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United States Government Accountability Office  
Washington, DC 20548

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December 19, 2005

The Honorable Todd R. Platts  
Chairman, Subcommittee on Government Management,  
Finance, and Accountability  
Committee on Government Reform  
House of Representatives

Subject: *Managerial Cost Accounting Practices: Departments of Education,  
Transportation, and the Treasury*

Dear Mr. Chairman:

Authoritative bodies have promulgated laws, accounting standards, information system requirements, and related guidance to emphasize the need for cost information and cost management in the federal government. For example, the Chief Financial Officers (CFO) Act of 1990,<sup>1</sup> contains several provisions related to managerial cost accounting, one of which states that an agency's CFO should develop and maintain an integrated accounting and financial management system that provides for the development and reporting of cost information. Statement of Federal Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and the Joint Financial Management Improvement Program's (JFMIP) *Framework for Federal Financial Management Systems*<sup>2</sup> established accounting standards and system requirements for managerial cost accounting (MCA) information at federal agencies. The Federal Financial Management Improvement Act of 1996<sup>3</sup> built on this foundation and required, among other things, CFO Act agencies' systems to comply substantially with federal accounting standards and federal financial management systems requirements.

MCA involves the accumulation and analysis of financial and nonfinancial data, resulting in the allocation of costs to organizational pursuits such as performance goals, programs, activities, and outputs. The data analyzed depend on the operations and needs of the organization. Nonfinancial data measure the occurrences of activities and can include, for example, the number of hours worked, units produced,

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<sup>1</sup> Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990).

<sup>2</sup> In 2005, JFMIP's responsibilities for financial management and policy oversight were realigned to the Office of Management and Budget, the Office of Personnel Management, and the Chief Financial Officer's Council.

<sup>3</sup> Pub. L. 104-208, div. A., § 101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

grants managed, inspections conducted, people trained, or time needed to perform certain functions.

In light of the requirements for federal agencies to prepare MCA information, you asked us to determine the extent to which federal agencies develop cost information and use it for managerial decision making. The objectives of our review were to determine how federal agencies generate managerial cost accounting information as well as how governmental managers use cost information to support managerial decision making and provide accountability.

This report summarizes information provided during our November 8, 2005, briefing to your staff concerning our review of MCA practices at the Department of Education (Education), the Department of Transportation (Transportation), and the Department of the Treasury (Treasury). This was our second in a series of briefings concerning the status of MCA activities at large government agencies. Our first briefing covered the status of MCA activities at the Department of Veterans Affairs and the Department of Labor.<sup>4</sup> The November 8, 2005, slides are presented in enclosure I.

### **Status of Departmental Efforts to Implement Managerial Cost Accounting**

Similar to issues that surfaced in our earlier assessment at the Department of Veterans Affairs and the Department of Labor, we found uneven progress in MCA implementation and a need for enhanced controls over MCA data at Education, Transportation, and Treasury.

#### Department of Education

At Education, 1 of 10 program offices had an MCA system in place at the time of our review. Education did not take a department-level leadership role to promote and monitor MCA implementation, nor did it have policies and procedures for implementing MCA departmentwide. Rather, according to Education officials, other priorities, such as improving controls over financial reporting, were taking precedence.

Federal Student Aid (FSA), the one Education program office with an operational MCA system, independently developed its MCA system after being statutorily designated as a performance-based organization in 1998. FSA managers, however, still did not have direct access to the system and had to rely on a team of cost accounting personnel to provide system outputs. In addition, FSA had not completed development of a training strategy for current and potential users of the data. Also, FSA had not documented the design of controls or completion of those control procedures when performed to help ensure the reliability of nonfinancial data. Adequately designed controls and properly implemented procedures are key when determining the cost of work outputs. Further, FSA had not performed and documented a comprehensive post-implementation review of its MCA system which

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<sup>4</sup> GAO, *Managerial Cost Accounting Practices: Leadership and Internal Controls Are Key to Successful Implementation*, GAO-05-1013R (Washington, D.C.: Sept. 2, 2005).

would have determined how well the system met expectations and cost estimates, and would have documented lessons learned for current and future stakeholders.

### Department of Transportation

Transportation has in recent years shown strong leadership in developing MCA systems both departmentwide and at the individual operating administrations (OA). For example, two staff members from the Office of the Secretary provided daily support to the OAs in the area of MCA and monitored their progress in implementing MCA. In addition, MCA was discussed at CFO Group meetings, and at meetings of the Cost Accounting Steering Group.

According to Transportation officials, the 12 OAs were developing MCA systems, tailored to their respective needs, which should be able to interface with Delphi — the department's integrated financial management system, a component of which could be used by OAs for cost accounting. One of the two largest OAs, the Federal Aviation Administration (FAA), was mandated to develop a cost accounting system in 1996, and had implemented MCA in two business lines covering over 80 percent of its budget. The other 11 OAs expected to have their MCA models in place by early fiscal year 2006.

While Transportation supported and monitored implementation of MCA, and had issued related procedures in 2002, it did not have a written departmentwide MCA policy. At FAA, officials cited several controls to help ensure the reliability of nonfinancial data, and stated that system improvements for assigning labor costs related to the maintenance of older National Airspace System equipment were planned.

### Department of the Treasury

By policy, Treasury delegated to its bureaus responsibility to implement MCA systems and processes to meet federal standards. Treasury retained oversight responsibility to ensure consistent implementation of MCA departmentwide. Treasury officials, however, had no specific procedures in place to ensure that consistent, periodic department-level oversight was conducted, and they promoted MCA and monitored MCA implementation on an informal and sporadic basis. This contributed to widely disparate implementation and use of MCA among Treasury's operating bureaus and department-level offices. For example, the Bureau of Engraving and Printing and the Financial Management Service (FMS) had established MCA systems and practices, and management utilized cost information to make key decisions. However, at Treasury's largest component, the Internal Revenue Service (IRS), MCA capability was limited. IRS's newly implemented MCA module had less than 1 full year of data, and could only account for costs by activity, output, or program when those activities, outputs, or programs were completely housed within a single cost center.

Controls to ensure the reliability of MCA data needed improvement in two of the three Treasury bureaus we reviewed. Specifically, at FMS and IRS, formal MCA policies and procedures had not been finalized, approved, or disseminated. Further,

improved department-level oversight of bureaus is needed to ensure appropriate systems that provide reliable information are implemented departmentwide.

## **Recommendations for Executive Action**

We are making 17 recommendations to the Secretaries of the Departments of Education, Transportation, and the Treasury.

### Recommendations to the Secretary of Education

To help ensure that Education components implement and use reliable managerial cost accounting methodologies, we recommend that the Secretary of Education direct the Chief Financial Officer of the Department of Education to develop and issue

- a policy for implementing MCA departmentwide and
- procedures for monitoring implementation of its departmentwide managerial cost accounting policy and for establishing a sound system of controls.

To help ensure cost data reliability, more efficient utilization of the agency's cost accounting system, and adequate staff knowledge of that system, we also recommend that the Secretary of Education direct the Chief Operating Officer of Federal Student Aid to

- document the design of controls that are being used to help ensure the reliability of the nonfinancial data,
- document the proper completion of these control procedures,
- provide all appropriate staff direct access to cost accounting system output information, and
- develop adequate training plans for all staff who could effectively utilize managerial cost accounting information.

We also recommend that the Secretary of Education direct the Chief Operating Officer of Federal Student Aid to perform and document a post-implementation review to evaluate whether managerial cost information meets organizational objectives and users' needs. This review should also determine the extent to which managers use or plan to use cost data in managing day-to-day operations.

### Recommendations to the Secretary of Transportation

To help ensure that Transportation components implement reliable cost accounting methodologies for use in managerial decision making in accordance with departmental objectives, we recommend that the Secretary of Transportation direct appropriate department officials to finalize and issue

- a policy for implementing MCA departmentwide, and
- formal procedures, revised as necessary, to monitor implementation of that policy and establish a sound system of controls.

In order for FAA to develop cost accounting information that is sufficiently reliable for ongoing managerial decision making, consistent with FAA-identified concerns and ongoing efforts, we also recommend that the Secretary of Transportation direct the Administrator of FAA to

- implement the planned system improvement for assigning labor costs to National Airspace System maintenance projects, with appropriate internal controls to help ensure data reliability, and
- implement managerial cost accounting in its two lines of business that have not completed implementation.

#### Recommendations to the Secretary of the Treasury

To help ensure that Treasury components implement and use reliable managerial cost accounting methodologies, we recommend that the Secretary of the Treasury direct the Chief Financial Officer of the Department of the Treasury to develop and implement written procedures, including a sound system of controls, to better carry out Treasury's policy to oversee the implementation and continued use of appropriate cost accounting methodologies at its bureaus and departmental offices.

To help ensure that the Internal Revenue Service implements and uses reliable cost accounting methodologies in accordance with management objectives, we recommend that the Secretary of Treasury require the Commissioner of Internal Revenue to direct the Chief Financial Officer of IRS to finalize and issue

- an Internal Revenue Service policy to carry out Treasury's managerial cost accounting policy and
- formal procedures, including a sound system of controls to implement that policy.

We also recommend that the Secretary require the Commissioner of Internal Revenue to direct the Chief Financial Officer of IRS to finalize development and implementation of a cost accounting system capable of determining the cost of activities, services, or products at levels of detail suitable to assist managerial decision making.

Similarly, we recommend that the Secretary require the Commissioner of Financial Management Service to direct the Chief Financial Officer of the Financial Management Service to finalize and issue

- a Financial Management Service policy to carry out Treasury's managerial cost accounting policy and
- formal procedures, including a sound system of controls, to implement that policy.

## **Agency Comments and Our Evaluation**

We requested comments on a draft of our briefing presentation from the Secretaries of Education, Transportation, and the Treasury or their designees. We received written comments from the Chief Financial Officer of the Department of Education and from the Acting Deputy Chief Financial Officer of the Department of the Treasury. Transportation elected not to provide written comments, but did provide technical comments. We incorporated the agencies' comments, as appropriate. Education and Treasury comments are reprinted as enclosures II and III, respectively.

### Comments from the Department of Education

Education agreed with six of our seven recommendations. In particular, it agreed with our four recommendations pertaining to data reliability and MCA utilization and said it would address these issues when implementing a new MCA system. Further, Education agreed with our two recommendations pertaining to departmentwide MCA policies and procedures for implementing that MCA policy, but said other priorities, such as improving controls over financial reporting, currently take precedence.

Regarding our seventh recommendation concerning the need to perform and document a post-implementation review for the managerial cost information system, Education stated that it conducted a post-implementation review of its activity-based costing system on an ongoing basis, but that the results of the review were not documented. While the review process used by Education has benefits, a comprehensive post-implementation review undertaken and documented in accordance with Office of Management and Budget (OMB) Circular A-130, *Management of Federal Information Resources*, would provide a broader range of information about FSA's system and how it is achieving its organizational objectives. This information could benefit current and future stakeholders. Accordingly, we made no change to our recommendation.

### Comments from the Department of Transportation

Transportation provided comments concerning MCA implementation at FAA and several other technical issues in two e-mails, but neither agreed nor disagreed with our four recommendations. We considered its technical comments and incorporated them, as appropriate.

### Comments from the Department of the Treasury

Treasury agreed with our six recommendations and stated that it recognizes the importance of addressing its cost accounting needs. However, Treasury stated that resource constraints limit the department's ability to oversee MCA activities and that the cost of MCA should be weighed against its benefits and other competing priorities. We agree that the costs and benefits of an activity are important considerations but believe that MCA, conceptually, is what is needed to help promote efficiency, productivity, and the best use of limited resources. In our view, properly functioning MCA capabilities, as envisioned in laws and regulations, could help Treasury meet its mission needs in an era of constrained resources.

Treasury also made several comments regarding specific information in the report. Treasury commented that information we presented about current MCA efforts at IRS and the status of its MCA system were not accurate. It said that the IRS system allocates costs to over 13,000 IRS-defined cost centers. While IRS may have cost-center-level accounting, we remain concerned that according to IRS officials, IRS can only account for costs by activity, output, or program when those activities, outputs, or programs reside completely within a single cost center, thus not allowing IRS an enterprise-wide perspective on costs.

Treasury also said that once sufficient data are collected, the current system along with information from other systems, such as performance data, will be used to obtain cost data in greater detail to support decision making. However, during our review, IRS officials told us that such analysis was not possible with the current system without implementing certain system upgrades. We believe that this perceived difference in position between Treasury and IRS officials about the capabilities of the current IRS system and the agency's MCA requirements needs to be resolved. In any event, we continue to believe that the ability to generate more detailed cost information could be enhanced if an upgraded and integrated cost module or similar system was in place. Accordingly, we did not modify our position on this topic.

In addition, Treasury said that the disparate implementation of MCA across the department is not solely the result of informal and sporadic departmental oversight. We clarified our briefing to instead acknowledge that the informal and sporadic oversight was a contributing factor to disparate MCA implementation, and also noted that the sophistication, extent, and cost of implementing MCA would depend on the operations and needs of the organization.

### **Scope and Methodology**

Our methodology was consistent with the one employed in our prior review of MCA practices at the Department of Labor and the Department of Veterans Affairs.<sup>5</sup> To obtain an understanding of how MCA systems at Education, Transportation, and Treasury generate cost information, we interviewed officials and reviewed documentation on the status of MCA system implementation and the related obstacles to managerial costing. We also examined departmental guidance and looked for evidence of leadership and commitment to the implementation of entity-wide cost management practices. Using the *Standards for Internal Control in the Federal Government*<sup>6</sup> as a guide, we identified internal controls over the reliability of financial and nonfinancial information used in MCA. To determine how managers use cost information to support managerial decision making and provide accountability, we obtained an understanding of how Education, Transportation, and Treasury use cost accounting data for budgeting, costing services or products,

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<sup>5</sup> GAO-05-1013R, 12.

<sup>6</sup> GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

preparation of the Statement of Net Cost, and other managerial uses through interviews of agency officials and a review of documentation provided by the departments.

During our review, we visited Education, Transportation, and Treasury headquarters in Washington, D.C. We interviewed managers and senior-level officials about their MCA activities at the departmental level and at selected component agencies. When possible, we corroborated information obtained in interviews with agency documents such as policies, procedures, system descriptions, and flowcharts. We also reviewed prior office of inspector general and GAO reports regarding MCA activities, systems, and data. The agencies provided comments on a draft of this report, which we considered and incorporated as appropriate. We performed this work in accordance with U.S. generally accepted government auditing standards from May 2005 through October 2005.

We are sending this report to the Secretaries of Education, Transportation, and the Treasury; the Director of OMB; and other interested parties. Should you or your staff have any questions on the matters discussed in this correspondence, please contact me at (202) 512-6131 or martinr@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs can be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure IV.

Sincerely yours,

A handwritten signature in black ink that reads "Robert E. Martin". The signature is written in a cursive style with a large, prominent initial "R".

Robert E. Martin  
Director, Financial Management and Assurance

**November 8, 2005 Briefing**



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## **Managerial Cost Accounting Practices**

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Departments of Education, Transportation, and the Treasury

Briefing to the Subcommittee on Government Management, Finance, and  
Accountability, Committee on Government Reform, House of  
Representatives

November 8, 2005

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## Introduction and Objectives

- Authoritative bodies have promulgated laws, accounting standards, system requirements, and related guidance to emphasize the need for cost information and cost management in the federal government:
  - Congress
  - Federal Accounting Standards Advisory Board (FASAB)
  - Joint Financial Management Improvement Program (JFMIP)
  - Office of Management and Budget (OMB)
- In light of these requirements, you asked us to determine the extent to which federal agencies develop cost information and use it for managerial decision making.

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## Introduction and Objectives

- The objectives of our review were to determine how
  - federal agencies generate managerial cost accounting (MCA) information and
  - government managers use cost information to support managerial decision making and provide accountability.
- This is the second in a series of briefings concerning the status of MCA activities at large government agencies.
- This briefing summarizes our observations at the Department of Education (Education), Department of Transportation (Transportation), and the Department of the Treasury (Treasury).

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**Scope and Methodology**

- To determine how MCA systems at Education, Transportation, and Treasury generated cost information, we interviewed officials and obtained documentation at headquarters offices and selected component agencies (e.g., bureaus and offices) on
  - the status of MCA system implementation;
  - departmental guidance, leadership, and commitment to the implementation of cost management practices entitywide;
  - departmental internal controls to help ensure the reliability of financial and nonfinancial information used in MCA; and
  - obstacles to managerial costing.



**Scope and Methodology**

- To determine how Education, Transportation, and Treasury managers used cost information to support managerial decision making and provide accountability, we interviewed officials at the department level and at several component agencies on the use of cost accounting data for
  - budgeting; costing activities, services or products; monitoring operations; and enhancing performance measures and operational efficiency;
  - preparing the Statement of Net Cost; and
  - any other uses.



### Scope and Methodology

- We visited Education, Transportation, and Treasury headquarters in Washington, D.C., and interviewed officials about their MCA activities at the department level and at selected component agencies.
- When possible, we corroborated information obtained in interviews with agency documents such as policies, procedures, system descriptions, and flowcharts. We also reviewed prior Office of Inspector General (OIG) and GAO reports regarding MCA activities, systems, and data.
- We performed this work from June through September 2005 in accordance with U.S. generally accepted government auditing standards.

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### Results in Brief

- Education management did not take a leadership role to promote the benefits of cost accounting policies or systems departmentwide, and presently has a cost accounting system in only one of 10 program offices — Federal Student Aid (FSA). FSA independently developed its system after being statutorily designated as a Performance Based Organization. One drawback of its system is that FSA managers do not have access to the system and must depend on system operators for information.
- At Transportation, individual operating administrations (OA) are building MCA models tailored to their respective needs based on Delphi, a departmentwide integrated financial management system that includes a module that can be used for MCA. At the time of our review, FAA, one of Transportation's two largest OAs, had substantially implemented a MCA system linked to Delphi in two of its four lines of business covering over 80 percent of FAA's budget. Transportation management expects all 12 of its OAs to have implementation of their MCA systems underway in fiscal year 2006.

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**Results in Brief**

- Treasury assigned responsibility for MCA implementation to its nine operating bureaus. In the absence of effective department-level leadership, the extent of MCA implementation varied among the bureaus. Five bureaus, including the Internal Revenue Service (IRS), Treasury's largest bureau, did not have well-established MCA systems.
- Education, Transportation, and Treasury officials cited some existing and several planned uses of MCA information by component agencies and certain department-level offices for budgeting, resource allocation, financial reporting, and other managerial decision-making purposes.



**Results in Brief**

- MCA-related internal controls needed strengthening.
- Education and Transportation lacked formal written policies about MCA and Education lacked procedures about implementing MCA department-wide. Certain component agencies at Treasury also lacked formal written policies and procedures about MCA.
- To address our findings, we made recommendations to each of the three agencies: seven to Education, four to Transportation, and six to Treasury. We received written comments from Education and Treasury and technical comments from Transportation. We considered and incorporated the comments, as appropriate.



**Background**

- The Chief Financial Officers (CFO) Act of 1990, Statement of Federal Financial Accounting Standards (SFFAS) No. 4: *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and JFMIP's *Framework for Federal Financial Management Systems* establish requirements and accounting standards for MCA information at federal agencies.<sup>1</sup>
- The Federal Financial Management Improvement Act of 1996 (FFMIA) builds on the foundation provided by the CFO Act and includes requirements for CFO Act agencies' systems to comply substantially with, among other things, federal financial management systems requirements and federal accounting standards.

<sup>1</sup>In 2005, JFMIP's responsibilities for financial management and oversight were realigned to OMB, OPM, and the Chief Financial Officers Council.



**Background**

- MCA involves the accumulation and analysis of financial and nonfinancial data to determine the cost of achieving performance goals, delivering programs, and pursuing other activities. The data analyzed, as well as the sophistication, extent, and, therefore, the cost of implementing and maintaining MCA systems and activities, depend on the operations and needs of the organization.
- Nonfinancial data measure the occurrence of outcomes, outputs, and activities to which costs are assigned.
- Nonfinancial data could include the number of electronic payments, reductions in staffing levels, the number of hours worked, units produced, grants managed, inspections conducted, people trained, or time needed to perform certain functions.



**Department of Education  
Background**

- Education was established to promote (1) equal educational opportunity for every individual and (2) improvements in the quality and usefulness of education.
- Education has 10 program offices and 12 management and staff offices.
- In fiscal year 2005, Education had approximately 4,500 employees and a budget of about \$68 billion.
- According to Education officials, about 98 percent of the agency budget goes to grants, guaranteed loans, and direct loans. They said that about 93 percent of all Education loans and grants were disbursed by FSA, the Office of Elementary and Secondary Education (OESE), and the Office of Special Education and Rehabilitative Services (OSERS). FSA alone accounted for 47 percent.

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**Department of Education  
MCA Systems in Place**

- Education had not issued MCA policies and only one component had a MCA system.
  - Department officials have not considered cost accounting a key issue because most of the appropriations were disbursed as grants and loans. Administrative costs made up only about 2 percent, or \$1.3 billion, of Education's appropriations. Further, according to Department officials, 61 percent of the \$1.3 billion were administrative costs attributable to FSA and were already subject to MCA methodologies.
  - Education used allocation methodologies to assign costs to its programs on the Statement of Net Costs for department-level external reporting, but, except for one component, did not assign costs to activities, services, and products to assist managerial decision making.

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- FSA was the only component with a cost accounting system. Neither Education officials nor officials at the other two largest components we contacted had plans to implement cost accounting systems.
- FSA began development of an activity based cost (ABC) system in 1999 in response to a 1998 statutory requirement that designated it a performance-based organization and required it to reduce administrative costs.
- FSA's Chief Operating Officer (COO) fully supported and promoted the development of the system.
  - FSA's COO emphasized to us that she is committed to the goal of reducing administrative costs and to using ABC, stating, "Everything we do is about costs."

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- The FSA system used commercial off-the-shelf (COTS) software.
  - GAO reviewed early models of FSA's system in 2002 and expressed concerns about the system, which included using budget obligations in lieu of actual costs and not using full costs.<sup>2</sup> We reported in October 2004 that newer models were developed and, although not operational at the time, they had the potential to identify full costs.<sup>3</sup>
  - According to FSA, the current MCA assigns full costs — both direct and indirect costs, including non-FSA overhead — to business processes.

<sup>2</sup> GAO, *Federal Student Aid: Additional Management Improvements Would Clarify Strategic Direction and Enhance Accountability*, GAO-02-255 (Washington, D.C.: Apr. 30, 2002).

<sup>3</sup> GAO, *Better Strategic and Human Capital Planning*, GAO-05-31 (Washington, D.C.: Oct. 6, 2004).

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**Department of Education  
MCA Systems in Place**

- FSA told us the system became fully operational in early 2005.
- Managers did not have direct access to FSA's MCA system but had to rely on a team of cost accounting personnel who could provide system outputs. This could limit managers' ability to use cost information as needed.
- FSA officials told us that they are in the process of
  - acquiring new software to provide end-user-friendly reporting using web-based capabilities, and
  - developing a training strategy to provide more training to all current and potential users of the data.

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**Department of Education  
MCA Systems in Place**

- Obstacles encountered during implementation at FSA included:
  - many managers focusing on budget execution, as opposed to the full cost of outputs;
  - managers not understanding how to use MCA data in their day-to-day operations; and
  - software limitations in data presentation and reporting capabilities.
- FSA incorporated financial information from the department's general ledger, and nonfinancial information, such as workloads, from other sources.

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**Department of Education  
MCA Systems in Place**

- Various controls over financial data were in place:
  - FSA's MCA system was documented in writing.
  - FSA's separate financial statements were subject to independent audit and received unqualified audit opinions for fiscal years 2002 through 2004.
  - Financial data for the MCA system was pulled from the department's general ledger system and reconciled to the Statement of Net Costs.

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**Department of Education  
MCA Systems in Place**

- For nonfinancial data, FSA relied mainly on controls within the offices that are the sources of the data.
  - FSA's Enterprise Performance Management Services team reviewed the nonfinancial performance data periodically for anomalies by comparing data to standard system reports.
  - FSA's cost accounting team performed trend analysis and compared data for consistency; however, it had not documented the design of controls that are being used to help ensure the reliability of the nonfinancial data, nor had it documented that control procedures were properly completed.

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**Department of Education  
MCA Systems in Place**

- FSA has identified requirements for its system, but it had not performed and documented a more comprehensive post-implementation review of its ABC system to determine if the system adequately meets its needs. Such a review would:
  - evaluate the extent to which the project results met expectations,
  - evaluate the differences between estimated and actual costs, and
  - provide opportunities for management to extract “lessons learned” and improve control processes.

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**Department of Education  
Use of MCA Information**

- According to FSA officials, they used data from the system to
  - assist in preparation of its fiscal year 2007 budget request,
  - identify targets for business process improvements including analyzing the costs and benefits of specific investments, and
  - develop cost reductions for the FSA Five-Year Performance Plan.

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**Department of Education  
Use of MCA Information**

- Unlike FSA, the other two components (OESE and OSERS) we contacted did not analyze their grant processing costs.
- To provide an indication of its output costs, Education used full time equivalent employees (FTE) and average labor costs to compute and report average costs of \$6,100 per grant in its 2004 performance and accountability report (PAR) for components other than FSA.
  - However, because of MCA system limitations, component officials told us they did not know if reported departmentwide average costs were representative of actual processing costs for their components.

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**Department of Transportation  
Background**

- Transportation's mission is to serve the United States by ensuring a safe transportation system that furthers our vital National interests and enhances the quality of life of the American people.
- For fiscal year 2005, Transportation had a budget of approximately \$58 billion and employed approximately 59,000 people.
- Transportation consists of 12 operating administrations (OA). Two of these operating administrations, Federal Aviation Administration (FAA) and Federal Highway Administration (FHWA) make up about 80 percent of Transportation's budget.

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**Department of Transportation  
MCA Systems in Place**

- In November 2003, Transportation implemented a new integrated financial management system called Delphi, a component of which may be used by OAs for cost accounting. Delphi uses COTS financial management system software.
- Each of the 12 OAs were developing their own MCA system tailored to their respective needs. FAA's MCA system was implemented in two of its four lines of business covering over 80 percent of its budget and was already linked to Delphi. Management at FHWA and the other 10 OAs expect to have MCA models in place by early fiscal year 2006.

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**Department of Transportation  
MCA Systems in Place**

- Transportation provided strong support for MCA from the Department Secretary. Examples of support include:
  - Two staff members from the Office of the Secretary provided daily support to the OAs in the area of MCA, and monitored their progress.
  - The Office of the Secretary emphasized the importance of MCA in several memorandums to the OAs, and outlined steps the OAs should follow to implement MCA.
  - MCA was discussed at monthly CFO Group meetings as well as at meetings of the Cost Accounting Steering Group.

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**Department of Transportation  
MCA Systems in Place**

- While Transportation supported and monitored the implementation of MCA, it did not have a written departmentwide MCA policy. Procedures for implementing MCA departmentwide were issued in 2002.
  
- Individual OAs also provided support for MCA:
  - According to FAA officials, FAA's Strategic Plan contains a directive for every organization in FAA to develop productivity metrics such as unit costs.
  
  - FHWA contracted with Grant Thornton Consultants to implement MCA methodologies for its three programs by February 2006.

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**Department of Transportation  
MCA Systems in Place**

- FAA was mandated to develop a cost accounting system in 1996. Since then, FAA has worked to implement its MCA system which is referred to as CAS for "Cost Accounting System."
  
- CAS provides managers with fully allocated costs of FAA products and services. CAS takes direct cost data from Delphi and allocates direct, indirect, and overhead costs to benefiting organizations, products, or services.

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**Department of Transportation  
MCA Systems in Place**

- FAA and Transportation officials stated that CAS is implemented in the Air Traffic Organization (ATO) and Commercial Space Transportation, two of FAA's four lines of business which cover over 80 percent of its budget.
- These two lines of business implemented CAS using PeopleSoft software. The remaining lines of business — Aviation Safety and Airports — are expected to implement CAS using Oracle Projects software.
- According to FAA officials, costs roll up to Transportation performance goals.

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**Department of Transportation  
MCA Systems in Place**

- FHWA started implementing MCA in October 2003.
- FHWA's costs are generated by three types of programs: General Operating Expenses/Research and Development, Federal Lands, and Federal Aid to States. According to FHWA officials, each program is expected to have its own MCA system by February 2006.
- According to FHWA officials, their MCA system will allocate indirect costs and overhead, and will produce cost reports with overhead (i.e., full cost) and without overhead.
- Management expects MCA systems for all 3 programs to roll up costs to Transportation performance goals.

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Department of Transportation  
MCA Systems in Place

- Transportation officials said that financial data was subject to classic accounting controls such as
  - financial audits by independent auditors,
  - monthly reconciliations between the general ledger and Delphi modules, and
  - weekly exception reports such as invoices on hold, and errors with data.
- However, in its report on internal controls related to Transportation's fiscal year 2004 financial statements, the OIG stated that extraordinary efforts were needed to produce audited financial statements for that year.

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Department of Transportation  
MCA Systems in Place

- Because of continuing material deficiencies in internal control over financial management and reporting activities, FHWA in particular continued to encounter significant problems generating reliable financial information. Over \$18 billion of adjustments to the financial statements were needed to correct errors and omissions in FHWA's accounting records at the end of fiscal year 2004.
- Material weaknesses in internal control may adversely affect any decision by FHWA management that is based, in whole or in part, on information that is inaccurate because of these weaknesses. According to FHWA officials, they were working on a solution to this issue and it should be fixed in fiscal year 2006, by the time it implements MCA.

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**Department of Transportation  
MCA Systems in Place**

- FAA officials cited several internal controls over nonfinancial data such as intensive oversight by the OIG, which is statutorily required to report annually on CAS implementation.
  - Nonfinancial data, specifically labor data, was subject to controls such as
    - supervisory review of time and attendance coding, and
    - front-end edit checks of data for validity.
- FAA officials noted the need to revise labor cost data related to maintenance of older National Airspace System equipment because it may be unreliable. They expect the next version of FAA's CAS, scheduled for release in January 2006, to correct this problem.
- FAA officials said they recently created a new Internal Controls Division, within the FAA CFO's office. A key responsibility of the division will be to test the internal controls over both financial and nonfinancial systems.

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**Department of Transportation  
Use of MCA Information**

- In their fiscal year 2004 PAR, Transportation officials noted that they used cost information in a variety of ways. For example, they
  - linked costs to strategic performance areas, and used highway and air traffic safety data to link performance to financial information; and
  - used cost finding techniques in the fiscal year 2006 budget cycle to estimate marginal cost of performance (what results can be achieved at different levels of funding) for selected programs.
- Transportation officials also said they studied the costs of replacing retiring employees, and whether they needed to be replaced at the same grade level.
- According to Transportation officials, they were in the process of streamlining selected processes so that the Statement of Net Cost can be produced directly out of the core financial system.

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**Department of Transportation  
Use of MCA Information**

- According to FAA officials, significant benefits have already been obtained from CAS. For example, FAA officials told us they used CAS data to
  - contract out ATO Flight Service Stations in 2003, saving about \$2.2 billion over 10 years (these savings included reductions in operating, facilities, and equipment costs as well as a reduction of 400 staff),
  - cancel a \$27 million medium airport weather program, and
  - modify an airport radar surveillance program, avoiding a cost of \$7 million.

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**Department of Transportation  
Use of MCA Information**

- According to FHWA officials, its MCA system, once implemented, will be able to generate data and reports on cost by strategic goal, office, activity, and performance objective.
- FHWA planned to use these reports for, among other things,
  - benchmarking against like organizations,
  - resource allocation,
  - budgeting, and
  - performance measurement.

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Department of the Treasury  
Background

- Treasury's mission is to promote the conditions for prosperity and stability in the United States and encourage prosperity and stability in the rest of the world.
- In fiscal year 2005, Treasury had an annual operating budget of approximately \$18 billion and employed approximately 113,000 people, of which nearly 100,000 worked at IRS.
- Treasury consists of 9 operating bureaus and 5 departmental offices.

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Department of the Treasury  
MCA Systems in Place

- Treasury policy delegated to its bureaus the responsibility to implement MCA systems and processes to be aligned with the particular operating environment of each entity, requiring each to individually meet or exceed the objectives and standards of SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*.
  - Treasury retained oversight responsibilities to ensure consistent implementation in accordance with the standards.
- The policy stated that the department will oversee and contribute to the improvement of MCA at the bureau level by addressing consistency, when appropriate, sharing best practices, and facilitating improvements to bureau systems. However, according to department officials, they executed these oversight responsibilities on an informal, sporadic basis. Further, there were no specific procedures in place to ensure that consistent, periodic oversight was conducted.

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**Department of the Treasury  
MCA Systems in Place**

- Additionally, in the 2004 PAR, the OIG stated that the department had not incorporated MCA into all of its business activities, which undermined the accuracy and usefulness of program performance reporting.
- At the time of our review, Treasury was currently developing a strategic performance management framework, a component of which is MCA, that is intended to provide management with reporting tools integrating cost, financial, and performance data.

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**Department of the Treasury  
MCA Systems in Place**

- Treasury bureaus include manufacturing and monetary-item processing entities with operating MCA systems.
  - The Bureau of Engraving and Printing (BEP) used COTS software to accumulate and assign full costs to products, organizational units, and specific operations.
    - Various controls over financial and nonfinancial data were in place including annual financial statement audits that resulted in unqualified opinions; periodic reviews of labor, material, and overhead costs; and risk-based inventory cycle counts of production units such as ink and paper to measure utilization and shrinkage.

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**Department of the Treasury  
MCA Systems in Place**

- Treasury's Financial Management Service (FMS) uses COTS software for MCA purposes, which integrates financial and nonfinancial data from payroll, travel, requisition, and property systems.
  - Internal controls included data validation rules to help ensure transmitted data is accurate and falls within predetermined ranges. Also, FMS officials said that they review data for reasonableness and research variances to ensure the accuracy of the data. Finally, certain FMS accounts were also subject to annual financial statement audits.
  - However, formal MCA policies and procedures had not been finalized, approved, or disseminated to reflect new systems and processes. Formal MCA policies and procedures would provide a reference resource for users of cost methodology and procedures employed by FMS.

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**Department of the Treasury  
MCA Systems in Place**

- Management asserted that Bureau of Public Debt and U.S. Mint also had fully functional and operating MCA systems. We did not review MCA activities at these component agencies.
- Management told us that other Treasury bureaus, which generally provide oversight, did not yet have fully implemented and operational MCA systems.

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**Department of the Treasury  
MCA Systems in Place**

- At IRS, officials said they plan to utilize the cost module of the Integrated Financial System for MCA information and executive decision making in fiscal year 2007.
  - The cost module, implemented in November 2004, had less than a full year of cost data loaded at the time of our review.
  - IRS officials said the cost module enabled them to assign full costs to some cost centers.
  - However, this system linked costs to activities only at the cost center level. It did not facilitate more detailed analysis by activity, output, or program unless costs pertained to a single cost center.
    - The system did not provide for nonfinancial data (e.g., hours worked) needed to calculate detailed cost analyses.
  - Further, management had not yet assessed whether this newly implemented cost module would meet the agency's managerial decision-making needs.

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**Department of the Treasury  
MCA Systems in Place**

- IRS officials said that a MCA policy had been drafted, but it had not been finalized, approved, or disseminated.
- According to IRS officials, all future changes to its system had been placed on hold because of a lack of funding. Data required to compute detailed costing such as number of hours worked and cases worked, will only become available when, and if, an upgraded cost module or a similar system is put in place.
- Other bureaus, including Office of the Comptroller of the Currency, Financial Crime Enforcement Network, Alcohol and Tobacco Tax and Trade Bureau, and Office of Thrift Supervision, use various cost finding techniques and analyses, which management sometimes noted to be time consuming, and manual processes performed only upon special request.

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**Department of the Treasury  
MCA Systems in Place**

- In our audit report on IRS financial statements for fiscal year 2004,<sup>4</sup> we stated that weaknesses in internal control over the financial reporting process resulted in IRS (1) not being able to prepare reliable financial statements without extensive compensating procedures and (2) not having current and reliable ongoing information to support management decision making and prepare cost-based performance measures.
- We reported that material weaknesses in internal control may adversely affect any decision by IRS management that is based, in whole or in part, on information that is inaccurate because of these weaknesses. Also, unaudited financial information reported by IRS, including performance information, may also contain misstatements resulting from these weaknesses.

<sup>4</sup> GAO, *Financial Audit: IRS's Fiscal Years 2004 and 2003 Financial Statements*, GAO-05-103 (Washington, D.C.: Nov. 1, 2004).



**Department of the Treasury  
Use of MCA Information**

- Because BEP operates as a revolving fund, it should recover its full cost of operations. According to BEP officials, uses of MCA information included the following:
  - Analysis of cost and spoilage information to help implement a new automated inspection process. Officials said this implementation resulted in a substantial reduction in cost without jeopardizing quality.
  - Cost and benefit analysis of a proposed robotics currency packaging system. BEP officials said that this potentially could reduce two out of three FTEs performing related functions at each of their two manufacturing facilities.
  - Review of key MCA performance indicators to identify decreasing efficiency in older manufacturing presses. In targeting these machines for overhaul, BEP management expects to achieve significant cost savings.



**Department of the Treasury  
Use of MCA Information**

- FMS provides centralized electronic and paper payment, collection, and reporting services for the federal government. According to FMS officials, examples of MCA information usage included:
  - formulating budgets, evaluating programs, and setting fees and prices for services provided to other government entities; and
  - analyzing and reporting unit costs for federal government payments and collections, so that FMS can provide services at a lower cost.

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**Department of the Treasury  
Use of MCA Information**

- At the time of our review, Treasury's Office of Strategic Planning and Performance Management was currently developing a framework that is intended to integrate financial, cost, and performance data into a management decision-making tool. Its planned benefits include:
  - evaluative reporting tools to manage Treasury corporate performance,
  - unit cost and value measures for each of Treasury's major activities,
  - integration of performance into budget formulation, and
  - assessment of Senior Executive Service (SES) performance.

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**Conclusions**

- Strong leadership in the departments will be required to implement MCA across government. This is true regardless of whether the department chooses a departmentwide system or delegates responsibility for system development to component agencies. In either case, the leadership will need to focus on promoting the benefits of MCA, monitoring its implementation, and establishing a sound system of controls to help ensure the reliability of the data used.



**Conclusions**

**Department of Education**

- The Department of Education neither promoted nor monitored MCA implementation at 9 of 10 program offices and at all 12 of its management and staff offices. Expanded use of MCA to additional offices would improve managerial decision making and the reliability of reported cost information departmentwide. At FSA, the one program office with an operational MCA system, stronger internal controls could help ensure the reliability of its MCA data. Additional staff training and easier access to MCA information would improve utilization of MCA information.



### Department of Transportation

- Transportation has shown strong leadership in developing MCA systems both departmentwide and at the individual OAs by promoting the benefits of MCA and actively monitoring its implementation at the Office of the Secretary level. Furthermore, Transportation put into practice controls over the data in its MCA systems through various audits, reconciliations, exception reports, supervisory reviews, and input controls. However, a departmentwide MCA policy for MCA implementation and oversight had not been completed. Also, stronger internal controls would help improve the reliability of MCA data.



### Department of the Treasury

- Officials told us the department promoted MCA and monitored MCA implementation on an informal and sporadic basis. This contributed to widely disparate levels of implementation and use of MCA among Treasury's operating bureaus and department-level offices. At Treasury's largest component, IRS, a MCA policy was not finalized and MCA capability was limited. Further, controls to ensure the reliability of MCA data needed improvement in two of the three bureaus we reviewed, including IRS. Improved department-level oversight of bureaus would help ensure that appropriate systems that provide reliable information are implemented departmentwide.



**Recommendations to the Secretary of Education**

- To help ensure that Education components implement and use reliable MCA methodologies, we recommend that the Secretary of Education direct appropriate department officials to develop and issue
  - a departmentwide MCA policy that focuses on the benefits of MCA, and
  - procedures for monitoring implementation of its departmentwide MCA policy and for establishing a sound system of controls.



- To help ensure MCA data reliability, more efficient utilization of FSA's MCA system, and adequate staff knowledge in using FSA's MCA system, we also recommend that the Secretary of Education direct appropriate FSA officials to
  - document the design of controls that are being used to help ensure the reliability of the nonfinancial data,
  - document the proper completion of these control procedures,
  - provide all appropriate staff direct access to MCA system output information, and
  - develop adequate training plans for all staff who could effectively utilize information from MCA.



**Recommendations  
for Executive Action**

- We also recommend that the Secretary of Education direct appropriate FSA personnel to perform and document a post-implementation review to evaluate whether managerial cost information meets organizational objectives and users' needs. This review should also determine the extent to which managers use or plan to use cost data in managing day-to-day operations.



**Recommendations  
for Executive Action**

**Recommendations to the Secretary of Transportation**

- To help ensure that Transportation components implement reliable MCA methodologies for use in managerial decision making in accordance with departmental objectives, we recommend that the Secretary of Transportation direct appropriate department officials to finalize and issue
  - departmentwide MCA policy that focuses on the benefits of MCA, and
  - formal procedures, revised as necessary, to monitor implementation of that policy and establish a sound system of controls.



**Recommendations  
for Executive Action**

- In order for FAA to develop MCA information that is sufficiently reliable for ongoing managerial decision making, consistent with FAA-identified concerns and ongoing efforts, we also recommend that the Secretary of Transportation direct appropriate FAA officials to
  - implement the planned system improvement for assigning labor costs to National Airspace System maintenance projects, with appropriate internal controls to help ensure data reliability, and
  - implement MCA in its two remaining lines of business.

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**Recommendations  
for Executive Action**

**Recommendations to the Secretary of the Treasury**

- To help ensure that Treasury components implement and use reliable MCA methodologies, we recommend that the Secretary of the Treasury direct appropriate department-level officials to
  - develop and implement written procedures including a sound system of controls to better carry out Treasury's policy to oversee the implementation and continued use of appropriate MCA methodologies at its bureaus and departmental offices.

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**Recommendations  
for Executive Action**

- To help ensure that IRS implements and uses reliable MCA methodologies in accordance with management objectives, we recommend that the Secretary of Treasury direct appropriate IRS officials to finalize and issue:
  - an IRS MCA policy to carry out Treasury’s MCA policy, and
  - formal procedures including a sound system of controls to implement that policy.
- We also recommend that the Secretary direct appropriate IRS officials to finalize development and implementation of a MCA system capable of determining the cost of activities, services, or products at levels of detail suitable to assist managerial decision making.



**Recommendations  
for Executive Action**

- Similarly, we recommend that the Secretary direct appropriate FMS officials to finalize and issue
  - an FMS MCA policy to carry out Treasury’s MCA policy, and
  - formal procedures including a sound system of controls to implement that policy.



**Agency Comments  
and Our Evaluation**

- We received comment letters from Education and Treasury on a draft of this briefing and we assess their comments herein. Transportation elected not to send us a comment letter but did provide technical comments by email. We incorporated the agencies' comments in this briefing, as appropriate.

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**Agency Comments  
and Our Evaluation**

- Education agreed with six of our seven recommendations and disagreed with one. Education agreed with our two recommendations pertaining to departmentwide MCA policies and procedures for implementing that MCA policy but said other priorities such as improving controls over financial reporting take precedence. Education also agreed with our four recommendations pertaining to data reliability and MCA utilization and said they would address these when they implement a new MCA system.

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**Agency Comments  
and Our Evaluation**

- However, regarding our recommendation that they perform a formal post-implementation review for the managerial cost information system, Education stated that the review of their ABC system is an ongoing process.
- Though the process used by Education has benefits, a comprehensive post-implementation review undertaken and documented in accordance with OMB Circular No. A-130, *Management of Federal Information Resources*, would provide additional information for management concerning how FSA's MCA system is achieving its objectives. This information would benefit current and future stakeholders. Accordingly, we made no change to our recommendation.

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**Agency Comments  
and Our Evaluation**

- Transportation provided technical comments on our draft in two emails but neither agreed nor disagreed with our recommendations. We considered their technical comments and incorporated them, as appropriate.

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**Agency Comments  
and Our Evaluation**

- Treasury agreed with our recommendations and stated that it recognizes the importance of addressing its cost accounting needs. However, Treasury stated that resource constraints limit the department's ability to oversee MCA activities and that the cost of MCA should be weighed against its benefits and other competing priorities. We agree that the cost and benefits of an activity is an important consideration but believe that MCA helps promote efficiency, productivity, and the best use of limited resources and that properly functioning MCA capabilities could help Treasury in meeting its mission needs in an era of constrained resources.
- Treasury also made several comments regarding specific information in the report. Treasury commented that information we presented about current MCA efforts at IRS and the status of its MCA system were not accurate. It said that the IRS system allocates costs to over 13,000 IRS-defined cost centers. We agree and clarified our report, noting also that the current system generally did not facilitate analysis by activity, output, or program in greater detail than at the cost center level.

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**Agency Comments  
and Our Evaluation**

- Treasury also said that once sufficient data is collected, the current system along with information from other systems, such as performance data, will be used to obtain cost data in greater detail to support decision-making. However, during our review, IRS officials told us that such analysis was not possible with the current system. We believe that this difference in position between Treasury and IRS officials about the capabilities of the current IRS system and the agency's MCA requirements needs to be resolved. In any event, the ability to generate more detailed cost information could be enhanced if an upgraded and integrated cost module or similar system was in place. We did not modify our briefing for this comment.
- In addition, Treasury said that the disparate implementation of MCA across the department is not solely the result of informal and sporadic departmental oversight. We clarified our briefing by stating that the informal and sporadic oversight was a contributing factor.

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## Comments from the Department of Education



### UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

November 1, 2005

Mr. Robert E. Martin  
Government Accountability Office  
Director, Financial Management and Assurance  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Martin:

We are in receipt of your proposed report entitled Managerial Cost Accounting (MCA) Practices: Departments of Education, Transportation, and the Treasury. Thank you for the opportunity to review the draft report. Written comments to be reflected in the final report follow.

#### **I. Background**

The Department of Education manages a loan portfolio of over \$90 billion, makes new loans of \$27.5 billion annually, administers a budget of \$71.5 billion, made grants of over \$58 billion last year and operates some 150 programs that ensure equal access to education and promote educational excellence throughout the nation. Although Education has the smallest workforce of the 15 cabinet-level departments (4,366 employees), it manages the third highest annual appropriation of discretionary funds. Education's student loan portfolio is exceeded in total loan volume, education related or otherwise, by only two American banks. Administrative overhead comprises a mere 2 percent of the Department's appropriated funding.

The Department of Education has made significant progress in recent years. In 1998 the Department faced a number of serious challenges including the fact that the Department's independent auditor was unable to express an opinion on our financial statements. The Department failed three consecutive financial audits receiving qualified opinions that featured three material weaknesses and four reportable conditions. Management met these challenges and spearheaded initiatives to correct the problems.

One of the critical steps in the Department of Education's transformation was the implementation of a new accounting system in FY 2002. However the implementation of the new system alone did not resolve the significant challenges the Department had to overcome to get its financial house in order. These challenges included implementing effective processes for reconciling fund balances with Treasury Department records, reconciling feeder systems and the general ledger, and identifying and resolving budget and proprietary account relationship issues. The fundamental processes required to address these issues were ineffective or non-existent.

A major step taken by the Department to address the challenges was to reengineer many of its business processes. In the past, these ineffective processes had created the need for many reconciliations that were not effective or not performed. By reducing the number of transactions

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*Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.*

posted to certain accounts, the Department was able to significantly reduce the effort required to analyze and reconcile those accounts. In addition, the Department assessed the validity of every accounting event and modified the accounting where appropriate.

As part of the reengineering, the Department has performed monthly “flux analyses” for all significant account balances to identify and correct unnatural balances and abnormal activity, with special attention toward correcting systemic problems. In order to ensure that the new monthly analysis and reconciliation processes were effective, a management review process was put in place to monitor the quality of the reconciliations and analysis, and to ensure that issues raised are quickly addressed and that actions taken to resolve the issues are effective. This is accomplished through monthly validation and codification of key statistical and other financial data. These data are then published in the Department’s monthly Executive Fast Facts brief, which gives key executives the ability to make informed management decisions using real-time financial information.

As a result of the processes initiated in FY 2002 and refined in succeeding years, the Department is now able, on a monthly basis, to produce financial statements, reconcile all control and subsidiary accounts and test the budgetary and proprietary account relationships for its over 200 appropriations. Monthly, quarterly and daily financial information is now readily available from the system. In FY 2002 the Department received the first of its three consecutive clean audit opinions with no material weaknesses.

Other major accomplishments include receipt of the President’s Quality Award for Improved Financial Performance Agency-wide for FY 2004; being the first cabinet-level agency and one of only five agencies in FY 2003 to receive a green status on the President’s Management Agenda Score Card for Improved Financial Performance; receipt of Treasury and Risk Management Magazine’s Alexander Hamilton Award for using technology to ensure the effective and timely management of cash assets; being one of the FY 2004 and FY 2003 recipients of the Certificate of Excellence in Accountability Reporting awarded by the Association of Government Accountants for a clearly articulated, comprehensive and integrated report on the financial and performance status of the agency; and submitting FY 2005 financial statements to the independent auditors in twelve calendar days.

## **II. Management Focus and Leadership Approach**

The Department of Education, like many entities, faces the challenge of maximizing organizational capabilities while minimizing the impact of administrative activities on budget resources and ensuring the timely delivery of services and satisfactory program performance. This challenge requires that Department executives set and implement priorities that create the most value to the public. To that end, the Department has elected to undertake numerous major initiatives that address critical needs to ensure integrity and accountability, and enhance the public trust. Several of these initiatives are described below:

- In January 2002, the Department implemented Oracle 11.0.3, which significantly improved financial management functions and allowed the Department to focus on performance data. The project was the first fully integrated, department-wide

implementation of Oracle Financials for a cabinet level agency, and since its start the Department has received three consecutive unqualified audit opinions.

- The Department is implementing the next version of Oracle Federal Financials, also known as Oracle 11i. The Oracle 11i implementation seeks to consolidate the financial management systems of the Department and Federal Student Aid (FSA) by tightening integration between the two current systems, improving the efficiency of the Department's financial systems and operations, validating assumptions and decisions made during the previous implementation, taking advantage of business process reengineering opportunities, and continuing the Department's track record of successful, effective Oracle Federal Financials implementation.
- The Office of the Chief Financial Officer (OCFO) has developed the Executive Fast Facts Information Summary, which is a report designed to provide summary information for managers to use in implementing plans and measuring performance. Executive Fast Facts provides a monthly comprehensive overview of financial and program performance and is used as a tool throughout the Department to measure effectiveness and efficiency of program operations and assist managers in making management decisions. Included in Executive Fast Facts is the monthly Statement of Net Cost, by reporting group.
- The Office of Federal Student Aid created a management report - The Federal Student Aid Executive Dashboard - that is specific to its operations. The Executive Dashboard provides current data on student aid applications, program disbursements, default collections, program performance measures, and system performance. It is provided to all managers weekly and is used at weekly senior officers meetings to track progress and determine if specific actions are required to address identified issues.
- The Department is in the process of a total redesign of our Grants and Administrative Payments System.
- The Department is implementing a new procurement management system.
- The Department is implementing a new web-based travel management system.
- The Department is currently implementing the requirements of OMB Circular A-123. These new requirements involve extensive review, documentation and potential modification of internal controls throughout the Department. This project will require substantial resources and may take several years of effort. Management focus at all levels of the Department will be required to ensure that goals are met and that resources are employed in the most efficient manner.

### III. Specific Areas of Concern

The GAO draft report included comments and recommendations specific to the Department in general and to the Federal Student Aid (FSA) implementation of MCA. Our responses to these comments and recommendations are as follows:

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**GAO Comments:**

- ◆ *“Education Management did not take a leadership role to promote the benefit of cost accounting policies or systems departmentwide, and presently has a cost accounting system in only one of 10 program offices – Federal Student Aid...”*

**Response:** In FY 2005, 61 percent of Education's administrative cost was attributable to FSA and hence was subject to analysis using MCA methodologies. Additionally, in FY 2004, 62 percent of the Department's administrative cost was attributable to FSA and was subject to analysis using MCA methodologies. In sum, although only one of our 10 program offices uses an MCA system, the great majority of our administrative costs were subject to MCA methodologies. The final GAO report should reflect that fact.

- ◆ *“Education does not have a departmentwide managerial cost accounting system, nor does it have managerial cost accounting policies. Education has not demonstrated leadership and commitment to cost accounting concepts throughout the Department.”*

**Response:** While the Department does not have a department-wide managerial cost accounting system, the Department collects data on workload and grants to reflect the full costs of operating our programs. These data, including data on personnel and other administrative costs, are used in internal and external budget documents and in the Department's decision-making.

**GAO Recommendation:** *“...develop and issue a departmentwide policy that focuses on the benefits of MCA...”*

**Response:** We concur in principle with the goal of establishing a department-wide MCA policy. We intend to further MCA efforts in the future. However, at this time we are focusing on competing priorities that have moved ahead of MCA (described in Section II above).

**GAO Recommendation:** *“...develop and issue procedures for monitoring implementation of its departmentwide MCA policy and for establishing a sound system of controls.”*

**Response:** We concur in principle with the objective of establishing procedures for monitoring implementation of a department-wide MCA policy and for establishing a sound system of controls. However, at this time we are focusing on competing priorities that have moved ahead of MCA (described in Section II above).

**GAO Recommendation:** *“To help ensure MCA data reliability, more efficient utilization of FSA's MCA system, and adequate staff knowledge in using FSA's MCA system, we also recommend that the Secretary of Education direct appropriate FSA officials to:*

- ◆ *Document the design of controls that are being used to help ensure the reliability of the nonfinancial data.*
- ◆ *Document the proper completion of these control procedures.”*

**Response:** We agree that it is necessary to continue to further refine and document FSA controls, where appropriate, around the non-financial data used in FSA's ABC (Activity-Based Costing) model. FSA currently has controls over some pieces of the non-financial data applied

in the model. However, these controls need to be reinforced and fully documented after the new ABC software system is procured and implemented.

**GAO Recommendation:**

- ◆ *Provide all appropriate staff direct access to MCA system output information.*

**Response:** We agree that managers or end users of the cost accounting data should have direct access to the data and that the computer model should have reporting capabilities for those users. But implementing that access to the current model, which will be replaced in the near future, would not be cost effective. The new model will offer that access.

**GAO Recommendation:**

- ◆ *Develop adequate training plans for all staff who could effectively utilize information from MCA.*

**Response:** We concur with GAO's recommendations regarding the development of training plans for FSA staff; however, this would not be cost beneficial if applied to the current computer model and ABC environment. As GAO recognizes in the report, FSA is acquiring a new software system to provide end-user reporting and interfaces to other FSA systems. As part of that procurement, FSA will develop a training strategy for FSA staff that could utilize the ABC data. The new system will be end-user friendly, providing managers the direct access to the data they need in managing day-to-day operations.

**GAO Recommendation:** *“We also recommend that the Secretary of Education direct appropriate FSA personnel to perform and document a post implementation review to evaluate whether managerial cost information meets organizational objectives and users’ needs. This review should also determine the extent to which managers use or plan to use cost data in managing day-to-day operations.”*

**Response:** The Department views the ABC model, current and future, as a tool that produces information used to manage, improve delivery and reduce costs in targeted aspects of our business operation. Managers have used information from the current model to derive specific performance measures included in our Five Year Plan. Post-implementation review is an ongoing process for ABC, unlike a one-time system implementation review.

**IV. Conclusion**

The Department of Education takes its fiduciary responsibility to the public and the children of this nation very seriously. As such, it continues to take steps to ensure that its funds are properly managed and reported. Metrics that are key to how well the Department is executing its mission include the ability to provide assurance of sound fiscal practices, adequate internal controls and timely financial reporting.

The Department continues to strive for excellence in financial management, which has been an iterative process. For each of the last four years, the Department has focused its energies and resources on the fundamental building blocks of Financial Reporting, such as data cleanup,

reconciliations, validations of posting models, sub-ledger interface integrity, and accuracy of general ledger data. Now, management's key focus is on furthering the institution of internal controls and strengthening its commitment to the control environment.

In FY 2005, we continued to improve financial reporting and transparency. As part of this effort, our energies are focused on refining and documenting our internal control over financial reporting and assessing our overall internal control framework. In FY 2006, management will be required to provide its assurance to both the external auditors and to OMB that our internal control over financial reporting is adequate and operating effectively. This will provide additional assurance to the President and the American taxpayer.

The Department understands the importance of cost accounting policies and systems. While there are several existing MCA practices and systems in place, further work needs to be done. We intend to further MCA efforts in the future. However, we believe that at present we must remain focused on competing priorities, as mentioned above, that have moved ahead of MCA. We believe that although our current systems need strengthening we have made significant strides in the early stages of MCA implementation. We will continue to explore methods for moving our MCA practices to full implementation in the future.

Sincerely,



Jack Martin

cc: Theresa S. Shaw, COO, Federal Student Aid  
Victoria Bateman, CFO, Federal Student Aid

## Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20020

October 28, 2005

Mr. Jack Warner  
Assistant Director, Financial Management and Assurance  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. Warner:

We are writing to provide our comments on Treasury's portion of the proposed Government Accountability Office (GAO) report entitled, "*Managerial Cost Accounting Practices: Departments of Education, Transportation, and the Treasury.*"

The Department appreciates the need to more fully develop our managerial cost accounting capabilities, as described in the proposed report, and agrees with its recommendations. To the extent possible, however, we would appreciate GAO acknowledging that resource constraints at the Departmental level generally restrict the level of oversight we can provide to bureau activities. It would likewise be beneficial to recognize that significant costs often need to be incurred to install managerial cost accounting systems, and that these costs must be weighed against the projected benefits and competing priorities for shrinking budgetary resources. We do not want the audience for GAO's report to get the impression that the Department does not recognize the importance of addressing its cost accounting needs.

Our specific comments on the proposed report follow:

- The Financial Management Service (FMS) agrees with the GAO recommendation and has already begun the process of developing the necessary FMS Managerial Cost Accounting (MCA) policy and procedures to implement Treasury's MCA policy. FMS plans to publish the MCA policy and procedures in its Manual of Administration by the end of the first quarter of FY 2006. FMS will prepare a corrective action plan with targets and milestones in response to the applicable findings and recommendations identified by GAO.
- The third bullet on page 8 regarding MCA-related internal controls could be expanded to clarify where the strengthened controls are needed.
- Several of the bullets mention specific software vendors by name. We prefer that specific references to vendor names be deleted.
- The Internal Revenue Service (IRS) only recently implemented a cost accounting module as part of its new Integrated Financial System (IFS). The integrated MCA system will provide more detailed and accurate cost information to all levels of the organization. The ability to

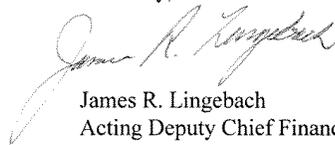
have cost data down to the group level will provide more robust information to facilitate decision-making.

- The third bullet on Page 17 does not accurately reflect IRS' current efforts in relation to MCA. The bullet states that IRS' system only links costs to upper level cost centers. However, the cost module allocates costs to over 13,000 IRS-defined cost centers and includes information on hours worked for each cost center.
- The second bullet on Page 18 that discusses future enhancements to IFS does not accurately reflect the IRS situation and should be clarified. We agree that an integrated work management module would routinely provide a greater level of detail for costing purposes. However, the current system allows IRS to implement an MCA program. Once sufficient data has been collected, IRS will use cost data from IFS with information from other systems, such as performance data, to enhance the quality and detail of data to support decision making.
- IRS expects to issue the final IRS MCA policy by the end of December 2005. The policy will define the roles and responsibilities of IRS business organizations. Once fully implemented, the system, policy, and controls will provide tools to assist managers with decision-making.
- The bullet on page 24 notes that implementation of MCA among Treasury's bureaus is widely disparate. We do not think this is solely the result of our "informal and sporadic" oversight efforts. Rather, in part this is by design, as our policy encourages our bureaus to proceed cautiously in this area and recognizes that our bureaus have widely disparate MCA needs. Of course, we realize that all the bureaus need some level of MCA.

Thank you for the opportunity to respond to this draft GAO report. We appreciate GAO's work in this area and also appreciate the professionalism and thoroughness of the GAO audit team.

If you have any questions or wish to discuss these comments further, please contact me at (202) 622-1450.

Sincerely,



James R. Lingeback  
Acting Deputy Chief Financial Officer

Enclosure IV

## **GAO Contact and Staff Acknowledgments**

### **GAO Contact**

Robert E. Martin (202) 512-6131 or martinr@gao.gov

### **Acknowledgments**

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