The second firm audited the results of the statement efforts

on behalf of the FCC's Office of Inspector General. Incidentally, the FCC received an unqualified opinion on that first set of fully compliant CFO Act statements.

As a result of the efforts to prepare statements, the FCC has: Compiled financial operating procedures; conducted a full agency inventory of property; implemented an annual inventory review system; redesigned the Commission's revenue systems; implemented a customer numbering and tracking system; altered the agency's financial record keeping to record transactions in the U.S. Standard General Ledger formats; formalized financial reporting processes and responsibilities; compiled loan files, standardized loan processing functions and initiated the transfer of loan servicing functions to an outside loan servicer; implemented credit reform reporting; and initiated efforts to link objectives and performance measures to the strategic plan and annual financial statements.

This auditing process is still very new to the FCC. Fiscal year 2001 is only the second year we have issued fully compliant statements, and we continue to make improvements in our financial accounting systems and safeguards. Complying with the accounting reporting requirements of the CFO Act is a time-consuming and expensive process. We were in a position to cover most of these costs through the use of auctions generated funding.

For the FCC, the preparation of an auditable financial statement has been necessary and beneficial. Because of the additional financial programs, we are not "typical" as compared to other small agencies. I cannot speak to the difficulty other agencies may experience in preparing annual financial statements and having them audited, but I do know from our experience that it is an arduous undertaking.

Again, thank you, Mr. Chairman, for the opportunity to offer this testimony. The FCC is very proud of the financial improvements it has made over the last few years. We still face many formidable challenges in this regard.

[The prepared statement of Mr. Reger follows:]

Testimony of Mark Reger

Chief Financial Officer

Federal Communications Commission

Before

U.S. House of Representatives

Committee on Government Reform

Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations

Tuesday, May 14, 2002

2:00 p.m.

2247 Rayburn House Office Building

Washington, D.C. 20515

Regan

Mr. Chairman and Members of the Government Reform Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, I appreciate your invitation to testify concerning the Federal Communications Commission's (FCC) experience with compiling its auditable annual financial statements. I serve as the Chief Financial Officer of the FCC. The FCC is committed to using the taxpayer's money responsibly and to facilitating financial integrity and complete financial reporting.

Let me begin by describing the Commission's financial situation -- which is different from many other small independent agencies. We are an agency of 1,975 people. Our appropriated budget is rather small -- $26.3 million in direct appropriations for Fiscal Year 2002 with a total budget of $245.071 million. We generate 89% of that budget by our collection of statutorily mandated regulatory fees. We will also collect approximately $25 million from statutorily mandated licensing fees. Those, however, are not the only monies included in our financial portfolio. We also administer the auction of radio spectrum and oversee the administration of other funds. For example, in Fiscal Year 2001, the Commission collected over $17.8 billion in auction receipts, managed a loan portfolio valued at just over $5.9 billion, and oversaw the administration of a fund which annually collects and disburses $4 billion.

These additional programs substantially increase the level of sophistication of our accounts. It became apparent to us that we needed to improve our financial record keeping process to reflect this increased sophistication. On its own motion, in 1998 the

FCC initiated efforts to compile auditable financial statements. We were not required to do so by the Chief Financial Officer's Act of 1990 (CFO Act), but nonetheless began efforts to prepare financial statements and subject them to an audit as would have been required by the CFO Act. Subsequently, in September of 1998, the United States Treasury Department directed the FCC to prepare certain auditable information for inclusion in Treasury's annual financial statements. Treasury had directed the FCC to pursue the compilation of auditable statements because of the financial implications of the spectrum auction program on total receipts recorded in the consolidated United States government statements and the value of the auctions' loan portfolio to asset values in those same statements.

As a result of both the Commission's efforts and Treasury's directive, the FCC compiled its first Generally Accepted Accounting Principles (GAAP) Balance Sheet and accompanying notes for Fiscal Year 1999. With that action completed, we generated a full set of CFO Act compliant financial statements for Fiscal Year 2000 and subjected them to audit. We enlisted the aid of two professional accounting firms to assist in these efforts. One firm provided credit subsidy information concerning the Commission's auction loan portfolio, which had not previously been treated under the provisions of credit reform, and assisted our limited finance staff in actually compiling the statements. The second firm audited the results of our statement compilation efforts on behalf of the FCC's Office of Inspector General. Incidentally, the FCC received an unqualified opinion on that first set of fully complaint CFO Act statements.

As a result of the efforts to prepare statements, the FCC has:

- Compiled financial operating procedures;
- Conducted a full agency inventory of property;
- Implemented an annual inventory review system;
- Redesigned the Commission revenue systems;
- Implemented a customer numbering and tracking system;
- Altered the agency financial recordkeeping to record transactions in the U.S. Standard General Ledger formats;
- Formalized financial reporting process and responsibilities;
- Compiled loan files, standardized loan processing functions and initiated the transfer of loan servicing functions to an outside load servicer;
- Implemented credit reform reporting; and
- Initiated efforts to link objectives and performance measures to the strategic plan and annual financial statements.

This auditing process is still very new to the FCC. Fiscal Year 2001 is only the second year we have issued fully compliant statements and we continue to make improvements in our financial accounting systems and safeguards. Complying with the accounting reporting requirements of the CFO Act is a time consuming and expensive process. We were in a position to cover most of these costs through the use of auctions generated funding. For the FCC, the preparation of an auditable financial statement has been beneficial as well as necessary. Because of the additional financial programs beyond our appropriated funds, we are not "typical" as compared to other small agencies.

I cannot speak to the difficulty other agencies may experience in preparing annual financial statements and having them audited, but I do know from our experience that it is an arduous undertaking.

Again, Mr. Chairman, thank you for the opportunity to offer this testimony. The FCC is very proud of the financial improvements it has made over the last few years but we still face many formidable challenges in this regard.

Mr. HORN. Alison L. Doone is the Deputy Staff Director for Management of the Federal Election Commission.

Welcome.

Ms. DOONE. Good afternoon, Mr. Chairman, and members of the subcommittee. I serve as the FEC's Chief Financial Officer. It's a pleasure to be here today to testify regarding the utility of audited financial statements for the FEC. The FEC is a small independent bipartisan regulatory agency charged with administering and enforcing the Federal Election Campaign Act, the statute that governs the financing of Federal elections.

In October 2001, the FEC responded to the GAO survey on Expansion of Financial Statement Audit Requirements. The FEC responses mirrored those of the surveyed agencies, as mentioned in the November 30, 2001, GAO survey results.

The fiscal year 2002 FEC appropriation is $43.7 million and 362 FTE; 70 percent of the budget is spent on salaries and benefits, 10 percent on information technology projects, and 8 percent on rent. The remaining 12 percent funds FEC operations including contracts, travel, training, equipment and supplies.

FEC assets are nominal. As of September 30, 2001, FEC assets totaled $9.4 million. Of that, $6.7 million, 72 percent of the total, is the cumulative FEC appropriated fund balance of unobligated and unexpended funds from fiscal years 1996 through 2001. Only $2.7 million is equipment.

FEC liabilities are also modest. As of September 30, 2001, FEC liabilities totaled $2 million and consisted primarily of accrued annual leave and accrued payroll.

Like other survey respondents, the FEC believes that an agency's fiduciary responsibilities, risks associated with agency operations, amount of liabilities, amount of assets and amount of budget authority are all important factors to consider in determining the need for audited financial statements.

We note the survey respondents ranked fiduciary responsibility and risks associated with agency operations as the most important considerations, and placed equal weight on the amount of assets, liabilities and budget authority as the next most important factors. We agree with those rankings.

The amount of budget authority is not the most important factor in whether an agency should prepare annual audited financial statements and should not be the sole determinant in the decision. Materiality is measured by more than just the size of an agency's budget.

The agency operations and the types of programs administered by an agency should be more important than size of budget in determining the need for audited financial statements. For example, an agency with a budget less than $25 million that has fiduciary responsibility for a trust fund, administers a grant program or operates revenue-generating programs may be the type of agency that should prepare audited financial statements. Whereas, the FEC, with a budget greater than $25 million with none of those features, with minimal assets and liabilities and with a budget that primarily funds personnel costs and rents, should not be required to prepare audited financial statements.

The issue of whether audited financial statements would increase internal controls also varies among agencies. The FEC has strong internal controls and senior management review and oversight of financial operations and allocation and expenditure of funds. FEC audited financial statements would not result in greater accountability or tighter controls.

Audited financial statements for agencies with the characteristics that I just mentioned may be necessary. In agencies lacking those features, like the FEC, preparation of audited financial statements would increase costs with few or no material benefits.

I would like to thank you, Mr. Chairman, and the subcommittee for the opportunity to appear before you to present our views. I would be delighted to answer any questions you may have.

Mr. HORN. Thank you.

[The prepared statement of Ms. Doone follows:]

FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

STATEMENT OF ALISON L. DOONE
DEPUTY STAFF DIRECTOR FOR MANAGEMENT
FEDERAL ELECTION COMMISSION

BEFORE THE SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS
COMMITTEE ON GOVERNMENT REFORM
ON H.R. 4685, THE "ACCONTABLITY OF TAX DOLLARS ACT OF 2002"

TUESDAY, MAY 14, 2002

Good afternoon, Mr. Chairman and Members of the Subcommittee. I am Alison Doone, Deputy Staff Director for Management at the Federal Election Commission (FEC). I have served in this position since November 1999 and as such, I am the FEC's Chief Financial Officer. I am responsible for the Planning and Management, Finance, Information Technology, and Administrative Offices. Prior to my appointment as Deputy Staff Director, for eleven years I served as the Deputy Director, Investments at the Federal Retirement Thrift Investment Board. I received a Master of Business Administration degree with a concentration in Finance, from the University of Michigan in May 1981.

It is a pleasure to be here today to present testimony in connection with H.R. 4685, the "Accountability of Tax Dollars Act of 2002."

The FEC is a small, independent bipartisan, regulatory agency charged with administering and enforcing the Federal Election Campaign Act (FECA)—the statute that governs the financing of federal elections. The FEC has jurisdiction over the financing of campaigns for the U.S. House of Representatives, the U.S. Senate and the Presidency and Vice Presidency. As such, the Commission has a general policy of not taking a position on the substance of proposed legislation; we defer to Congress on broad policy questions

such as those presented in H.R. 4685. We do, however, endeavor to point out areas of potential administrative concerns. My testimony will therefore be limited to those areas.

In October 2001, the FEC responded to the General Accounting Office's (GAO) Survey on Expansion of Financial Statement Audit Requirements. In general, the FEC responses mirrored those of the surveyed agencies as presented in the November 30, 2001 Survey Results of Selected Non-CFO Act Agencies' Views on Having Audited Financial Statements.

The FY 2002 FEC appropriation is $43,689,000 and 362 FTE. Seventy percent of the budget is spent on salaries and benefits; ten percent funds information technology projects; and eight percent pays FEC rent in a building leased by GSA. The remaining twelve percent of the budget funds a variety of expenditures to support FEC operations, including contracts, travel, training, equipment, and supplies.

FEC assets are nominal. As of September 30, 2001, FEC assets totaled $9.4 million. Of the $9.4 million, $6.7 million, 72% of the total, is the cumulative FEC appropriated fund balance of unobligated and unexpended funds from fiscal years 1996 through 2001. Only $2.7 million is equipment.

FEC liabilities also are modest. As of September 30, 2001, FEC liabilities totaled $2 million and consisted primarily of accrued annual leave and accrued payroll.

Like the other survey respondents, the FEC believes that an agency's fiduciary responsibilities, risks associated with agency operations, amount of liabilities, amount of assets, and amount of budget authority are all important factors to consider in determining the need for audited financial statements. We note that the survey respondents ranked fiduciary responsibility and risks associated with agency operations as the most important considerations and placed equal weight on the amount of assets, liabilities, and budget authority as the next most important factors. We agree with those rankings.

The amount of budget authority is not the most important factor in whether an agency should prepare annual audited financial statements and should not be the sole determinant in the decision. Materiality is measured by more than just the size of an agency's budget.

Agency operations and the types of programs administered by an agency should be more important than size of budget in determining the need for audited financial statements. For example, an agency with a budget less than $25 million that has fiduciary responsibility for a trust fund, administers a grant program, or operates revenue-generating programs may be the type of agency that should prepare audited financial statements. Whereas, the FEC, with a budget greater than $25 million with none of those features, with minimal assets and liabilities, and with a budget that primarily funds personnel costs and rent should not be required to prepare audited financial statements.

The issue of whether audited financial statements would increase internal controls also varies among agencies. The FEC has strong internal controls and senior management review and oversight of financial operations and allocation and expenditure of funds. FEC audited financial statements would not result in greater accountability or in tighter controls.

Mr. Chairman, in summary, audited financial statements for agencies with the characteristics described above may be necessary. In agencies lacking those features, like the FEC, preparation of audited financial statements would increase costs with few or no material benefits.

I would like to thank you, Mr. Chairman, and the Subcommittee for the opportunity to appear before you to discuss H.R. 4685 the "Accountability of Tax Dollars Act of 2002." This concludes my testimony. I would be delighted to answer any questions you may have.

Mr. HORN. We'll go to the next presenter, the Honorable Frederick J. Zirkel, Inspector General, Federal Trade Commission.

Mr. ZIRKEL. Good morning, Mr. Chairman and members of the subcommittee. I am Frederick Zirkel, Inspector General of the Federal Trade Commission. I'm pleased to testify before the subcommittee today in support of financial statement audits.

The FTC is a non-CFO agency that has its financial statements audited annually by the OIG. To accomplish its competition and consumer protection missions, the agency was authorized approximately $156 million and 1,074 work-years for fiscal year 2002.

Funds are provided the agency from two major sources: premerger filing fee collections and annual appropriations. For financial statement reporting purposes the Financial Accounting Standards Advisory Board defines the agency's premerger filing fees as "exchange" revenue; that is, funds that the agency has earned and can use with its annual appropriation to pay for salaries and other operating expenses to achieve its mission objectives.

The FTC also receives "nonexchange" revenues. For example, the agency collects civil penalties. Civil penalties cannot be used to pay for agency operating expenses, but instead must be remitted to the U.S. Treasury. An agency with substantial nonexchange revenue is expected to prepare as part of its financial statement package, under the CFO Act, a "Statement of Custodial Activity."

I mention these accounting concepts and authorities because the FTC, as part of its financial statement package, prepares a custodial activity statement. During the years under audit the FTC's nonexchange revenue has always exceeded its exchange revenue. Yet, without a financial statement audit, this major area of financial activity would receive little, if any, scrutiny.

Furthermore, for the FTC, the preparation and audit of the custodial activity statement has helped management integrate its financial and program management systems. In addition, the statement provides information that interested third parties could use to judge how well the agency is meeting its basic mission responsibilities.

A word about audit approach: At the FTC, the annual financial statement audit is performed by an audit team comprised of OIG staff and an independent public accounting firm under contract to the OIG. As IG, I sign the audit opinion. In each of the 5 years the audit has been conducted the agency has received a clean opinion.

A word about audit benefits: I believe that annual audits are worth the expenditure of agency funds for many of the reasons stated in the GAO survey. The benefits specific to the FTC include improvements of internal control, strengthening of financial management systems and enhanced accountability.

Of course, obtaining a clean audit opinion is not an end in itself, but merely the first step to improving agency financial management. It is also, I believe, a necessary step if an agency is to fully implement GPRA, that is, tie performance measures and/or objectives to audited costs contained in the Statements of Net Cost.

A word about audit cost: The OIG at the FTC is provided with an annual budget of 5 work-years and contracting dollars of about $100,000. The OIG budget, when adjusted for inflation, has stayed relatively constant over the past 5 years for the time span we have

been conducting financial statement audits. From this budget, my office commits approximately $60,000 per year to an IPA contract to perform the financial statement audit.

In addition, my office also applies approximately one-half to three-quarters of an FTE, or work-year, to the audit. Consequently, conducting a financial statement audit is a major commitment of my office. Yet, I believe the resource commitment is a wise expenditure of taxpayer funds.

A few comments on management cost: A financial statement audit should be, or I view it as, a quality control activity that is an integral part of the overall management process. It provides needed feedback to management. The absence of such audits in past years may explain in part why government financial management is often viewed in low esteem.

Finally, when considering management costs, I think it is important to distinguish between the incremental cost that an audit requires managers to incur from the need to incur costs to correct a procedural weakness or respond to a system breakdown.

These points lead me to a general statement about auditing costs. All other things being equal, the better managed the unit or organization being audited, the lower the cost of the audit will be for the management team. The more knowledge the audit team has of the organization being audited, the lower the cost will be for the audit organization.

A word about lessons learned: First, the process is evolutionary. It improves with age. As you go through it, you get better. Second, I think you need to stay the course. It instills a discipline and improves the systems as years go on. That's the experience that we have had at the FTC, and I believe the systems are stronger and the information is better.

I would like to thank you, Mr. Chairman, for this opportunity to provide my comments. I would be happy to answer any questions.

Mr. HORN. We thank you.

[The prepared statement of Mr. Zirkel follows:]

Prepared Statement of the Inspector General of
the Federal Trade Commission
Before the House Subcommittee on
Government Efficiency, Financial Management and Intergovernmental Relations
of the
Committee on Government Reform

Washington, D.C.

May 14, 2002

Audited Financial Statements for Non-CFO Agencies - Why They're a Good Idea

Introduction

Good morning Mr. Chairman. I am Frederick J. Zirkel, Inspector General of the Federal Trade Commission (FTC). I am pleased to testify[1] before the Subcommittee today in support of financial statement auditing.

The FTC is a non-CFO agency that has its financial statements[2] audited annually. The mission of the FTC is to assure that the nation's markets are competitive, efficient, and free from undue restrictions. The FTC also seeks to improve the operation of the marketplace by ending unfair and deceptive practices, with an emphasis on those practices that might unreasonably restrict or inhibit the free exercise of informed choice by consumers. The work of the FTC is critical in protecting and strengthening free and open markets in the United States.
To accomplish its competition and consumer protection missions the agency was authorized $155,982,000 and 1074 FTE's for fiscal year 2002. Funds are provided the agency from two

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[1]This written statement, my oral presentation and any responses to questions I might provide reflect my views and do not necessarily reflect the views of the Commission or any individual Commissioner, nor are they endorsed by either the PCIE or the ECIE.

[2]The financial statements prepared by the FTC follow OMB form and content guidance for executive branch agencies.

major sources: premerger filing fee collections and an annual appropriation. For financial statement reporting purposes the Financial Accounting Standards Advisory Board (FASAB) defines the agency's premerger filing fees as "exchange" revenue. That is, funds that the agency has earned and can use with its annual appropriation to pay for salaries and other operating expenses to achieve its mission objectives.

The FTC also receives "non-exchange" revenues.[3] For example, the agency collects civil penalties. Civil penalties cannot be used to pay for agency operating expenses but instead must be remitted to the U.S. Treasury. According to FASAB Statement of Federal Financial Accounting Standard No. 7, an agency with substantial non-exchange revenue is required to prepare, as part of its financial statement package, a "Statement of Custodial Activity (SCA)."

I mention these accounting concepts/authorities because the FTC as part of its financial statement package, prepares a custodial activity statement. During the years under audit, the FTC's non-exchange revenue has always exceeded its exchange revenue. Yet, without a financial statement audit this major area of financial activities would receive little if any scrutiny. Futhermore, for the FTC, the preparation and audit of the SCA has helped management integrate its financial and program management systems. In addition, the statement provides information that interested third parties could use to judge how well the agency is meeting its basic mission responsibilities.

Audit Approach

At the FTC, the annual financial statement audit is performed by an audit team comprised of OIG staff and an independent public accounting firm (IPA) under contract to the OIG. As IG, I sign the audit opinion. In each of the five years the audit has been conducted the agency has received a clean opinion. The OIG and the IPA have always been in agreement as to the final opinion. As

[3]Non-exchange revenues are inflows of resources that the Government demands or receives by donation. Such revenues include taxes, fines and penalties.

audit efficiency and effectiveness increases with experience, the OIG utilizes a multi-year contract to obtain IPA services.

Audit Benefits

I believe annual audits are worth the expenditure of agency funds for the reasons detailed on page 19 of GAO survey report 02-281R (survey)[4]. The benefits specific to the FTC include improvements in internal control, strengthening of financial management systems and enhanced accountability.

Of course, obtaining a clean audit opinion is not an end in itself but merely the first step to improving agency financial management. It is also a necessary step if an agency is to fully implement GPRA, i.e., tie performance measures and/or objectives to audited costs contained in the Statements of Net Cost.

The OIG has made a practice of identifying at least one vulnerability/finding stemming from our financial statement work each year for detailed audit follow-up. In addition, the OIG prepares a separate summary of selected Custodial Activity Statement information originating from the financial statements that is provided to program managers.

It is important to note that the information appearing in the aforementioned analysis is not what either management or the OIG defines as necessary to manage the agency's consumer protection program. Rather, this financial information is what FASAB defines as being minimally necessary for FTC management to meet its accountability mandate.

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[4]Benefits include: enhanced accountability, improved financial systems, improved reliability of management information, improved internal controls and more timely identification of inefficiencies and/or weaknesses.

In short, the OIG attempts to use the financial audit as a building tool for other purposes.

Audit Cost

The OIG at the FTC is provided with an annual budget of 5 FTE's and contracting dollars of approximately $100,000 per year. The OIG budget, when adjusted for inflation, has stayed relatively constant over the past 5 years or for the time span we have been conducting financial statement audits. From this budget, my office commits approximately $60,000 per year to an IPA contract ($56,500 in 1997 and $60,500 in 2001) to perform the financial statement audit. In addition, my office also applies approximately one half to three quarters of an FTE to the audit. Consequently, conducting a financial statement audit is a major commitment of OIG resources.

Yet, I believe the resource commitment is a wise expenditure of taxpayer funds. For example, in reviewing the comparative FTC financial statements for fiscal years 2000 and 2001, a total of over $616,000,000 was subjected to audit. The OIG audit cost for these two years (IPA contract cost plus OIG staff) totaled approximately $240,000. To use an analogy, this is similar to an individual earning $100,000 ($616 million) annually who decides to spend $39 ($240,000) on a physical exam.

A few comments on management cost.

1- When public servants are provided control over taxpayer funds they have an obligation to ensure that such funds are properly managed and accounted for. Undertaking a financial statement audit is a recognized way to discharge this important obligation.

2 - A financial statement audit should be viewed as a quality control activity that is an integral part of the overall management process. It provides needed feedback to management. The absence of such audits in past years may in part explain why government financial management is held in low regard.

3 - When considering management costs, it is important to distinguish between the incremental cost of an audit verses the cost management will need to incur to correct a procedural weakness or respond to a system breakdown. For example, taking the time to meet with auditors to discuss adjustments on a cash reconciliation that ties a Treasury cash account to the agency's general ledger account would be an incremental cost. When auditors request management to prepare or correct a routine reconciliation required of all financial organizations, the resources needed to complete this task should be assigned to the cost of administering an effective financial operation and not the audit.

These points lead me to a general statement about auditing cost. All other things being equal, the better managed the unit or organization being audited the lower the cost of the audit will be for management. The more knowledge the audit team has of the organization being audited the lower the cost will be for the audit organization.

Finally, from either side of the cost ledger one should also consider audit recommendations that result in money being returned to the agency. For example, in FY 2000 the OIG audit team identified rent overpayments by the agency of $189,000. In 2001, the majority of these overpayments were repaid to the agency. While audit savings can help offset audit cost and are therefore important, they should not be the driving force for justifying why a financial statement audit should be performed. This is particularly true for small agencies where such savings will be intermittent or even in larger organizations whose financial management program functions effectively.

Lessons Learned

1 - The process is evolutionary. Management needs to believe that they have a chance to succeed and that sufficient resources and accounting help is available. This is particularly important in the first few years when no blueprint or financial statements exist.

2 - If a custodial activity statement is required the OIG should involve itself directly in the audit as the IPA learning curve will result in a high contract price.

3 - Stay the course. Ad hoc efforts to provide information to the auditors in the early years are ultimately replaced with systems that routinely collect needed data which is used to prepare the financial statements. Obtaining quality information becomes easier over time.

4 - After a number of years of performing the audits it becomes possible to identify trends. Unusual trend deviations provide worthwhile areas to investigate further.

5 - The OIG should make an effort to use the results of its financial statement audit to select targets for more in-depth follow-up reviews.

Managers in non-CFO agencies were provided flexibility by Congress when their agencies were not named as needing to comply with the CFO Act. This exclusion provided federal managers with the freedom to move into financial statement auditing at a pace of their choosing. After all, the CFO Act does not preclude agencies from undertaking financial statement audits. It appears based on the GAO survey, that many managers viewed their agency exclusion from the CFO Act as a reason for not needing to undergo a financial statement audit. I view this as a lost opportunity.

In the GAO survey which provides background for today's hearing, a chart appears on page 15 that details the "Key Legislation Requiring FS Audits." These various pieces of legislation make it clear how broad based financial statement audit coverage is and how universally recognized its value is as a method to improve internal controls, identify weaknesses and thereby help to ensure accountability.

I believe the onus should be placed on those officials who do not perform financial statement

audits to explain why such an expenditure is so low on their list of spending priorities. They should be asked to explain how they are currently satisfying themselves that all funds under their control are being accounted for, particularly in light of the long legislative history of requiring such reviews of other public and private organizations of differing size.

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Mr. Chairman, this concludes my remarks. I would be happy to answer any questions you or any member of the Subcommittee may have about my office's experience in conducting financial statement audits at the FTC.

Mr. HORN. Our last presenter, and then we'll go to questions, is the Honorable Paul Brachfeld, Inspector General for the National Archives and Records Administration.

Mr. BRACHFELD. Good afternoon. I am Paul Brachfeld, the Inspector General of the National Archives and Records Administration. I thank you for the opportunity to testify before this distinguished subcommittee.

I must first apologize for not having presented a written statement prior to my testimony, as I was just called upon yesterday to join this distinguished panel. However, I am pleased to be here to lend my support to this proposed legislation.

I speak as the Inspector General of the National Archives and Records Administration and in my former capacity as Assistant Inspector General for Audits at both the Federal Communications Commission and the Federal Election Commission.

In fiscal year 2002, NARA was appropriated an annual budget of approximately $289 million and 2,794 full-time equivalent positions, or FTEs. The $289 million includes appropriations for operations, repairs and restoration of facilities and grants.

NARA operations are spread throughout 37 facilities nationwide to include archives and records services facilities and Presidential libraries. NARA also publishes the Federal Register, administers the Information Security Oversight Office and makes grants for historical documentation through the National Historical Publication and Records Commission.

In addition to our annual appropriation, Public Law 106–58 established the Records Centers Revolving Fund on September 29, 1999. The enabling legislation authorized NARA to charge customers for records storage and services. Income from these operations in fiscal year 2002 is estimated to be approximately $107 million.

NARA also maintains a gift fund with estimated fiscal year 2002 availability of approximately $9.2 million, and Trust Funds with estimated fiscal year 2002 operating income of approximately $15.9 million.

I am pleased to report that in the 2 years that I have served as the IG at NARA, the components of the agency which are subject to financial audit have received clean or unqualified opinions. These audits of Revolving Fund and Gift and Trust Funds were performed under the control and direction of the OIG. While no material weaknesses were detected, the Independent Professional Accounting Firm [IPA], did identify opportunities to strengthen financial accounting practices and procedures and enhance internal controls, most notably as related to information technology controls and continuity of operations.

Currently, NARA does not perform a financial statement audit over our appropriated funds. The OIG does not have any funding or resources to oversee or perform this work.

As you know, the GAO transmitted a survey to my agency dated September 28, 2001, focusing upon whether financial statement audit requirements should be expanded to certain agencies, including NARA. Question 54 of the survey was "Why has your agency chosen not to have its financial statement audited?"

In response, the NARA Director of Financial Management Services checked all four boxes provided. They were as follows: Not statutorily required; insufficient funding; insufficient financial management staff; insufficient expertise in preparing financial statements.

I think that "choice" should be removed from this equation and that the OIG should be provided the necessary staffing and resources to perform in work.

At NARA, the proposed price for this first option year of a multiyear contract with an IPA to provide financial auditing services to the Revolving Fund and Trust and Gift Funds is approximately $260,000. The OIG does not have any dedicated financial auditors on staff to administer the contract and performance; thus, this collateral part-time duty is shared by myself, the Assistant Inspector General for Audits and an information technology auditor. I do not consider this to be an optimal staffing solution.

Financial accountability and stewardship over funds is too important a matter to compromise due to a lack of enabling resources. I believe that this office should have the necessary resources to accomplish our mission and that defined by Congress and Public Law 100–504, the Inspector General amendments. Thus, should this legislation be ratified, there is a critical need to provide funding and resources to support the intent of Congress.

I continue to face a critical shortage in resources, and in this semiannual reporting period, I have continued to alert Congress to the situation. I firmly support the adoption of this legislation, but I'm well aware that without funding and, more importantly, auditors on staff with financial statement auditing expertise, the task of performing this work will be daunting.

Over a decade ago, when I served as the Assistant Inspector General for Audits at the FCC, I met with the chairman to brief him on the results of my limited financial statement audit of selected balance sheet accounts that I had single handedly performed. The balance sheet line items I looked at were accounts receivable, accounts payable, and property, plant and equipment. In this audit, constrained by lack of resources and staff I was all alone, I identified significant deficiencies.

When I met with the former chairman and attempted to explain my findings, he confessed that he could not follow my presentation. Thus, I simplified them by asking him whether he would invest in a company that couldn't track its receivables and payables, and didn't place a valuation on their property, plant and equipment. He laughed and said, "Of course not," at which point I congratulated him on being the CEO of that company.

Since that meeting I held in, I believe, 1991, the FEC has moved quite a distance as OIG auditors, with the support of the CFO, are now performing full financial statement audits and received unqualified clean opinions. However, this progress may not be shared by all agencies.

I believe that we owe it to the taxpayers to demonstrate proper stewardship of our assets and account for how we budget and spend our money. We owe it to them to guarantee that we in the public sector are using timely, reliable and comprehensive financial

information when making decisions which impact upon them and the welfare of their loved ones.

It's not logical to me that certain Federal agencies are required to perform annual financial statement audits while others are excluded from these requirements. I believe that sound financial auditing practices, as required by the CFO Act, can and do provide tangible benefits to our customers and should be extended to a broader range of agencies as called for in this proposed legislation.

Mr. Chairman, this concludes my remarks. I would be happy to answer any questions you or any member of the subcommittee may have about my office's experience related to financial or related matters. Thank you very much.

Mr. HORN. Well, thank you.

[The prepared statement of Mr. Brachfeld follows:]

Horn
Putnam
Schakowsky
Kanjorski

Prepared Statement of the Inspector General of
The National Archives and Records Administration
Before the House Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations
of the
Committee on Government Reform

Washington, D.C.

May 14, 2002

Accountability of Tax Dollars Act of 2002

Introduction

Good afternoon, I am Paul Brachfeld, the Inspector General of the National Archives and Records Administration (NARA) and I thank you for the opportunity to testify[1] before this distinguished Subcommittee. I must first apologize for not having presented a written statement prior to my testimony as I was just called upon just yesterday to join this distinguished panel. However, I am pleased to be here to lend my support to this proposed legislation. I speak as the Inspector General of the National Archives and Records Administration and in my former capacity of Assistant Inspector General for Audits at both the Federal Communications Commission and at the Federal Elections Commission.

[1] This written statement, my oral presentation and any responses to questions I might provide reflect my views and do not necessarily reflect the views of NARA, nor any other Inspector General in the PCIE/ECIE community.

In Fiscal Year (FY) 2002 NARA was appropriated an annual budget of approximately $289 million and 2,794 Full-time Equivalent positions or FTEs. The $289 million included appropriations for operations, repairs and restorations of facilities, and grants. NARA operations are spread throughout 37 facilities nationwide to include archives and records services facilities and Presidential libraries. NARA also publishes the Federal Register, administers the Information Security Oversight Office, and makes grants for historical documentation through the National Historical Publications and Records Commission (NHPRC).

In addition to our annual appropriation, Public Law 106-58 established the Records Centers Revolving Fund on September 29, 1999. The enabling legislation authorized NARA to charge customers for records storage and services. Income from these operations in FY 2002 is estimated to be approximately $107 million dollars. NARA also maintains a Gift Fund with estimated FY 2002 availability of approximately $9.2 million and a Trust Fund with estimated FY 2002 Operating Income of approximately $15.9 million dollars.

Current Status of Financial Audit Activity

I am pleased to report that in the two years that I have served as the IG at NARA, the components of the agency which are subject to financial audit have received clean or unqualified opinions. These audits of the Revolving Fund, and Gift and Trust Funds were performed under the control and direction of the OIG. While no material weaknesses were detected, the Independent Professional Accounting firm or IPA, did identify opportunities to strengthen financial accounting practices and procedures and enhance internal controls most notably as related to information technology controls and continuity of operations.

Currently, NARA does not perform a financial statement audit over our appropriated funds. The OIG does not have any funding or resources to oversee or perform this work. As you know the GAO transmitted a survey to my agency dated September 28, 2001 focusing upon whether financial statement audit requirements should be expanded to certain agencies including NARA. Question 54 of that survey was "why has your agency chosen not to have its financial statements audited?" In response, the NARA

Director, Financial Services Division checked all four boxes provided. They were as follows:

- Not statutorily required
- Insufficient funding
- Insufficient financial management staff
- Insufficient expertise in preparing financial statements

I think that "choice" should be removed from this equation and that the OIG should be provided the necessary staffing and resources to perform this work.

Audit Cost and Resources Required

At NARA, the proposed price for this first option year of a multi-year contract with an IPA to provide financial statement auditing services to the Revolving Fund and Trust and Gift Funds is approximately $260,000. The OIG does not have any dedicated financial auditors on staff to administer the contract and performance, thus this collateral part-time duty is shared by

myself, the Assistant Inspector General for Audits and an Information Technology auditor. I do not consider this to be an optimal staffing solution.

Financial accountability and stewardship over taxpayer funds is too important a matter to compromise due to a lack of enabling resources. I believe that this office should have the necessary resources to accomplish our mission and that defined by Congress in PL 100-504, the Inspector General Act Amendments. Thus, should this legislation be ratified there is a critical need to provide funding and resources to support the intent of Congress. I continue to face a critical shortage in resources and in this semiannual reporting period I have continued to alert Congress to this situation. I firmly support the adoption of this legislation but am well aware that without funding and more importantly auditors on staff with financial statement auditing expertise, the task of performing this work will be daunting.

Why Should Financial Audits be Performed?

Over a decade ago, when I served as the Assistant Inspector General for Audits at the FCC, I met with the Chairman to brief him on the results of a limited financial statement audit of selected accounts on the Balance Sheet that I had single handedly performed. The balance sheet line items included accounts receivables, accounts payable, and property, plant and equipment. In this audit constrained by a lack of staff and resources (I was the only auditor on staff at that time) I identified significant deficiencies. When I met with the former Chairman and attempted to explain my findings he confessed that he could not follow my presentation. Thus I simplified them by asking him whether he would invest in a company that couldn't track receivables and payables, and didn't place a valuation on their property, plant and equipment. He laughed and said "of course not" at which point I congratulated him for being the CEO of that company.

Since that meeting held in I believe 1991, the FCC has moved quite a distance as OIG auditors with the support of the CFO are now performing full financial statement audits and have received unqualified or clean opinions. However, this progress may not be shared by all agencies. I

believe that we owe it to the taxpayers to demonstrate proper stewardship over our assets and account for how we budget and spend our money. We owe it to them to guarantee that we in the public sector are using timely, reliable, and comprehensive financial information when making decisions which impact upon them and the welfare of their loved ones. It is not logical to me that certain Federal agencies are required to perform annual financial statement audits while others are excluded from these requirements. I believe that sound financial auditing practices as required by the CFO Act, can and do provide tangible benefits to our customers and should be extended to a broader range of agencies as called for in this proposed legislation.

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Mr. Chairman, this concludes my remarks. I would be happy to answer any questions you or any member of the Subcommittee may have about my office's experience related to financial and related matters.

Mr. HORN. We're now going to go to questions. It will be 5 minutes for each of us. We'll just start with myself and then the ranking member, then Mr. Kanjorski.

Let's start with Mr. Engel, Director of Financial Management and Assurance for the U.S. General Accounting Office. Mr. Engel, your testimony generally supports the thrust of H.R. 4685. From your experience, what do you see as the primary benefits to an agency to prepare agency-wide financial statements and having them audited?

Mr. ENGEL. Yes, Mr. Chairman. My experience with the CFO Act agencies, as well as in the private sector, prior to coming into the Federal Government, was very similar to the results that we had seen from the surveyed agencies and that is displayed on the chart over here.

Enhancing accountability is certainly an experience that many of the CFO Act agencies have had during these initial audits since the CFO Act was passed. Identifying inefficiencies and weaknesses and improving internal controls, we've seen that while, as you had mentioned earlier, a lot of the agencies still are not receiving unqualified opinions, we have seen improvements in the number of weaknesses and reportable conditions that are being identified out at the agencies.

The agencies are being alerted to where the real problems are, which is one of the benefits of having a financial statement audit by an independent auditor; and actions are being taken to address these.

The reliability of financial information is also a key result of having a financial audit. When you recall, back to the early years of the CFO Act and the audits of the IRS financial statements, I believe in front of this subcommittee, there were various hearings and there was a lot of discussion about the amounts of taxes receivable.

There were large amounts that were originally on the books, but it was through the financial statement audits that it was determined that many of those amounts were not valid receivables. In many cases, we had duplicates, even triplicates of amounts being counted as receivables. So we really were not reacting to an amount that we could go after and collect.

We also did not have a very good idea of what the collectability of those receivables were. It's been through the audit process that we're getting a better handle on how much we could expect to go after and collect so that we can plan future decisions down the road.

These would be some of the key things I'd identify.

Mr. HORN. Mr. Engel, what changes, if any, would the General Accounting Office propose making to H.R. 4685?

Mr. ENGEL. I think some of the key ones relate to discussions we've had here today.

We had a lot of discussion about the dollar threshold. As our survey had identified, one of the factors was using the budget authority. But there were several other factors that we felt important and the respondents, I believe, felt important as well. These included the fiduciary responsibilities and the risks of the operations themselves.

The idea of using a dollar threshold certainly makes it more simple to design the law itself. One way around that—again, that I had mentioned in my testimony—if you wanted to stick with that, but still build in the factors, is to give OMB the authority to make decisions as to adding or excluding agencies that meet the dollar threshold; but maybe they do not meet some of the other factors that have been identified as important in making a decision as to whether or not an audit should be done or not.

That would be one mechanism I think should be considered.

Another is the waiver authority that's being authorized. The way the legislation is drafted right now would identify and give a transition period. I believe it's typically needed for entities that have not been through a financial statement audit. The waiver authority allows OMB to waive the first 2 years of audit to the agencies, but if you do have agencies coming on subsequent to what the initial cut-off of agencies are, we need to build something for those agencies to be able to have a transition period.

Mr. HORN. I'm going to have to move to the third question with you. Other than the dollar threshold, what factors should be considered in deciding whether an agency should be included in the legislation?

Mr. ENGEL. Some of the most important ones, I think, are to take a look at that agency and determine if they are responsible for fiduciary responsibilities. Are they handling funds on behalf of others? Do they have retail operations—let's say, more risky operations that involve the collection of funds? Do they provide insurance, do they make loans, or loan guarantees?

Those types of factors I think would be important to consider in determining whether an agency should be audited.

Mr. HORN. Good.

Five minutes and 5 minutes, Ms. Schakowsky.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman.

Mr. Engel, can you give us any kind of an estimate of the financial or personnel resources that might be necessary to carry out the provisions of the bill?

Mr. ENGEL. I can give you some of the information that we had from the surveys themselves. There really was a range depending upon the size of the agency.

One of the dependencies is whether you have multiple offices. Nonintegrated systems can contribute to what it could cost; the range was actually from $11,000 as a low up to $350,000 for the audit cost itself.

Now, in between there—and those really did range from an agency that had less than $25 million of budget authority, didn't have a lot of assets or liabilities, to one that was up over $6 billion of budget authority——

Ms. SCHAKOWSKY. You didn't just look at agencies over the $25 million?

Mr. ENGEL. We actually included in this survey some agencies that were less than $25 million. They were all above $10 million, but there were some that were under $25 million.

Ms. SCHAKOWSKY. OK.

Ms. Doone, you raised some questions about the $25 million threshold. What were your discussions about how we might be able

to setup some sort of other criteria by which we gauge whether someone would fall under this act?

Ms. DOONE. I noted in Mr. Engel's testimony, and then in his response to the questions, giving that authority or giving some room to OMB to make that determination based on assets, liabilities and risks of the agencies. I think that would be an appropriate course. That way you would be looking at budget authority as well as assets, liabilities, and fiduciary responsibilities. That I would give a more complete picture as to the need for audited financial statements.

Ms. SCHAKOWSKY. Do you have any problem with the $25 million number being static? Even if we were to use $25 million as the threshold and then make other kinds of criteria?

Mr. Engel.

Mr. ENGEL. Yes. Again, what I was proposing in my statement was that you could get around the inflationary effect of that having a static number, again through OMB's allowance of having the authority, if all they saw was the reason that an agency was coming on to meet the threshold was because, over time, inflation had gotten them there, they could exclude that agency and explain to Congress that they don't believe that agency should be added.

Ms. SCHAKOWSKY. Mr. Reger, I was interested, you indicated that the Federal Communications Commission still has a number of formidable challenges in complying with the audit requirements.

Can you describe those challenges?

Mr. REGER. Integrating financial systems is probably one of the largest challenges. We have a number of systems, and trying to make them all work in a timely manager—you're aware that the financial CFO Act requires ever-decreasing timeframes now for providing audited financial statements.

Those timeframes are difficult for us as we try to gather information from many systems, just as an example.

Ms. SCHAKOWSKY. And so, what do you conclude with that? Are you in support of that legislation?

Mr. REGER. The Commission hasn't taken a position, ma'am.

Ms. SCHAKOWSKY. But you're saying right now you would not be in a position to comply?

Mr. REGER. No, we do in fact comply. We currently generate auditable financial statements.

Ms. SCHAKOWSKY. But it's hard?

Mr. REGER. It is very difficult.

Ms. SCHAKOWSKY. Mr. Brachfeld, you indicated that the burdens of an audit requirement would strain your office's resources.

Do you have some idea of the number of staff positions and the budget authority you'd need if this bill were to pass?

Mr. BRACHFELD. Based upon my past experience in the Federal Communications Commission, where I served as AIG and actually worked with Mr. Reger, I would estimate at least two people, two OIG staff financial auditors; and then the financial dollars, if we brought in a contractor.

Right now, we pay, I think approximately—I quoted somewhere, I think, about $180,000 or so for the larger part of the Revolving Fund financial statement audit. To incorporate our appropriation,

I would guess we'd probably look—say we'd have to bring in a vendor for probably $300,000 more, or something along those lines.

Ms. SCHAKOWSKY. Let me ask this last question. Anyone can answer.

Since this legislation does not include any increase in either personnel or financial resources to—so that you could comply, what would happen to your agencies were it to pass without that, those resources? Would you have to make cuts elsewhere? What would you cut? What would you do.

Mr. BRACHFELD. On the IG's side, we would have to honor the request of Congress and honor the law; and we would, therefore, have to borrow or take staff away from other projects.

But not only would we have to take staff from other projects, we would have to have the staff in house that would have that expertise, because converting an IT order or a contract order to do financial statements is a completely different discipline.

So not only would it be a staffing in terms reallocating staff, we may not have the skills on board to conduct this type of work.

Mr. ZIRKEL. I think for the Federal Trade Commission—since we already go through this process, I don't believe that as a result of passing the law, there would be any additional cost associated with this mandate.

I also looked at this when the original CFO Act was passed. We at non-CFO agencies were provided an opportunity by Congress to move forward at our own pace into this area, realizing that this was a basic accountability responsibility or obligation that management had to the taxpayers.

And so, I know that audits and the cost of audits, whether it's management that's incurring the cost or whether it's an IG that's incurring the cost, there are more important things that people see being done. But in the long list of different priorities, even if it's not the highest priority, I just believe it shouldn't be "no priority" or off the list. It should be somewhere in there, so that, in fact, management is held accountable to the public.

And there was one chart that I found interesting from the GAO study, and that was a list of all of the legislation over the years where financial statement audits were mandated. It started, I guess, in 1934 with the Securities and Exchange Act. And while people always question financial statement audits, it doesn't seem like we've found another alternative to meet this obligation.

So it's one thing to say, well, you don't have enough money, but what are you doing to fulfill your responsibility there? That's sort of the middle ground here. I mean, you have to almost move to do it until you find an alternative that is better, more cost-efficient. Then, if you do, I'm sure a lot of people might run to that.

Without that alternative, I think what we have here seems to work. Even if it's not the highest priority, it should certainly fall somewhere in the whole scheme of things.

Mr. HORN. Five minutes to the gentleman from Pennsylvania, Mr. Kanjorski.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

I guess to the full panel, if this piece of legislation is passed, do you anticipate any savings that may occur by doing the auditing

process that would, therefore, pay for and justify the audits, or is this just duplicative?

Mr. ZIRKEL. My experience is that—for example, I mentioned that we have an IPA, and we also put in about a half a work-year on our staff. The IPA is a CPA firm under contract to the OIG for around $60,000 a year.

In the year 2000, for example, we found an overpayment of rent at the FTC that totaled $189,000. The FTC had closed some regional offices and, in fact, the landlord was continuing to bill the agency. When we located that, then they went—the next year, they went back and got a refund for the overpayment.

Well, this $189,000, in essence, would pay for 3 or 4 years of my audit.

I am not one to justify a financial statement audit based on savings. That puts a lot of pressure on the system, and it sort of sets-up the wrong relationship between management and the auditors. Nevertheless, and particularly in small agencies, savings will be intermittent, but they will help. And this was just one example.

In most years we always have some savings and, most years, they're smaller. So I think that savings are a very real benefit. It's just difficult to say that those savings in all cases will offset all of the costs. So in fact this is a cost-efficient approach.

In most cases, I believe it will be.

Mr. KANJORSKI. To a large extent, an audit would determine whether or not the agency is performing its mission?

Mr. ZIRKEL. Yes.

Mr. KANJORSKI. And it is a way of Congress and the executive branch knowing where it's going; is that correct?

Mr. ZIRKEL. I believe for agencies that have custodial activity statements that where we get into these fiduciary responsibilities, that moves into the mission of the agency. And I believe it also will help in terms of—there's another statement called the Net Cost Statement, and then that cost statement, I think, is audited costs that can be used with GPRA. So in that respect, a financial statement audit with net cost will help and make sure that management is not coming up with costs to tie to a performance measure that is not tied to anything.

Mr. KANJORSKI. Just for the efficacy, do you fear this may put pressure, external pressure on your agency since you regulate those of us who sit up here?

Ms. DOONE. I don't think we would be concerned about external pressure, but going to your previous question and the one from the last round, we don't think there would be any cost savings for us, because we believe our internal controls are quite tight, and we do think there would be, in fact, an increased cost. We have a very small IG office, a staff of four. Either they would have to stop work on existing projects or we would have to contract out.

Mr. KANJORSKI. We may like you to have them stop work on certain projects. Mr. Engel, I am particularly interested in the Endowment for Democracy. Are you aware of that organization? That's funded by Congress, too, at about $33 million a year, and is a recipient of incredible amounts of money that they send out around the world. And it is structured, as I understand it, as a nonprofit 501(c)(3) corporation established by Congress to, I guess, aid and

assist the State Department, CIA and other agencies of the Federal Government, but they practically—I have been in Congress 18 years and I can't find out everything they give their money to.

But Mr. Chairman, I have a piece from the New York Times I would like to make part of the record of their most recent activities in Venezuela.

Mr. HORN. Without objection, this will be put in the record.

[The information referred to follows:]

but financial cleanup, local party offi- ... lens, and I ended up in prison."

U.S. Bankrolling Is Under Scrutiny for Ties to Chávez Ouster

By CHRISTOPHER MARQUIS

WASHINGTON, April 24 — In the past year, the United States channeled hundreds of thousands of dollars in grants to American and Venezuelan groups opposed to President Hugo Chávez, including the labor group whose protests led to the Venezuelan president's brief ouster this month.

The funds were provided by the National Endowment for Democracy, a nonprofit agency created and financed by Congress. As conditions deteriorated in Venezuela and Mr. Chávez clashed with various business, labor and media groups, the endowment stepped up its assistance, quadrupling its budget for Venezuela to more than $577,000.

While the endowment's expressed goal is to promote democracy around the world, the State Department's human rights bureau is examining whether one or more recipients of the money may have actively plotted against Mr. Chávez. The bureau has put a $1 million grant to the endowment on hold pending that review, an official said.

"We wanted to make certain that U.S. government resources were not going to underwrite the unconstitutional overthrow of the government of Venezuela," said the official, who occupies a midlevel job in the department and asked not to be identified. The deputy spokesman for the State Department, Philip Reeker, said he was unaware of the proposed grant.

Of particular concern is $154,377 given by the endowment to the American Center for International Labor Solidarity, the international arm of the A.F.L.-C.I.O., to assist the main Venezuelan labor union in advancing labor rights.

The Venezuelan union, the Confederation of Venezuelan Workers, led the work stoppages that galvanized the opposition to Mr. Chávez. The union's leader, Carlos Ortega, worked closely with Pedro Carmona Estanga, the businessman who briefly took over from Mr. Chávez, in challenging the government.

The endowment also provided significant resources to the foreign policy wings of the Republican and Democratic parties for work in Venezuela, which sponsored trips to Washington by Chávez critics.

An endowment created by Congress sent money to Venezuelan groups.

The National Democratic Institute for International Affairs was given a $210,500 grant to promote the accountability of local government. The International Republican Institute, which has an office in Venezuela, received a grant of $339,998 for political party building. On April 12, the day of the takeover, the group hailed Mr. Chávez's ouster. "The Venezuelan people rose up to defend democracy in their country," the institute's president, George A. Folsom, said in a statement. "Venezuelans were provoked into action as a result of systematic repression by the government of Hugo Chávez."

The statement drew a sharp rebuke from Carl Gershman, the endowment president, for the openly political stance, which he said would undercut the institute's work in Venezuela in the future.

The institute has close ties to the Bush administration, which had also embraced the short-lived takeover; Lorne Craner, the assistant secretary of state for democracy, human rights and labor, is a former president of the organization.

In an interview, Mr. Folsom said discussions at the institute on Venezuela involved finding ways to remove Mr. Chávez by constitutional means only.

Chris Sabatini, the endowment's senior program officer for Latin America and the Caribbean, said his agency's funds went to specific projects to bolster the democratic opposition in Venezuela — including training in civics, journalism and conflict resolution — and did not contribute to the attempted ouster of Mr. Chávez.

"None of our funds in any way were used to support the coup," he said.

Mr. Sabatini acknowledged that the endowment had hurriedly increased its outlays in Venezuela in the past year as Mr. Chávez and his supporters restricted press freedoms and sought to suppress growing dissent against his leftist policies. The goal was to create political space for opponents to Mr. Chávez, not to contribute to his ouster, he said.

"We were very explicit that we had no opinion of Chávez," but were responding to events, Mr. Sabatini said.

The Bush administration, which has made no secret of its disdain for Mr. Chávez — and his warm relations with nations like Cuba and Iraq — has turned to the endowment to help the opposition to Mr. Chávez.

With an annual budget of $33 million, the endowment disburses hundreds of grants each year to prodemocracy groups from Africa to Asia. Advocates say the agency's independent status enables the United States to support democratic actors in nations where American government aid might be cumbersome or unwelcome. Its supporters proudly cite critical assistance from the endowment to countries emerging from repressive systems like Poland and South Africa.

Jane Riley Jacobsen, a spokeswoman for the endowment, said her agency scrupulously maintained its independence from the federal government and avoided foreign policy debates.

But critics say recipients of endowment aid do not have the same accountability that government programs require, which opens the door for rogue activities and freelancing. The agency overreached, those critics say, in Chile in 1988 and in Nicaragua in 1989, when endowment funds were used to sway the outcomes of elections.

Barbara Conry, an analyst at the libertarian Cato Institute, said the organizing philosophy behind the endowment was flawed.

"You ended up with the worst of both worlds," she said. "Everybody knew it was directly funded by Washington. That didn't fool too many people. But it wasn't really accountable."

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Submitted by Cong. Kanjorski
For the record
Govt. Efficiency - 2247 RHOB - 2:00 p.m. Hearing

H.R. 4665, the Accountability for Sat Dollars Act 7/2002

Mr. KANJORSKI. Do you think we ought to extend the group that we are looking at auditing and since this nonprofit organization that is a part of the U.S. Government carries on a portion of our foreign policy and invests in elections to unseat democratically elected presidents sometime; that it may be worthwhile to audit some of these independent agencies or quasi-governmental agencies that expend government funds?

Mr. Engel.

Mr. ENGEL. I think that could be considered. It could actually be considered and part of this legislation. If so, it would be probably on an agency-by-agency or entity-by-entity basis and looking at the risks.

Mr. KANJORSKI. You wouldn't see anything that the crook here is the fact that the agency or bureau or a quasi-government agency is using Federal funds. That justifies our reason why to have an audit performed?

Mr. ENGEL. Yes.

Mr. KANJORSKI. And so it wouldn't be inconsistent with this act or general good principles of government if we included an agency like the Endowment for Democracy to be audited also.

Mr. ENGEL. To cover the government funding.

Mr. KANJORSKI. You are with the General Accounting Office?

Mr. ENGEL. Yes.

Mr. KANJORSKI. And you never heard for the Endowment for Democracy? Well, anybody else?

Mr. HORN. Nobody would do it from GAO unless we request it. Sometimes you dig it up yourself. But actually, it's is a rather fine group. And as I remember, the leaders came mostly out of the American labor movement because they were upset by the Stalinist, Marxist, Soviet type of labor.

Mr. KANJORSKI. It did grow out of the cold war, Mr. Chairman, but I think the cold war ended sometime in the last decade. But it carries on——

Mr. HORN. It hasn't ended in Cuba at this point and it hasn't in some of the types of—well, even in the party now in control in part of the Duma is Communist. As I remember when I was in the Department of Labor, that basically was to get——

Mr. KANJORSKI. So the record is clear, it just doesn't fund the labor movement. It is an uncanny organizational structure that has four basic institutes: It funds the National Chamber of Commerce and it funds the AFL–CIO Institute, so they balance off labor and big business and they get their portion of the funds.

It also funds the Republican Institute, Republican party so it can have a travel agency; and it funds the Democratic Party Institute so it can have a travel agency. But above and beyond that, and far beyond the appropriated funds, it receives actually unknown funds from aid and other Federal agencies that get channeled. And it just strikes me the last time I raised this issue, the Endowment for Democracy funded a poll against the President of France, for the purpose of creating some democracy, I am not sure. But there are a great deal of funds, almost $1 million are channeled into organizations that brought about, or attempted to bring about the fall of the democratic-elected president in Venezuela. I don't necessarily support the policies of that democratically elected president. But I

begin to wonder if we have an audit that we're talking about here with quote, executive agencies that exist out there, maybe we ought to start auditing some of these agencies that are below the radar screen.

Mr. HORN. Well, as I remember, they also try to get fair elections and go as pollsters and observers and see if——

Mr. KANJORSKI. All functions could be performed by the State Department or other executive agencies of the United States.

Mr. HORN. Well, I would think somebody's knows that a precinct is a lot better than a lot of the people in the Department of State. They can analyze it. They can read the newspapers. They do a very fine job, but if you are going to talk to real people, we ought to be getting people from Chicago, Jan, and they would know how an election ought to be—and hopefully it wouldn't be a resurrection day which has been in places like Pittsburgh, Philadelphia, Boston, so forth. But it is very interesting. Was that a recent part of the New York Times?

Mr. KANJORSKI. Last week, I believe.

Mr. HORN. OK. We will startup again now and use 5 minutes. And Ms. Doone, in your testimony, you mentioned your agency already has strong internal controls and that audited financial statements would not result in greater accountability or tighter controls. What type of controls does the Federal Election Commission currently have in place?

Ms. DOONE. We have a Finance Committee composed of commissioners who determine and propose to the full commission the allocation of our budget authority among offices and projects. Once that is established after we have received our appropriation, we have monthly budget execution reports which show the moneys that have been obligated and expended for each object class for each division within the agency.

Further, on the lowest level there must be supervisory approval for all obligations and expenditures within each office. There is further approval going all the way up into the administrative office as well as the finance office who puts these together. Further, when invoices are received, the invoices go back to the procuring office where they assign to the people who have procured the services or goods to sign-off and certify that the amount is correct.

Before the payment is made, we have a certifying officer independent of the whole process reviewing the invoices to ensure everything is in order before payment is made. Further, when we submit our quarterly SF133s to Treasury, we must balance with our balances over at the Treasury Department. We do this quarterly, and annually we submit a SF 2108 so that we know our balances are in order.

With respect to contracting, the Commission must again approve all FEC-issued contracts. We believe from the lowest level to the highest level we have checks and balances throughout our budgetary and expenditure process.

Mr. HORN. But basically, your agency ensures financial accountability and effective internal controls without independent verifications by auditors.

Ms. DOONE. That's correct.

Mr. HORN. You have an internal auditor situation. Has there ever been an audit in the history of the Federal Election Commission? Has it ever been under an audit by an outside accountant?

Ms. DOONE. In terms of the financial statements, no.

Mr. HORN. That's right.

Ms. DOONE. For the financial statements.

Mr. HORN. So that is part of the good government that we passed here about 10 years ago. Is your statement that the Federal Election Commission doesn't conduct outside audits, but conduct internal controls are the equivalent?

Ms. DOONE. As I mentioned, we have an IG whose audits, because the IG is not auditing programmatic issues at the FEC, most of their audits are confined to the administrative side. We do have IG audits that are performed on our procurement policies, training procedures, how we procure training. But yes, it's correct that we have never had audited financial statements.

Mr. HORN. How would your agency fund the cost of a financial statement audit?

Ms. DOONE. Our IG office consists of four employees. It is unlikely that they would have the resources among the current staff to do the audited financial statements themselves. If they were to, they would have to stop working on other projects. If that is not a desirable outcome, we would have to fund it from the rest of our budget, and at this point, I don't know where the Commission would decide to take the funds.

Those funding decisions are made initially by the Finance Committee, and then the recommendations are submitted to the full Commission for approval. So I don't know at this point where we would take the funds, but they would have to come from some program area.

Mr. HORN. What is the budget now for the Federal Election Commission?

Ms. DOONE. For fiscal year 2002, our appropriation is $43.7 million.

Mr. HORN. Now I think about eight to 10 years ago, Congress gave the FEC about $3 million to computerize your operation. They didn't do it. And I remember the Appropriations Committee saying I will never do anything for that agency again, which I can understand when a group says this is what we need it for, we give it to them, they don't use it and just hire more people. And the question was, how to get the clients to see the various financial matters that we have to put as people running for office and the citizens need to be able to access that computer base.

What can you tell me about that computer base now? What kind of satisfaction are you giving to either reporters, to politicians, to staff, to every citizen that wants access?

Ms. DOONE. Mr. Chairman, over the past few years, we have been working very closely with the House Appropriations Committee who have been very supportive in funding our information technology projects and in fact has been earmarking funds for us over the past few years to accomplish that. We are in the midst of converting to a client server system for our disclosure data base to which you were referring where the financial disclosure reports are placed. We are converting into the new environment now.

As you may know, we implemented mandatory electronic filing in 2001, so that now over 80 percent of our transactions are coming into the Commission electronically. We are moving in the right direction to move toward using technology to give a more complete picture of disclosure.

Mr. HORN. Well, we will move from you to Mr. Zirkel on the Federal Trade Commission. In your testimony, you indicated that the Federal Trade Commission has been audited for the past 5 years; is that correct?

Mr. ZIRKEL. Yes, that is.

Mr. HORN. And describe the level of effort that went into preparing and having audited financial statements for the first time.

Mr. ZIRKEL. The first time, the first and second year was much more difficult because what we found is that the audit team had to work much more closely with management in developing reconciliations. And when we would ask for, let's say for a list of judgments, how much was the agency's judgments for the year, that would have to be in fact created because those lists didn't exist. As the audits went on over the years, what happened with the discipline of the audit was that all of a sudden systems begin to develop and the next year, the reconciliation was there. The system was in place and we learned that the program people would discuss and reconcile matters with the finance staff. So as the years went on, the cost of the audit from the IG standpoint—it's around $120,000 a year but the cost of the audit would stay the same. The quality of our audits is improving every year. And again, intermittently throughout the years we would find some savings in the audits to offset the cost of the audit, but we don't focus on that.

I think the IG also has the responsibility to make use of this financial statement in order to, not just a throw it to management when we find something where we think additional benefits are, we will schedule another audit outside the financial statement audit to look in that area. We have done that over the last few years and that has paid some dividends.

Mr. HORN. Now you went through this. There are other agencies that might go through this as well. What problems, if any, did your agency encounter during that first year audit? What would you advise other commissions and agencies?

Mr. ZIRKEL. I think you start with the proposition that management is rather nervous about this whole process. They don't know what the costs are or what the outcome is going to be. I think even in the finance units they are afraid that they are going to fail. You have to start out with the proposition that you are there—that as a result of this effort, we're going to improve management at the agency and we are working together, even though we're independent and we are still all working for the taxpayer.

I think with that idea and also saying that we are going to provide some accounting expertise, the development and creation of the financial statements requires a high-level of professional accounting. It requires FASP standards and understanding of OMB's form and content standards. I think the audit team can bring some expertise and help management in these areas.

If they are willing to commit the resources to do that, then in the first year, it will be successful; it will be trying but successful.

From there, you can build on that. I believe if you get into an area where you have an agency where there is a custodial activity statement involved, this is the fiduciary side, that it's important for an IG auditor to work with an IPA auditor and because a lot of these agencies have so many unique programs. If you want to be efficient, you have to know the program and IG staff know the program. So a partnership between IPA and IG audits would keep the audit costs down from the side of the OIG. Those were some of the lessons we learned.

Mr. HORN. The 24 Chief Financial Officer Act agencies are also required to issue a report on internal controls and compliance with laws and regulations, and to state whether the agency is in compliance with the Federal Financial Management Improvement Act. Have the Federal Trade Commission auditors prepared these reports for your agency? If so, what were the results?

Mr. ZIRKEL. Yes. We go through the—in the opinion, the overall opinion, we not only certify to the financial statements, but we certify to internal controls. We go through that process and we do note problems with compliance when staff reports the information, so we have done that and the agency is generally in compliance with its various laws and regulations.

Mr. HORN. Would you propose any changes to Mr. Toomey's bill, H.R. 4685?

Mr. ZIRKEL. No. I don't have a personal opinion on the level or the size that it should be. I know there has been some discussion here today. I would say, though, that to the extent that an organization or an agency has no fiduciary responsibility, it has a small budget and it has good controls. The cost of a financial statement audit should not be excessive. My experience is that to the extent that the financial offices are operating effectively, the cost of the audit is way down. The extent of agency problems really raise the cost of an audit. So getting back to answering the question, I don't have a limit or a dollar limit so I can't really add to that.

Mr. HORN. Mr. Brachfeld, what about your thoughts on Mr. Toomey's bill? Is there anything else that we ought to look at there?

Mr. BRACHFELD. Again, I want to reemphasize that I think it is very valuable to do this work. I should say some Federal agencies contract out most of their accounting to a larger agency or larger component, and then they basically minimize their own accounting staff. They believe that because somebody else is doing their bookkeeping, they don't need to have seasoned financial auditors or accountants, I should say, on their staff.

That leads to a climate where I believe fraud can take place. I have identified that on a number of occasions in my career where, again, they think that somebody else is—they are paying the good money to GSA or Department of Agriculture. One of the big guys is handling their accounting and they basically go to sleep and forget about internal controls and forget they need to have an external audit oversight.

So I support the context of this bill, and again, I am just reemphasizing that I am already sinking under a volume of work, and I would support any opportunity to put a strong reliance that the IG should be given sufficient resources to do these audits properly.

Mr. HORN. That is an excellent point, and we will take that into account because you can't just have "accountants." You have to get those documents if the leadership of the agency is going to use it for management purposes. I think you're right about making sure that anybody that is handling cash or anything else, or any way of—people, citizens, whatnot, that is a real problem. We shouldn't hire auditors. I had an auditor when I was president of a university. I had him practically stationed at my door. When they moved in, sometimes people started running and it worked.

So the question is what do you do? Anything else we have here? I have enjoyed what you have done. Is there anything else you want to add on the Toomey bill itself?

Mr. ENGEL. I would like to point out since we had a lot of discussion about costs and benefits, I want to call attention to the results of our survey, figure 3 in my testimony where we did discuss that there was, for most parties, reported back that the benefits outweighed the costs. I think that's consistent with what we've seen in those CFO Act agencies as well. I know Ms. Doone had mentioned that she feels they have strong internal controls at her agency. When a lot of the CFO Act agencies were first being audited, they were self-supporting, and many of them were identifying some weaknesses and controls. But when you started to get external auditors coming in and really scrutinizing the processes, you started identifying more critical control problems.

For example, you're aware of all the problems with computer security. That is a critical issue that has been identified through these financial audits, which you may not be able to point to a dollar savings, but you could point out there's been the prevention of some losses as a result of improvements made to systems controls.

So, I would say we need to take that into account. These were the results of actual agencies that have gone through the audit process, many of which volunteered to do this and they are saying that in many cases, the benefits substantially outweigh the costs. We have seen those types of benefits as well on the CFO Act agencies.

Mr. HORN. Any of you have any other thoughts? Going, going, gone. All right, I am going to thank all those besides the witnesses which were excellent. This is our staff: J. Russell George our staff director and chief counsel was here; Bonnie Heald, deputy staff director; Henry Wray, our senior counsel was also here for awhile. And we have Justin Paulhamus. He is the majority clerk, and Michael Sazonov is the professional intern. And the GAO detailee, we are thankful to have here. She is on my left, and your right, Rosa Harris, is doing a great job. And she will go back to the GAO and say, "boy, let me tell you how those people on Capitol Hill do." She will start giving seminars, I think, down there.

And now we have David McMillen, professional staff, long time excellent person; and Jean Gosa, the minority clerk. And we thank you both. And the court reporters are Julie Thomas and Nancy O'Rourke. And we thank you also. It is tough in these rooms and whatnot to hear everybody. So thank you very much all and we are adjourned.

[Whereupon, at 3:25 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Statement of the U.S. Securities and Exchange Commission
Concerning H.R. 4685, the "Accountability of Tax Dollars Act of 2002"

Before the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations
Committee on Government Reform
U.S. House of Representatives

The Securities and Exchange Commission is pleased to comment on H.R. 4685, the "Accountability of Tax Dollars Act of 2002." The proposed bill would require Federal executive agencies appropriated budget authority of more than $25 million and not currently subject to the Chief Financial Officers Act or other statute requiring audited financial statements, to prepare annual audited financial statements.

The Commission fully supports efforts to strengthen financial and performance reporting for Federal agencies. As the agency charged with overseeing the financial reporting of public companies, the SEC is uniquely aware of the importance of audited financial statements. Moreover, as a part of the federal government, we are aware of our obligation to the public to be faithful stewards of the fees we are authorized to collect and the funds we are annually appropriated.

H.R. 4685 reflects these principles by requiring all but the smallest federal government agencies to prepare and submit to the Congress and the Director of the Office of Management and Budget annual audited financial statements "covering all accounts and associated activities of each office, bureau, and activity of the agency." The bill would apply to the Securities and Exchange Commission, since it is not currently required by law to prepare full audited financial statements and its budget authority exceeds the threshold established in the bill.

The bill would require the SEC and other covered agencies to prepare audited financial statements beginning next fiscal year (although the Director of the Office of Management and Budget could grant waivers from this requirement for up to two years). Without detracting from our support for the important principle embodied in this bill, we respectfully suggest that the bill permit the smaller agencies it covers at least the same amount of time to introduce those statements as was provided to larger agencies under the Chief Financial Officers Act of 1990, Pub. L. No. 101-576 (1990), and the Government Management Reform Act of 1994, Pub. L. No. 103-356 (1994).

Last year the Commission began an effort to evaluate its ability to meet the requirements for preparation of such statements. In its authorization request for fiscal years 2002-2003, the Commission requested funds to allow it to assess the requirements for producing audited financial statements and to begin the necessary systems enhancements. To date, however, the Commission has not been authorized or appropriated funds for this purpose. SEC staff advises us that the Commission's current budget and staff resources are inadequate to make the necessary financial, information and management systems improvements to prepare audited financial statements. H.R.

4685's ambitious deadline, fiscal year 2003, would further stress those budgetary and staff resources.

Administrative management staffs of small agencies routinely face the challenges of meeting the government-wide management control and management improvement requirements imposed on the Cabinet-level and other large agencies with larger staff and budgetary resources. Therefore, if the bill is enacted, it should give small agencies the same amount of time that the larger agencies were granted to complete the extensive preparations for their first audited financial statements.

Moreover, a recent General Accounting Office survey indicates that most small agencies that do not now prepare audited financial statements expect to use consultants to advise the agency in preparing for audit. Those consultants usually are independent public accounting firms. The Commission would likely face additional challenges in securing such assistance, since the SEC has regulatory responsibilities over public accounting firms. This challenge should not prevent our preparing audited financial statements, but it may increase the costs and delay the completion of this initiative.

Thank you for the opportunity to submit this statement for the record of the Subcommittee's hearing on H.R. 4685. We hope that our comments will be useful to the Subcommittee.

United States Government
NATIONAL LABOR RELATIONS BOARD
OFFICE OF INSPECTOR GENERAL
Washington, DC 20570-0001

May 16, 2002

The Honorable Steve Horn
Chairman, Subcommittee on Government Efficiency,
Financial Management, and Intergovernmental Relations
Committee on Government Reform
United States House of Representatives
Washington, D.C. 20515-6065

Attn: Ms. Rosa Harris

Dear Mr. Chairman:

The Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations recently held a hearing on HR 4685, the Accountability of Tax Dollars Act of 2002. This legislation extends the financial statement audit requirements to agencies that are not currently subject to statutory financial statement audit requirements. We thought that our efforts in this area at the National Labor Relations Board (NLRB or Agency) would of interest to your subcommittee.

In December 2000, my office completed an audit of the NLRB's fiscal year 1999 accounting and reporting systems. In the audit report, we concluded that, although the NLRB is not required by law to prepare audited financial statements, choosing to prepare audited financial statements is a good business practice voluntarily adopted by several similarly sized agencies. By choosing to do so, the NLRB's credibility would be enhanced because it could demonstrate, through audited financial statements, that the Agency's financial management is sound and in conformance with applicable Government standards. We recommended that management coordinate with the General Counsel and Board to obtain a decision on whether the Agency will prepare annual financial statements and have periodic audits. Management agreed with the finding and took action to implement the recommendation. After due consideration, the Chairman and General Counsel decided that audited financial statements were not needed at that time. A copy of the audit report is provided as an enclosure.

In August 2001, the General Accounting Office initiated a review of selected agencies, including the NLRB, to determine whether financial statement audit requirements should be expanded to certain agencies that are not required by statute to have annual financial statement audits. Overall, the 26 surveyed agencies reported that they either achieved significant benefits or would anticipate achieving such benefits from having audited financial statements. Twenty-one of those agencies reported that, in general, Federal agencies should have their financial

statements audited. The NLRB was one of only five agencies that stated that its financial statements should not be audited.

I hope you find this information useful. If you have any questions or require additional information, please contact my Counsel, Dave Berry, or me at 202 273-1960.

Sincerely,

Jane E. Altenhofen
Inspector General

Enclosure

cc: Board
General Counsel

UNITED STATES GOVERNMENT
National Labor Relations Board
Office of Inspector General

Audit of NLRB's Fiscal Year 1999 Accounting and Reporting Systems

Report No. OIG-F-8-01-01

December 2000

INSPECTOR GENERAL

NATIONAL LABOR RELATIONS BOARD

WASHINGTON, DC 20570

December 12, 2000

I hereby submit an *Audit of NLRB's Fiscal Year 1999 Accounting and Reporting Systems*, Report No. OIG-F-8-01-01. This review was conducted to evaluate the Agency's capability to prepare audited financial statements.

The National Labor Relations Board (NLRB or Agency) is not required by law to prepare audited financial statements. However, choosing to prepare audited financial statements is a good business practice voluntarily adopted by several similarly sized agencies. NLRB's credibility would be enhanced if it could demonstrate, through audited financial statements, that the Agency's financial management is sound and in conformance with applicable government standards.

The Agency currently records most financial transactions that are needed to prepare the principal statements, and the data recorded is reasonably accurate. We identified five areas where transactions would have to be recorded or corrected. These were workers' compensation, imputed financing costs, a capitalized lease, amortization of computer software, and depreciation.

NLRB management is responsible for complying with laws and regulations applicable to the Agency. We found no instances of noncompliance with laws and regulations that would have to be reported in an audit of the financial statements. We found that the Agency's financial management systems substantially complied with the U.S. Government Standard General Ledger at the transaction level. The financial management systems did not substantially comply with the Federal financial management systems requirements or Federal accounting standards.

We considered one matter, information security, involving the internal control and its operation to be a material weakness. With respect to internal controls

related to performance measures, we obtained an understanding of the design of significant internal controls but do not provide an opinion on such controls.

We identified two conditions that would be reported to management in a letter rather than in the report on internal control. One was on time and attendance issues, the other involved capitalized and sensitive property.

Recommendations addressing these findings are numbered consecutively throughout the report and can be found on pages 5 and 8 of this report. Management agreed with the findings and completed actions on all recommended actions but one, and that will be done by the end of the year.

We recommended that the Finance Branch Chief coordinate with the General Counsel and Board to obtain a decision on whether the Agency will prepare annual financial statements and have periodic audits. After due consideration, the Chairman and General Counsel decided that audited financial statements need not be prepared at this time, but that the matter would be revisited at a later date at the Inspector General's request or if circumstances change.

Although we continue to believe auditing the financial statements is a sound business policy, we understand this decision in light of the fact that the Agency may have a new Chairman and General Counsel within a year. We will reassess our recommendation when we evaluate the potential impact of the Reports Consolidation Act, enacted on November 22, 2000, on Agency operations. This Act allows agencies to consolidate and adjust the frequency and timing of financial and performance management reports.

An exit conference was held on October 23, 2000, with the Deputy Director of Administration, Finance Branch Chief, and other officials from the Division of Administration. The Director of Administration submitted written comments on the draft report. She agreed with the findings and recommendations made in the report. The Director of Administration's comments are presented in their entirety as an appendix to this report.

Jane E. Altenhofen
Inspector General

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APPENDIX — Memorandum from the Director of Administration, Draft Report (OIG-F-8-01-01), dated November 30, 2000

BACKGROUND

Increasing demands for Government accountability led to passage of the Chief Financial Officers (CFO) Act of 1990. The CFO Act established a position in designated agencies for an official who reports directly to the head of the agency to oversee all financial management activities. To help improve the integrity of financial information, in 1990, the Office of Management and Budget (OMB), the Department of Treasury, and the General Accounting Office (GAO) established the Federal Accounting Standards Advisory Board (FASAB) to develop accounting standards for the U.S. Government.

Several laws enacted in 1996 further strengthened accountability. The Government Management and Reform Act (GMRA) of 1996 amended the CFO Act to require, among other things, the annual preparation and audit of organization-wide financial statements of 24 executive departments and agencies. The Federal Financial Management Improvement Act (FFMIA) of 1996 requires that the report on these audits state whether agency financial management systems comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (SGL) at the transaction level.

OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, defines the form and content of financial statements of executive departments and agencies that are required to prepare audited financial statements by 31 U.S.C. 3515(d). OMB Bulletin 97-01 incorporates the FASAB concepts and standards that are the basis for generally accepted accounting principles (GAAP) for the Federal Government. GAAP includes the Statements of Federal Financial Accounting Concepts and Statements of Federal Financial Accounting Standards (SFFASs) recommended by the FASAB and approved by the Secretary of the Treasury, Director of OMB, and the Comptroller General.

The National Labor Relations Board (NLRB or Agency) administers the principal labor-relations law of the United States, the National Labor Relations Act of 1935, as amended. Approximately 30,000 charges of unfair labor practices and 6,000 representation petitions are filed with the NLRB each year. For Fiscal Year (FY) 2000, the Agency was provided an appropriation of close to $206 million and authorized 1,947 full time equivalents to staff operations at Headquarters and 51 Regional, Subregional, and Resident Offices and 3 Division of Judges satellite offices.

Executive agencies, including the NLRB, are mandated by law to follow the accounting principles, standards, and requirements prescribed by the Comptroller General, and currently issued by FASAB. NLRB is not subject to the CFO Act; however, the Director of Administration serves as the Chief Financial Officer.

OBJECTIVES, SCOPE, AND METHODOLOGY

This review was conducted to evaluate the Agency's capability to prepare audited financial statements. To accomplish this we determined whether: current systems were capable of collecting and compiling information necessary to produce reliable financial reports; transactions were in compliance with applicable laws, regulations, and accounting principles; there was accountability over property; and internal controls were effective.

We interviewed Agency officials responsible for financial management, including program managers and Regional Office staff. On a test basis, we examined evidence supporting the amounts recorded in the financial reports during FY 1999. We tested internal controls and compliance with laws and regulations including: Anti-deficiency Act; Budget and Accounting Procedures Act; Federal Managers' Financial Integrity Act of 1982; Fair Labor Standards Act of 1938; Civil Service Retirement Act of 1930; Civil Service Reform Act of 1978; Federal Employees' Compensation Act; Federal Employees' Health Benefits Act of 1959; Prompt Payment Act; and Federal Travel Regulations.

We relied on several audit and inspection reports issued by the Office of Inspector General (OIG) as identified in the exhibit. We used these reports to form conclusions related to safeguarding of capitalized and sensitive property, predominately computers and related equipment, and internal controls and compliance with laws and regulations. During this audit we tested time and attendance (T&A) at the Division of Judges in Washington.

We tested items from the Payroll/Personnel System to determine whether employees were getting paid at the appropriate rate, that amounts charged for retirement, health insurance, and life insurance were correct, and entries into the system were authorized and appropriately documented. We reviewed official personnel files to determine whether they included forms: SF-61, Oath of Office; I-9, Employment Eligibility Verification; and SF-61B, Declaration of Appointee. We also reviewed administrative processing of the Federal Employee Compensation Act program.

We selected a sample of 15 pieces of capitalized property from the Agency's official property records and telephoned Regional Offices to confirm the property's existence, description, serial number, and bar code number.

We selected two statistical samples to test disbursement transactions: one for travel expenses and another that included transactions other than rent, travel, and compensation and benefits. Our testing determined whether disbursements were made in accordance with applicable laws and regulations, processed in accordance with Agency processes and procedures, supported by adequate documentation, and correctly classified. We analyzed space rental

charges to identify unusual activity and determined if amounts were accurately recorded in the Agency's financial records.

We reviewed account balances as of September 30, 1999. Cash balances on the SGL were traced to Department of Treasury reports. We reviewed accounts receivable and liability accounts for reasonableness, tested items by tracing them to supporting documentation, reviewed the process for recording accounts receivable, and searched for unrecorded liabilities at year end. We reviewed unliquidated obligations to determine if they were valid obligations and recorded in the correct period. We reviewed the compensation and benefits accrual and unfunded annual leave balance for reasonableness. We reviewed the accuracy of capitalized property records and verified depreciation calculations.

The effectiveness of internal controls and information security over financial management systems was determined through a review performed by an independent certified public account firm under contract with the OIG.

This audit was performed in accordance with generally accepted government auditing standards during the period January through October 2000.

FINDINGS

AUDITED FINANCIAL STATEMENTS

The NLRB is not required to prepare audited financial statements under either GMRA or the CFO Act. However, choosing to prepare audited financial statements is a sound business practice voluntarily adopted by several similarly sized agencies. NLRB's credibility would be enhanced if it could demonstrate, through audited financial statements, that the Agency's financial management is sound and in conformance with applicable government standards.

An audit of financial operations results in an opinion on the financial statements, a report on compliance with laws and regulations, and a report on internal control. A management letter may also be prepared which discusses findings and recommendations for improvements in internal controls that were identified during the audit, but were not material enough to be in the report on internal control. Generally, preparing audited financial statements leads to the development of better financial information which, when provided to management and decision makers, will provide the basis for producing better decisions. Reliable financial information is essential for analyzing the Government's financial condition and providing additional information beyond that provided in the budget.

With a reasonable amount of effort, the Agency could prepare the required financial statements for an audit. The necessary data is mostly available in existing documents and financial systems. The Finance Branch staff would need training to prepare the financial statements, but this training could easily be provided in conjunction with the training needed for the staff to maintain current knowledge of FASAB standards. A cost would be incurred for the audits that could be done on an annual or bi-annual basis.

As set forth in OMB Bulletin 97-01, a financial statement includes:

(1) Overview of the Reporting Entity (also called Management's Discussion and Analysis); and

(2) Principal Statements and Related Notes, including the:

(a) Balance Sheet;
(b) Statement of Net Cost;
(c) Statement of Changes in Net Position;
(d) Statement of Budgetary Resources;
(e) Statement of Financing;
(f) Statement of Custodial Activity, if applicable; and
(g) Notes to Principal Statements.

The overview of the reporting entity addresses the mission and organization structure, performance goals and results, and limitations of the financial statements. This section would require some original writing, but much of the information is already available in the reports prepared to meet requirements of the Government Performance and Results Act.

NLRB is required to record transactions in accordance with the FASAB. This data would be the basis for preparing the first five principal statements and related notes. As discussed in the next section, additional data would need to be recorded in order to be in full compliance with FASAB. NLRB would not need to prepare a statement of custodial activity which is required for entities that collect non-exchange revenue for the General Fund of the Treasury, a trust fund (such as Social Security), or other recipient entities. Custodial collections are usually items such as taxes or duties collected by the Internal Revenue Service or the U.S. Customs Service.

We specifically reviewed how backpay funds would be treated in the financial statements. The preferred method for backpay is for the respondent to write a check to the discriminatee and provide it to the Regional Office to deliver to the discriminatee. These transactions would not need to be recorded into the general ledger or reported in the financial statements according to an official from the GAO who consulted with the FASAB. When the Agency is provided backpay funds from the respondent and is responsible for making disbursements though the Department of Treasury, the Agency currently records these amounts in the general ledger in a manner that would allow them to be appropriately identified in the financial statements.

Other agencies that voluntarily prepare audited financial statements include the United States International Trade Commission, Federal Trade Commission, Federal Communications Commission, and Farm Credit Administration. Three of these agencies were able to report to Congress that auditors had issued unqualified opinions on the FY 1999 financial statements.

Recommendation

We recommend that the Finance Branch Chief:

1. Coordinate with the General Counsel and Board to obtain a decision on whether the Agency will prepare annual financial statements and have periodic audits.

Management's Comments

Management agreed with the finding and took action to implement the recommendation. After due consideration, the Chairman and General Counsel decided that audited financial statements need not be prepared at this time.

PRINCIPAL STATEMENTS

The Agency currently records most financial transactions that are needed to prepare the principal statements, and the data recorded is reasonably accurate. We identified five areas where transactions would have to be recorded or corrected in the SGL for the Agency records to be in accordance with OMB Bulletin 97-01 and GAAP. These involved liability for future workers' compensation, imputed financing costs, a capitalized lease, amortization of computer software, and depreciation.

Workers' Compensation

Liabilities for future workers' compensation claims were not recorded. A liability for Federal accounting purposes, as defined by SFFAS No.5, is a probable future outflow or other sacrifice of resources as a result of past transactions or events. SFFAS No. 5 further states that general purpose Federal financial reports should recognize probable and measurable future outflows arising from past exchange transactions, government-related events, government-acknowledged events, or non-exchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.

The Finance Branch would need to calculate the amount of liability for workers' compensation. For comparison, the Federal Trade Commission, an agency with under 1,000 employees, recorded approximately $2 million in future workers' compensation in FY 1999 and FY 1998.

Imputed Financing Costs

The Agency did not record imputed financing costs related to retirement and post-employment benefits of more than $11 million.

SSFAS No. 5 states that the actuarial determined liability and expense of the plan, including all its provisions, is part of the pension plan's liability and expense estimate. SSFAS No.5 further states that the Federal employer entity should recognize a pension expense in its financial report that equals the service cost for its employees for the accounting period, less the amount contributed by the employees, if any.

The Finance Branch calculated the imputed financing costs and provided the amount to the Office of Personnel Management (OPM). The Finance Branch would need to establish the appropriate accounts in order to record the costs in the Agency's financial management system. The Agency calculated the "imputed" cost as $11 million, which is the difference between the true cost of providing future benefits to employees and the employer and employee contributions remitted to OPM.

Capitalized Lease

The Agency did not identify and record as a capital lease a photocopy machine that met applicable criteria. A portion of the lease amount (approximately $24,000 of the $36,600 total cost) should have been recorded as capitalized equipment as well as the related liability and depreciation.

The Agency policy is to capitalize equipment costing more than $10,000 and depreciate photocopy equipment over a period of five years. Capital leases, as defined by SFFAS No.6, transfer substantially all the benefits and risks of ownership to the lessee. Leases are capitalized, if at inception, the lease:

- Transfers ownership of the property to the lessee by the end of the lease term;
- Contains an option to purchase the leased property at a bargain price;
- The term is equal to or greater than 75 percent of the estimated economic life of the leased property; **or**
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals 90 percent of the fair value of the leased property.

In June 1999 the Agency entered into a lease agreement for a photocopy machine. The lease plan was for 60 months at $610 per month, for a total of $36,600, of which $27,600 related to leasing costs and $9,000 related to maintenance. Since the lease term equals the depreciation period used by the Agency for photocopy equipment, we concluded that the term of the lease is greater than 75 percent of the estimated economic life of the leased property and the machine should be capitalized.

Amortization of Computer Software

The Agency did not record nearly $78,000 in amortization of capitalized automated data processing software. Approximately $4,500 was applicable to FY 1999 and $73,500 was for prior years.

SFFAS No. 6 refers to the SGL for identification of capitalized software. The SGL definition of Information Technology Software includes the capitalized cost of purchased off-the-shelf software and provides for related amortization.

The Agency depreciates computer equipment over a period of 3 years. We applied the same basis for software. The Agency capitalized nearly $78,000 of computer software purchased in FY 1997 or before. This software should have been mostly amortized in prior fiscal years, and was fully amortized as of September 30, 1999. The portion applicable to FY 1999 of $4,529.63 was the final amortization expense for $13,588.88 of software purchased in FY 1997.

Depreciation

The Agency incorrectly recorded depreciation expense in FY 1998, which resulted in a $6,343 overstatement of accumulated depreciation in FY 1999.

SFFAS No. 6 states that depreciation expense shall be recognized. Depreciation is the systematic allocation of the cost of property over its useful life. Property is recognized when title passes or it is delivered to the entity.

The NLRB depreciates computer equipment over a period of 3 years. Computer equipment costing $19,030 was received in October 1998 and paid for in November 1998. Depreciation expense of $6,343 was incorrectly recorded in FY 1998, which then resulted in an overstatement of the accumulated depreciation in FY 1999. The accumulated depreciation on this equipment was recorded as $12,687 as of September 30, 1999, but should have been $6,343.

Recommendations

We recommend that the Finance Branch Chief:

2. Establish accounts to record workers' compensation and imputed financing costs in future years;

3. Record a capitalized lease and related liability and depreciation for the photocopy machine;

4. Record accumulated amortization on the computer software purchased in FYs 1995, 1996, and 1997; and

5. Adjust accumulated depreciation on computer equipment acquired in FY 1999 rather than FY 1998.

Management's Comments

Management agreed with the findings and took action to implement most recommendations. The accounts were established to record workers' compensation and imputed financing costs and the Finance Branch Chief is determining the amounts to be recorded. The capitalized lease and corresponding liability have been posted; the depreciation will be recorded by December 31, 2000. The appropriate entries were made to record the accumulated amortization on computer software and accumulated depreciation on computer equipment.

COMPLIANCE WITH LAWS AND REGULATIONS

Management of the NLRB is responsible for complying with laws and regulations applicable to the Agency. Exclusive of FFMIA, we found no instances of noncompliance with laws and regulations that would have to be reported in an audit of the financial statements. We found the Agency's financial management systems substantially complied with the SGL at the transaction level. The financial management systems did not substantially comply with the Federal financial management systems requirements or Federal accounting standards.

In an audit of the Agency's financial statements, a report on compliance with laws and regulations would be prepared to conclude whether or not the Agency was in compliance with laws and regulations that would materially impact the financial statements. For FFMIA, the auditor must report on whether the Agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the SGL at the transaction level.

The financial management systems did not substantially comply with the Federal financial management systems requirements. The OIG *Review of Information Systems Security* reported the Agency was not in full compliance with government-wide policy requirements.

The financial management systems did not substantially comply with Federal accounting standards. As discussed previously in this report, the Agency did not record workers' compensation and imputed financing costs. Federal accounting standards require that these items be recorded in the SGL regardless of whether financial statements are prepared.

INTERNAL CONTROL

We considered one matter, information security, involving the internal control and its operation to be a material weakness. With respect to internal controls related to performance measures, we obtained an understanding of the design of significant internal controls but do not provide an opinion on such controls.

A report on internal control identifies reportable conditions and material weaknesses. Reportable conditions are matters relating to sufficient deficiencies in the design or operation of the internal controls that could adversely affect the Agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and

not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified material weaknesses in the Agency's financial management systems. The OIG *Review of Information Systems Security* reported access controls over financial systems need improvement and raised significant concerns about the reliability, accuracy, integrity, and completeness of the information maintained in the financial systems. The report further stated the Finance Branch had not developed adequate segregation of duty controls to prevent one person from performing incompatible functions, and service continuity controls did not provide sufficient protection against the impact of a local or national disaster or significant business disruptions.

MANAGEMENT LETTER

We identified several conditions that would be reported to management in a letter rather than in the report on internal control. These involved T&A and capitalized and sensitive property.

Time and Attendance

The Agency did not maintain adequate control over T&A in accordance with GAO Office Policy and Procedures Manual for Guidance of Federal Agencies, Title 6 - Pay, Leave, and Allowances, dated March 22, 1996, and Agency policy.

We found the following results in our inspections of four Regional Offices.

- Sick leave in all four offices was not advanced in accordance with Agency policy.
- Bi-weekly T&A reports were either not regularly approved or a significant number were not approved in three offices.
- Accurate work schedules evidencing supervisory approval did not exist in three offices.
- Credit hours earned by employees were not recorded into the Agency's official records in two offices.
- A significant number of leave slips were not maintained in two offices.
- One office had an inappropriate person performing T&A activities.

We performed comparable procedures at the Division of Judges in Washington. Of the 50 sick leave transactions reviewed we found: 10 were not supported by a leave slip; 14 leave slips were not approved by the supervisor; and 1 was not signed by the employee. Of the 50 annual leave transactions reviewed we found: 3 were not supported by a leave slip; 23 were not approved by a supervisor; and 1 was not signed by the employee. We reviewed the bi-weekly T&A reports related to the sick leave and annual leave transactions tested, 100

transactions in total. We found that: 93 were not initialed by the timekeeper; 2 were not initialed by the employee; and 42 were not signed by the supervisor.

These results were comparable to the findings reported in the OIG *Evaluation of Time and Attendance Practices*. We made multiple recommendations in that audit report for Agency-wide improvements. Management agreed to implement all but one of the recommendations. On June 19, 2000, the Director of Personnel issued a memorandum to all Agency employees that addressed many of the recommendations. When the remaining recommendations are implemented, T&A deficiencies in the Regions and the Division of Judges should be addressed.

Capitalized and Sensitive Property

Results obtained in three of the four Regional Offices we inspected showed that: official property records did not accurately reflect computer equipment at Regional Offices or the locations within the offices; records maintained by Regional Office staff did not accurately identify computer equipment in their office; and that computer property records maintained by Regional Offices were not in agreement with the official property records maintained at Headquarters by the Information Technology Branch. We also found that controls over computer equipment sent from Regional Offices to Headquarters for repair were not sufficient.

We selected a judgmental sample of 15 pieces of capitalized property from Agency records to verify the equipment's existence and the accuracy of the records. We found problems with six items, 40 per cent of the items reviewed. Serial numbers provided by Regional Offices did not match property records for three items. Two of these three did not have a bar code number. We also had one occurrence of three other errors: the property description in official Agency records was inconsistent with information provided by the Regional Office, property that was excessed was not annotated as such on Agency property records, and the bar code number provided by the Regional Office did not match official Agency property records.

OIG plans to schedule an audit of controls over automated data processing equipment in FY 2001.

EXHIBIT

Reports Relied Upon in the Audit of NLRB's FY 1999 Accounting and Reporting Systems

Title	Report Number	Date Issued
Accounting and Reporting Systems in the Brooklyn Regional Office	OIG-INS-06-00-03	July 6, 2000
Accounting and Reporting Systems in the Cleveland Regional Office	OIG-INS-07-00-04	July 6, 2000
Accounting and Reporting Systems in the Seattle Regional Office	OIG-INS-08-00-05	July 6, 2000
Accounting and Reporting Systems in the Chicago Regional Office	OIG-INS-09-00-06	July 6, 2000
Evaluation of Time and Attendance Practices	OIG-AMR-29-00-01	February 23, 2000
Review of Information Systems Security	OIG-AMR-30-00-03	September 29, 2000

APPENDIX

UNITED STATES GOVERNMENT
National Labor Relations Board

Memorandum

November 30, 2000

TO: Jane Altenhofen
Inspector General

FROM: Gloria Joseph
Director of Administration

SUBJECT: Draft Report (OIG-F-8-00-xx)

This is in response to your memorandum, dated October 24, 2000, regarding the Draft Report "Audit of NLRB's Fiscal Year 1999 Accounting and Reporting Systems".

Attached are five action plans that outline the specific actions, which have been taken with regard to each of the five recommendations. Actions in response to four of the five recommendations have been completed. Recommendation 3 of 5 has a target completion date of December 31, 2000.

We have no comment on any other aspect of the report. Please contact me on 273-3890 if you have any questions.

Attachment

Cc: Chairman
General Counsel
Finance Branch Chief

FAX

Date	*5/15/02*
Number of pages including cover sheet	*8*

Ms. Rosa Harris
Subcommittee on Government Efficiency
Washington, DC

Phone *225-5147*
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FROM: *Tina VanBrakle*
Federal Election Commission
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Washington, DC 20463

Phone *202-694-1006*
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CC:

REMARKS: ☐ *Urgent* ☒ *For your review* ☐ *Reply ASAP* ☐ *Please Comment*

Rosa, thank you for the opportunity to present testimony at yesterday's hearing on the "Accountability of Tax Dollars Act of 2002."

As I mentioned to you, the statement Chairman Horn made referencing the FEC not following appropriations direction was based on inaccurate information. I am attaching a letter our former Chairman sent to Chairman Horn back in March of 1998 clarifying the record on this very issue. Chairman Horn made a similar reference at a March 5, 1998 oversight hearing on the FEC. Unfortunately, the record was not corrected. This letter provides a detailed chronology of events with respect to the Commission's FY 1995 appropriations and its computerization budget.

Please know that the FEC, without question, has never violated appropriations law or ignored Congressional intent. In fact, the Clerk of the Treasury Subcommittee, who was the clerk in 1995, could verify this information should Chairman Horn wish. As Alison said yesterday, the FEC continues to work closely with our appropriations and oversight staff.

Additionally, in January 1999, PriceWaterhouseCoopers issued a management review and audit report of the FEC and found that the FEC has adhered to Congressional instructions for earmarking appropriations for computerization modernization and electronic filing (section 3.3.8.2, pp. 3-27 and 3-28). I have attached those pages from the PwC report for your reference.

I would appreciate it if you would include the March 1998 letter as part of the official hearing record. Please let me know if you have any questions. Thanks for your help.

Attachment

FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

OFFICE OF THE CHAIRMAN

March 13, 1998

The Honorable Stephen Horn
Chairman
Subcommittee on Government Management,
Information and Technology
House Committee on Government Reform and Oversight
B-373 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

At the March 5, 1998, oversight hearing on the Federal Election Commission (FEC), you asked the Commission to supply the committee with certain information regarding our Fiscal Year 1995 appropriation. That information follows.

During the hearing, you relayed an assertion that the FEC had violated appropriations law. Without question, the FEC never has violated appropriations law, particularly with regard to any fences or earmarks, or, for that matter, category B apportionments imposed by the Office of Management and Budget (OMB). In addition, the Commission never has ignored formal Congressional intent as expressed in committee report language.

The specific question raised was whether the FEC had violated provisions of the Fiscal Year 1995 Treasury, Postal Service, and General Government Appropriations Act, Public Law 103-329. For your information, the following chronology of events, leading up to and immediately following enactment of the Fiscal Year 1995 appropriations bill, is instructive.

The FEC is a concurrent submission agency. As mandated by the FECA we submit simultaneous budget requests to the President and Congress. We make every effort to agree with the Administration's proposed budget whenever we believe we can meet our responsibilities within the requested constraints. At the same time, however, the agency reserves the right to present its own request to Congress. The FEC was compelled to submit its own request for Fiscal Year 1995.

The Commission requested $31,793,000. This amount was $8,229,000 more than it had been appropriated in Fiscal Year 1994. This increase included $4,000,000 for computerization upgrades, including electronic filing. The Office of Management and Budget presented the Commission with a passback figure of $27,216,000, which included a proposed earmark of $4,000,000 for the computer upgrade. The Commission appealed the OMB passback, arguing that $27,216,000, with four million fenced, would not even meet basic agency needs. In fact, OMB's passback was less than the amount required to maintain current FEC operations at that time.

After numerous conversations with OMB, the Administration verbally agreed to remove the earmarking language because it could not give us the requested funding level. The Administration's final Fiscal Year 1995 budget for the FEC ultimately presented to Congress was for $27,216,000, and did not include "fencing" or earmarking language of any kind.

On May 18, 1994, during the Fiscal Year 1995 appropriations process, the House Subcommittee on Treasury, Postal Service and General Government marked up the FEC at $27,106,000. To help set the record straight, with respect to electronic filing, the Committee report stated:

> The Committee directs that any administratively imposed "fence" between personnel and equipment requirements be eliminated in FY 1995. The Committee's intent is that FEC meet its full complement of staffing as Congress intended in the passage of the FY 94 appropriations.

On June 15, 1994, during House floor debate on the Treasury bill, an amendment was offered and passed to reduce the FEC's funding by $3.5 million, which took FEC's funding level down to $23,564,000, the Fiscal Year 1994 level.

On June 22, 1994, the Senate passed the Treasury bill with the Commission funded at $27,106,000 and no funds fenced or earmarked.

On July 8, 1994, OMB sent a letter to then-Chairman Obey, House Appropriations Committee, stating: "The Administration urges the conferees to adopt the Senate position on funding for the Federal Election Commission (FEC) which is consistent with the Administration's requested level of funding." Again, please note the Senate did not include fencing language, nor did the Administration mention a fence in its July 8, 1994, Statement of Administration Policy to Congress.

On September 20, 1994, during the conference on the Treasury bill, the House receded to the Senate figure of $27,106,000. Language in the conference report stated:

> The conferees support the FEC's efforts to modernize its operations through computerization but are unable to earmark funds for the purpose at this time (emphasis added). The conferees have taken this step without prejudice and on the basis that any such earmark might undermine FEC's ability to carry out its statutory responsibilities in the upcoming fiscal year.
>
> Within available funds, the conferees urge the FEC to move as expeditiously as possible with their plans to modernize operations through computerization. The conferees encourage the FEC to develop options that will provide for the electronic filing of reports.

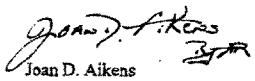
On February 23, 1995, the House Appropriations Subcommittee voted to rescind $2.8 million of the FEC's current (Fiscal Year 1995) funding. The amount of the rescission was split with the Senate during conference and the FEC ultimately had to rescind $1.4 million. The conferees noted that they expected the FEC to fulfill its commitment to spend not less than $972,000 on computerization. The conferees also directed the Commission to complete strategic plans, including both a requirements and cost-benefit analysis, on: (1) internal ADP modernization efforts; and (2) electronic filing. The FEC complied with that direction. Despite the severe impact of the rescission on Commission operations, the FEC did expend over $1,000,000 on computerization and electronic filing development in FY 1995.

For your information, every FEC appropriations bill and/or conference report beginning with Fiscal Year 1996 has included some type of earmarking language regarding computerization. The FEC has abided by all such language. In fact, the agency has made a good faith effort to comply with all committee direction and guidance regarding computerization and electronic filing. We have worked closely with Subcommittee staff to ensure the computerization process has proceeded both smoothly and in compliance with Appropriations Committee intent.

As requested, I also have enclosed six copies of "Campaign Finance Law 96," copies of our current Legislative Recommendations to Congress, excerpts from the testimony pertaining to reporting of PAC contributions from the Commission's February 11, 1998, hearing on Recordkeeping and Reporting, the General Counsel's report regarding Howard Glicken, and a listing of our outside contracts. The Inspector General will send information requested of her under separate cover.

I trust this information is responsive to your concerns. Please be assured the FEC takes the appropriations process very seriously. We will continue to make every effort to comply with appropriations law and committee intent. If you have any questions, do not hesitate to call me. My office number is 694-1045.

Sincerely,



Joan D. Aikens
Chairman

Enclosure

Technology and Performance Audit and Management Review of the Federal Election Commission

Volume I – Final Report

January 29, 1999

Prepared by PricewaterhouseCoopers LLP

1616 North Fort Myer Drive

Arlington, Virginia 22209

This report in its entirety is posted on the Internet at

www.gao.gov/special.pubs/publist.htm

The MIS system is automated and integrated for organizational units under the Office of Staff Director. Performance and financial information from the OGC is manually entered into the automated system, but this process will change when the case management system, now under development, comes on-line. How data are assembled and processed is left up to each office and division. This has led in some instances to inconsistent reporting metrics throughout the organization that makes reconciliation between MIS information and divisional tracking systems difficult.

The MIS provides comprehensive performance data, but it does not appear to be widely used by program mangers. Interviews suggest that some managers did not find the information reported from the MIS useful for their purposes. As a result, several units have designed their own internal tracking systems tailored to specific process flows.

3.3.8.2 Financial and Cost Management

The FEC is a concurrent submission agency. As mandated by the FECA, the Commission submits simultaneous budget requests to the President and to the Congress. OMB reviews the FEC submission for adherence to the Administration's overall proposed budget. Although the FEC budget is initially subject to OMB modification, the Commission has the right to disagree with the OMB review and present its own request to the Congress.

After FEC appropriations have been enacted, OPM prepares an annual management plan to guide the execution of the budget. **The FEC reliably monitors its budget and the allocation of FTE and nonpersonnel resources to each operating unit.** OPM tracks the number of the staff in each month to ensure adherence to statutory FTE ceilings. On a monthly basis, OPM generates and distributes a report with all obligations and expenditures to date. Based on input from managers, OPM periodically proposes changes to the management plan to reallocate funds among programs as needed, consistent with statutory requirements. The Finance Committee approves all proposed reallocations.

The FEC maintains an integrated financial system that appears to adhere to Standard General Ledger reporting requirements and conform to the provisions of the Federal Managers' Financial Management and Integrity Act and OMB Circulars A-123 and A-127.

The FEC appears to have adhered to Congressional appropriations report language instructions and category B "earmarks." During the March 5, 1998, Subcommittee on Government Management, Information, and Technology hearing on the oversight of the FEC, a concern was raised by

the Subcommittee that the FEC had ignored an FY 1995 Appropriations earmark regarding computer modernization. Language in the FY 1995 Appropriations Conference Report stated:

> The conferees support the FEC's efforts to modernize its operations through computerization but are unable to earmark funds for the purpose at this time. The conferees have taken this step without prejudice and on the basis any such earmark might undermine the FEC's ability to carry out its statutory responsibilities in the upcoming fiscal year.
>
> Within available funds, the conferees urge the FEC to move as expeditiously as possible with their plans to modernize operations through computerization. The conferees encourage the FEC to develop options that will provide for the electronic filing of reports.

Four months after the beginning of FY 1995, the Congress agreed to rescind $1.4 million from the then current FEC FY 1995 budget. The conferees noted that they expected the FEC to fulfill its commitment to spend not less than $972,000 on computerization. The conferees also directed the FEC to complete information system strategic plans, including both requirements and cost-benefit analyses on internal ADP modernization efforts and electronic filing. During FY 1995, FEC budget execution reports indicate that it obligated and expended more than $1 million towards ADP modernization and electronic filing.

During the subsequent three fiscal years, the Congress has enacted appropriations earmarks directed toward computerization modernization and electronic filing. Exhibit 3–10 compares the appropriations earmark with FEC Data System Division budgeted and actual expenditures related to electronic filing, ADP modernization, point-of-entry and case management projects for the Fiscal Years 1996–1998.

Exhibit 3–10

Earmarks for ADP Modernization

Category	FY 1996	FY 1997	FY 1998
Appropriations Earmark	$1,500*	$2,500*	$2,500*
DSD Budgeted Obligations	$1,903	$2,666	$2,932
DSD Actual Expenditures	$1,913	$2,803	$2,684
Difference Earmark & Actual	**$413**	**$303**	**$184**

Source: FEC FY 1996–1998 Management Plans, Data Systems Division responses to PwC data request.
*Amounts are shown in $000s.

An additional $1.3 million earmark was included in FY 1998 for enforcement and litigation document management and control operations in the Office of the General Counsel. As of

TOTAL P.09

United States Government
NATIONAL LABOR RELATIONS BOARD
OFFICE OF INSPECTOR GENERAL
Washington, DC 20570-0001

May 16, 2002

The Honorable Steve Horn
Chairman, Subcommittee on Government Efficiency,
Financial Management, and Intergovernmental Relations
Committee on Government Reform
United States House of Representatives
Washington, D.C. 20515-6065

Attn: Ms. Rosa Harris

Dear Mr. Chairman:

The Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations recently held a hearing on HR 4685, the Accountability of Tax Dollars Act of 2002. This legislation extends the financial statement audit requirements to agencies that are not currently subject to statutory financial statement audit requirements. We thought that our efforts in this area at the National Labor Relations Board (NLRB or Agency) would of interest to your subcommittee.

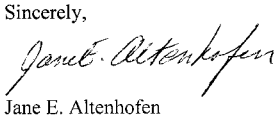
In December 2000, my office completed an audit of the NLRB's fiscal year 1999 accounting and reporting systems. In the audit report, we concluded that, although the NLRB is not required by law to prepare audited financial statements, choosing to prepare audited financial statements is a good business practice voluntarily adopted by several similarly sized agencies. By choosing to do so, the NLRB's credibility would be enhanced because it could demonstrate, through audited financial statements, that the Agency's financial management is sound and in conformance with applicable Government standards. We recommended that management coordinate with the General Counsel and Board to obtain a decision on whether the Agency will prepare annual financial statements and have periodic audits. Management agreed with the finding and took action to implement the recommendation. After due consideration, the Chairman and General Counsel decided that audited financial statements were not needed at that time. A copy of the audit report is provided as an enclosure.

In August 2001, the General Accounting Office initiated a review of selected agencies, including the NLRB, to determine whether financial statement audit requirements should be expanded to certain agencies that are not required by statute to have annual financial statement audits. Overall, the 26 surveyed agencies reported that they either achieved significant benefits or would anticipate achieving such benefits from having audited financial statements. Twenty-one of those agencies reported that, in general, Federal agencies should have their financial

statements audited. The NLRB was one of only five agencies that stated that its financial statements should not be audited.

I hope you find this information useful. If you have any questions or require additional information, please contact my Counsel, Dave Berry, or me at 202 273-1960.

Sincerely,



Jane E. Altenhofen
Inspector General

Enclosure

cc: Board
General Counsel

UNITED STATES GOVERNMENT
National Labor Relations Board
Office of Inspector General

Audit of NLRB's Fiscal Year 1999 Accounting and Reporting Systems

Report No. OIG-F-8-01-01

December 2000

INSPECTOR GENERAL

NATIONAL LABOR RELATIONS BOARD

WASHINGTON, DC 20570

December 12, 2000

I hereby submit an *Audit of NLRB's Fiscal Year 1999 Accounting and Reporting Systems*, Report No. OIG-F-8-01-01. This review was conducted to evaluate the Agency's capability to prepare audited financial statements.

The National Labor Relations Board (NLRB or Agency) is not required by law to prepare audited financial statements. However, choosing to prepare audited financial statements is a good business practice voluntarily adopted by several similarly sized agencies. NLRB's credibility would be enhanced if it could demonstrate, through audited financial statements, that the Agency's financial management is sound and in conformance with applicable government standards.

The Agency currently records most financial transactions that are needed to prepare the principal statements, and the data recorded is reasonably accurate. We identified five areas where transactions would have to be recorded or corrected. These were workers' compensation, imputed financing costs, a capitalized lease, amortization of computer software, and depreciation.

NLRB management is responsible for complying with laws and regulations applicable to the Agency. We found no instances of noncompliance with laws and regulations that would have to be reported in an audit of the financial statements. We found that the Agency's financial management systems substantially complied with the U.S. Government Standard General Ledger at the transaction level. The financial management systems did not substantially comply with the Federal financial management systems requirements or Federal accounting standards.

We considered one matter, information security, involving the internal control and its operation to be a material weakness. With respect to internal controls

related to performance measures, we obtained an understanding of the design of significant internal controls but do not provide an opinion on such controls.

We identified two conditions that would be reported to management in a letter rather than in the report on internal control. One was on time and attendance issues, the other involved capitalized and sensitive property.

Recommendations addressing these findings are numbered consecutively throughout the report and can be found on pages 5 and 8 of this report. Management agreed with the findings and completed actions on all recommended actions but one, and that will be done by the end of the year.

We recommended that the Finance Branch Chief coordinate with the General Counsel and Board to obtain a decision on whether the Agency will prepare annual financial statements and have periodic audits. After due consideration, the Chairman and General Counsel decided that audited financial statements need not be prepared at this time, but that the matter would be revisited at a later date at the Inspector General's request or if circumstances change.

Although we continue to believe auditing the financial statements is a sound business policy, we understand this decision in light of the fact that the Agency may have a new Chairman and General Counsel within a year. We will reassess our recommendation when we evaluate the potential impact of the Reports Consolidation Act, enacted on November 22, 2000, on Agency operations. This Act allows agencies to consolidate and adjust the frequency and timing of financial and performance management reports.

An exit conference was held on October 23, 2000, with the Deputy Director of Administration, Finance Branch Chief, and other officials from the Division of Administration. The Director of Administration submitted written comments on the draft report. She agreed with the findings and recommendations made in the report. The Director of Administration's comments are presented in their entirety as an appendix to this report.

Jane E. Altenhofen
Inspector General

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EXHIBIT — Reports Relied Upon in the Audit of NLRB's FY 1999 Accounting and Reporting Systems

APPENDIX — Memorandum from the Director of Administration, Draft Report (OIG-F-8-01-01), dated November 30, 2000

BACKGROUND

Increasing demands for Government accountability led to passage of the Chief Financial Officers (CFO) Act of 1990. The CFO Act established a position in designated agencies for an official who reports directly to the head of the agency to oversee all financial management activities. To help improve the integrity of financial information, in 1990, the Office of Management and Budget (OMB), the Department of Treasury, and the General Accounting Office (GAO) established the Federal Accounting Standards Advisory Board (FASAB) to develop accounting standards for the U.S. Government.

Several laws enacted in 1996 further strengthened accountability. The Government Management and Reform Act (GMRA) of 1996 amended the CFO Act to require, among other things, the annual preparation and audit of organization-wide financial statements of 24 executive departments and agencies. The Federal Financial Management Improvement Act (FFMIA) of 1996 requires that the report on these audits state whether agency financial management systems comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (SGL) at the transaction level.

OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, defines the form and content of financial statements of executive departments and agencies that are required to prepare audited financial statements by 31 U.S.C. 3515(d). OMB Bulletin 97-01 incorporates the FASAB concepts and standards that are the basis for generally accepted accounting principles (GAAP) for the Federal Government. GAAP includes the Statements of Federal Financial Accounting Concepts and Statements of Federal Financial Accounting Standards (SFFASs) recommended by the FASAB and approved by the Secretary of the Treasury, Director of OMB, and the Comptroller General.

The National Labor Relations Board (NLRB or Agency) administers the principal labor-relations law of the United States, the National Labor Relations Act of 1935, as amended. Approximately 30,000 charges of unfair labor practices and 6,000 representation petitions are filed with the NLRB each year. For Fiscal Year (FY) 2000, the Agency was provided an appropriation of close to $206 million and authorized 1,947 full time equivalents to staff operations at Headquarters and 51 Regional, Subregional, and Resident Offices and 3 Division of Judges satellite offices.

Executive agencies, including the NLRB, are mandated by law to follow the accounting principles, standards, and requirements prescribed by the Comptroller General, and currently issued by FASAB. NLRB is not subject to the CFO Act; however, the Director of Administration serves as the Chief Financial Officer.

OBJECTIVES, SCOPE, AND METHODOLOGY

This review was conducted to evaluate the Agency's capability to prepare audited financial statements. To accomplish this we determined whether: current systems were capable of collecting and compiling information necessary to produce reliable financial reports; transactions were in compliance with applicable laws, regulations, and accounting principles; there was accountability over property; and internal controls were effective.

We interviewed Agency officials responsible for financial management, including program managers and Regional Office staff. On a test basis, we examined evidence supporting the amounts recorded in the financial reports during FY 1999. We tested internal controls and compliance with laws and regulations including: Anti-deficiency Act; Budget and Accounting Procedures Act; Federal Managers' Financial Integrity Act of 1982; Fair Labor Standards Act of 1938; Civil Service Retirement Act of 1930; Civil Service Reform Act of 1978; Federal Employees' Compensation Act; Federal Employees' Health Benefits Act of 1959; Prompt Payment Act; and Federal Travel Regulations.

We relied on several audit and inspection reports issued by the Office of Inspector General (OIG) as identified in the exhibit. We used these reports to form conclusions related to safeguarding of capitalized and sensitive property, predominately computers and related equipment, and internal controls and compliance with laws and regulations. During this audit we tested time and attendance (T&A) at the Division of Judges in Washington.

We tested items from the Payroll/Personnel System to determine whether employees were getting paid at the appropriate rate, that amounts charged for retirement, health insurance, and life insurance were correct, and entries into the system were authorized and appropriately documented. We reviewed official personnel files to determine whether they included forms: SF-61, Oath of Office; I-9, Employment Eligibility Verification; and SF-61B, Declaration of Appointee. We also reviewed administrative processing of the Federal Employee Compensation Act program.

We selected a sample of 15 pieces of capitalized property from the Agency's official property records and telephoned Regional Offices to confirm the property's existence, description, serial number, and bar code number.

We selected two statistical samples to test disbursement transactions: one for travel expenses and another that included transactions other than rent, travel, and compensation and benefits. Our testing determined whether disbursements were made in accordance with applicable laws and regulations, processed in accordance with Agency processes and procedures, supported by adequate documentation, and correctly classified. We analyzed space rental

charges to identify unusual activity and determined if amounts were accurately recorded in the Agency's financial records.

We reviewed account balances as of September 30, 1999. Cash balances on the SGL were traced to Department of Treasury reports. We reviewed accounts receivable and liability accounts for reasonableness, tested items by tracing them to supporting documentation, reviewed the process for recording accounts receivable, and searched for unrecorded liabilities at year end. We reviewed unliquidated obligations to determine if they were valid obligations and recorded in the correct period. We reviewed the compensation and benefits accrual and unfunded annual leave balance for reasonableness. We reviewed the accuracy of capitalized property records and verified depreciation calculations.

The effectiveness of internal controls and information security over financial management systems was determined through a review performed by an independent certified public account firm under contract with the OIG.

This audit was performed in accordance with generally accepted government auditing standards during the period January through October 2000.

FINDINGS

AUDITED FINANCIAL STATEMENTS

The NLRB is not required to prepare audited financial statements under either GMRA or the CFO Act. However, choosing to prepare audited financial statements is a sound business practice voluntarily adopted by several similarly sized agencies. NLRB's credibility would be enhanced if it could demonstrate, through audited financial statements, that the Agency's financial management is sound and in conformance with applicable government standards.

An audit of financial operations results in an opinion on the financial statements, a report on compliance with laws and regulations, and a report on internal control. A management letter may also be prepared which discusses findings and recommendations for improvements in internal controls that were identified during the audit, but were not material enough to be in the report on internal control. Generally, preparing audited financial statements leads to the development of better financial information which, when provided to management and decision makers, will provide the basis for producing better decisions. Reliable financial information is essential for analyzing the Government's financial condition and providing additional information beyond that provided in the budget.

With a reasonable amount of effort, the Agency could prepare the required financial statements for an audit. The necessary data is mostly available in existing documents and financial systems. The Finance Branch staff would need training to prepare the financial statements, but this training could easily be provided in conjunction with the training needed for the staff to maintain current knowledge of FASAB standards. A cost would be incurred for the audits that could be done on an annual or bi-annual basis.

As set forth in OMB Bulletin 97-01, a financial statement includes:

(1) Overview of the Reporting Entity (also called Management's Discussion and Analysis); and

(2) Principal Statements and Related Notes, including the:

(a) Balance Sheet;
(b) Statement of Net Cost;
(c) Statement of Changes in Net Position;
(d) Statement of Budgetary Resources;
(e) Statement of Financing;
(f) Statement of Custodial Activity, if applicable; and
(g) Notes to Principal Statements.

The overview of the reporting entity addresses the mission and organization structure, performance goals and results, and limitations of the financial statements. This section would require some original writing, but much of the information is already available in the reports prepared to meet requirements of the Government Performance and Results Act.

NLRB is required to record transactions in accordance with the FASAB. This data would be the basis for preparing the first five principal statements and related notes. As discussed in the next section, additional data would need to be recorded in order to be in full compliance with FASAB. NLRB would not need to prepare a statement of custodial activity which is required for entities that collect non-exchange revenue for the General Fund of the Treasury, a trust fund (such as Social Security), or other recipient entities. Custodial collections are usually items such as taxes or duties collected by the Internal Revenue Service or the U.S. Customs Service.

We specifically reviewed how backpay funds would be treated in the financial statements. The preferred method for backpay is for the respondent to write a check to the discriminatee and provide it to the Regional Office to deliver to the discriminatee. These transactions would not need to be recorded into the general ledger or reported in the financial statements according to an official from the GAO who consulted with the FASAB. When the Agency is provided backpay funds from the respondent and is responsible for making disbursements though the Department of Treasury, the Agency currently records these amounts in the general ledger in a manner that would allow them to be appropriately identified in the financial statements.

Other agencies that voluntarily prepare audited financial statements include the United States International Trade Commission, Federal Trade Commission, Federal Communications Commission, and Farm Credit Administration. Three of these agencies were able to report to Congress that auditors had issued unqualified opinions on the FY 1999 financial statements.

Recommendation

We recommend that the Finance Branch Chief:

1. Coordinate with the General Counsel and Board to obtain a decision on whether the Agency will prepare annual financial statements and have periodic audits.

Management's Comments

Management agreed with the finding and took action to implement the recommendation. After due consideration, the Chairman and General Counsel decided that audited financial statements need not be prepared at this time.

PRINCIPAL STATEMENTS

The Agency currently records most financial transactions that are needed to prepare the principal statements, and the data recorded is reasonably accurate. We identified five areas where transactions would have to be recorded or corrected in the SGL for the Agency records to be in accordance with OMB Bulletin 97-01 and GAAP. These involved liability for future workers' compensation, imputed financing costs, a capitalized lease, amortization of computer software, and depreciation.

Workers' Compensation

Liabilities for future workers' compensation claims were not recorded. A liability for Federal accounting purposes, as defined by SFFAS No.5, is a probable future outflow or other sacrifice of resources as a result of past transactions or events. SFFAS No. 5 further states that general purpose Federal financial reports should recognize probable and measurable future outflows arising from past exchange transactions, government-related events, government-acknowledged events, or non-exchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.

The Finance Branch would need to calculate the amount of liability for workers' compensation. For comparison, the Federal Trade Commission, an agency with under 1,000 employees, recorded approximately $2 million in future workers' compensation in FY 1999 and FY 1998.

Imputed Financing Costs

The Agency did not record imputed financing costs related to retirement and post-employment benefits of more than $11 million.

SSFAS No. 5 states that the actuarial determined liability and expense of the plan, including all its provisions, is part of the pension plan's liability and expense estimate. SSFAS No.5 further states that the Federal employer entity should recognize a pension expense in its financial report that equals the service cost for its employees for the accounting period, less the amount contributed by the employees, if any.

The Finance Branch calculated the imputed financing costs and provided the amount to the Office of Personnel Management (OPM). The Finance Branch would need to establish the appropriate accounts in order to record the costs in the Agency's financial management system. The Agency calculated the "imputed" cost as $11 million, which is the difference between the true cost of providing future benefits to employees and the employer and employee contributions remitted to OPM.

Capitalized Lease

The Agency did not identify and record as a capital lease a photocopy machine that met applicable criteria. A portion of the lease amount (approximately $24,000 of the $36,600 total cost) should have been recorded as capitalized equipment as well as the related liability and depreciation.

The Agency policy is to capitalize equipment costing more than $10,000 and depreciate photocopy equipment over a period of five years. Capital leases, as defined by SFFAS No.6, transfer substantially all the benefits and risks of ownership to the lessee. Leases are capitalized, if at inception, the lease:

- Transfers ownership of the property to the lessee by the end of the lease term;
- Contains an option to purchase the leased property at a bargain price;
- The term is equal to or greater than 75 percent of the estimated economic life of the leased property; **or**
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals 90 percent of the fair value of the leased property.

In June 1999 the Agency entered into a lease agreement for a photocopy machine. The lease plan was for 60 months at $610 per month, for a total of $36,600, of which $27,600 related to leasing costs and $9,000 related to maintenance. Since the lease term equals the depreciation period used by the Agency for photocopy equipment, we concluded that the term of the lease is greater than 75 percent of the estimated economic life of the leased property and the machine should be capitalized.

Amortization of Computer Software

The Agency did not record nearly $78,000 in amortization of capitalized automated data processing software. Approximately $4,500 was applicable to FY 1999 and $73,500 was for prior years.

SFFAS No. 6 refers to the SGL for identification of capitalized software. The SGL definition of Information Technology Software includes the capitalized cost of purchased off-the-shelf software and provides for related amortization.

The Agency depreciates computer equipment over a period of 3 years. We applied the same basis for software. The Agency capitalized nearly $78,000 of computer software purchased in FY 1997 or before. This software should have been mostly amortized in prior fiscal years, and was fully amortized as of September 30, 1999. The portion applicable to FY 1999 of $4,529.63 was the final amortization expense for $13,588.88 of software purchased in FY 1997.

Depreciation

The Agency incorrectly recorded depreciation expense in FY 1998, which resulted in a $6,343 overstatement of accumulated depreciation in FY 1999.

SFFAS No. 6 states that depreciation expense shall be recognized. Depreciation is the systematic allocation of the cost of property over its useful life. Property is recognized when title passes or it is delivered to the entity.

The NLRB depreciates computer equipment over a period of 3 years. Computer equipment costing $19,030 was received in October 1998 and paid for in November 1998. Depreciation expense of $6,343 was incorrectly recorded in FY 1998, which then resulted in an overstatement of the accumulated depreciation in FY 1999. The accumulated depreciation on this equipment was recorded as $12,687 as of September 30, 1999, but should have been $6,343.

Recommendations

We recommend that the Finance Branch Chief:

2. Establish accounts to record workers' compensation and imputed financing costs in future years;

3. Record a capitalized lease and related liability and depreciation for the photocopy machine;

4. Record accumulated amortization on the computer software purchased in FYs 1995, 1996, and 1997; and

5. Adjust accumulated depreciation on computer equipment acquired in FY 1999 rather than FY 1998.

Management's Comments

Management agreed with the findings and took action to implement most recommendations. The accounts were established to record workers' compensation and imputed financing costs and the Finance Branch Chief is determining the amounts to be recorded. The capitalized lease and corresponding liability have been posted; the depreciation will be recorded by December 31, 2000. The appropriate entries were made to record the accumulated amortization on computer software and accumulated depreciation on computer equipment.

COMPLIANCE WITH LAWS AND REGULATIONS

Management of the NLRB is responsible for complying with laws and regulations applicable to the Agency. Exclusive of FFMIA, we found no instances of noncompliance with laws and regulations that would have to be reported in an audit of the financial statements. We found the Agency's financial management systems substantially complied with the SGL at the transaction level. The financial management systems did not substantially comply with the Federal financial management systems requirements or Federal accounting standards.

In an audit of the Agency's financial statements, a report on compliance with laws and regulations would be prepared to conclude whether or not the Agency was in compliance with laws and regulations that would materially impact the financial statements. For FFMIA, the auditor must report on whether the Agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the SGL at the transaction level.

The financial management systems did not substantially comply with the Federal financial management systems requirements. The OIG *Review of Information Systems Security* reported the Agency was not in full compliance with government-wide policy requirements.

The financial management systems did not substantially comply with Federal accounting standards. As discussed previously in this report, the Agency did not record workers' compensation and imputed financing costs. Federal accounting standards require that these items be recorded in the SGL regardless of whether financial statements are prepared.

INTERNAL CONTROL

We considered one matter, information security, involving the internal control and its operation to be a material weakness. With respect to internal controls related to performance measures, we obtained an understanding of the design of significant internal controls but do not provide an opinion on such controls.

A report on internal control identifies reportable conditions and material weaknesses. Reportable conditions are matters relating to sufficient deficiencies in the design or operation of the internal controls that could adversely affect the Agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and

not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified material weaknesses in the Agency's financial management systems. The OIG *Review of Information Systems Security* reported access controls over financial systems need improvement and raised significant concerns about the reliability, accuracy, integrity, and completeness of the information maintained in the financial systems. The report further stated the Finance Branch had not developed adequate segregation of duty controls to prevent one person from performing incompatible functions, and service continuity controls did not provide sufficient protection against the impact of a local or national disaster or significant business disruptions.

MANAGEMENT LETTER

We identified several conditions that would be reported to management in a letter rather than in the report on internal control. These involved T&A and capitalized and sensitive property.

Time and Attendance

The Agency did not maintain adequate control over T&A in accordance with GAO Office Policy and Procedures Manual for Guidance of Federal Agencies, Title 6 - Pay, Leave, and Allowances, dated March 22, 1996, and Agency policy.

We found the following results in our inspections of four Regional Offices.

- Sick leave in all four offices was not advanced in accordance with Agency policy.
- Bi-weekly T&A reports were either not regularly approved or a significant number were not approved in three offices.
- Accurate work schedules evidencing supervisory approval did not exist in three offices.
- Credit hours earned by employees were not recorded into the Agency's official records in two offices.
- A significant number of leave slips were not maintained in two offices.
- One office had an inappropriate person performing T&A activities.

We performed comparable procedures at the Division of Judges in Washington. Of the 50 sick leave transactions reviewed we found: 10 were not supported by a leave slip; 14 leave slips were not approved by the supervisor; and 1 was not signed by the employee. Of the 50 annual leave transactions reviewed we found: 3 were not supported by a leave slip; 23 were not approved by a supervisor; and 1 was not signed by the employee. We reviewed the bi-weekly T&A reports related to the sick leave and annual leave transactions tested, 100

transactions in total. We found that: 93 were not initialed by the timekeeper; 2 were not initialed by the employee; and 42 were not signed by the supervisor.

These results were comparable to the findings reported in the OIG *Evaluation of Time and Attendance Practices*. We made multiple recommendations in that audit report for Agency-wide improvements. Management agreed to implement all but one of the recommendations. On June 19, 2000, the Director of Personnel issued a memorandum to all Agency employees that addressed many of the recommendations. When the remaining recommendations are implemented, T&A deficiencies in the Regions and the Division of Judges should be addressed.

Capitalized and Sensitive Property

Results obtained in three of the four Regional Offices we inspected showed that: official property records did not accurately reflect computer equipment at Regional Offices or the locations within the offices; records maintained by Regional Office staff did not accurately identify computer equipment in their office; and that computer property records maintained by Regional Offices were not in agreement with the official property records maintained at Headquarters by the Information Technology Branch. We also found that controls over computer equipment sent from Regional Offices to Headquarters for repair were not sufficient.

We selected a judgmental sample of 15 pieces of capitalized property from Agency records to verify the equipment's existence and the accuracy of the records. We found problems with six items, 40 per cent of the items reviewed. Serial numbers provided by Regional Offices did not match property records for three items. Two of these three did not have a bar code number. We also had one occurrence of three other errors: the property description in official Agency records was inconsistent with information provided by the Regional Office, property that was excessed was not annotated as such on Agency property records, and the bar code number provided by the Regional Office did not match official Agency property records.

OIG plans to schedule an audit of controls over automated data processing equipment in FY 2001.

EXHIBIT

Reports Relied Upon in the Audit of NLRB's FY 1999 Accounting and Reporting Systems

Title	Report Number	Date Issued
Accounting and Reporting Systems in the Brooklyn Regional Office	OIG-INS-06-00-03	July 6, 2000
Accounting and Reporting Systems in the Cleveland Regional Office	OIG-INS-07-00-04	July 6, 2000
Accounting and Reporting Systems in the Seattle Regional Office	OIG-INS-08-00-05	July 6, 2000
Accounting and Reporting Systems in the Chicago Regional Office	OIG-INS-09-00-06	July 6, 2000
Evaluation of Time and Attendance Practices	OIG-AMR-29-00-01	February 23, 2000
Review of Information Systems Security	OIG-AMR-30-00-03	September 29, 2000

APPENDIX

UNITED STATES GOVERNMENT
National Labor Relations Board

Memorandum

November 30, 2000

TO: Jane Altenhofen
Inspector General

FROM: Gloria Joseph
Director of Administration

SUBJECT: Draft Report (OIG-F-8-00-xx)

This is in response to your memorandum, dated October 24, 2000, regarding the Draft Report "Audit of NLRB's Fiscal Year 1999 Accounting and Reporting Systems".

Attached are five action plans that outline the specific actions, which have been taken with regard to each of the five recommendations. Actions in response to four of the five recommendations have been completed. Recommendation 3 of 5 has a target completion date of December 31, 2000.

We have no comment on any other aspect of the report. Please contact me on 273-3890 if you have any questions.

Attachment

Cc: Chairman
General Counsel
Finance Branch Chief