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**FINANCIAL
MANAGEMENT**

**USDA Continues to Face
Major Financial
Management Challenges**

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G A O

Accountability * Integrity * Reliability

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss U. S. Department of Agriculture (USDA) financial management issues. Much of my testimony today is an update of our March 2000 testimony on USDA's financial management,¹ which focused on the problems identified in the USDA Inspector General's (IG) audit report on USDA's fiscal year 1999 financial statements.

In February 2000 the IG issued a disclaimer of opinion² on USDA's fiscal year 1999 consolidated financial statements—the sixth disclaimer of opinion in as many years—indicating that the agency has pervasive problems in accounting for its \$118 billion in assets and \$120 billion in budgetary resources provided for fiscal year 1999. Before USDA can achieve financial accountability, it must address a number of issues that we and USDA's Office of Inspector General (IG) have reported as serious problems. Financial accountability is achieved when an agency has strong financial management systems and internal controls that can generate useful, relevant, and reliable day-to-day financial information to support ongoing management and accountability.

My statement will focus on the agency's challenges in achieving financial accountability and complying with key financial management laws and regulations. I will also discuss the corrective actions that USDA and its component agencies have completed or have underway to resolve these problems. Regarding financial accountability, USDA faces significant challenges in four major areas: (1) implementing the Federal Credit Reform Act of 1990 and related accounting standards,³ (2) reconciling its Fund Balance with Treasury accounts, (3) addressing weaknesses in the Forest Service's financial accounting and reporting, and (4) correcting certain other material internal control weaknesses.

¹*Financial Management: USDA Faces Major Financial Management Challenges* (GAO/T-AIMD-00-115, Mar. 21, 2000).

²A disclaimer of opinion means that the auditor is unable to form an opinion on the financial statements. A disclaimer results when a pervasive material uncertainty exists, or there is a significant restriction on the scope of the audit.

³The Federal Accounting Standards Advisory Board (FASAB) developed the accounting standard for credit programs, Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees* (SFFAS No. 2), which became effective beginning in fiscal year 1994. This statement was supplemented by SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, which becomes effective for periods beginning after September 30, 2000.

In brief, USDA continues to face major challenges in correcting severe and long-standing financial management problems and achieving financial accountability. During the last 2 years USDA financial managers have taken these challenges seriously and made a commitment of resources not only to resolve financial management weaknesses that have precluded the agency from receiving an unqualified, or “clean” opinion on its financial statements, but also to begin moving toward a long-term goal of achieving financial accountability. There is one notable exception, however, to our assessment of USDA’s efforts. In August 2000, we reported⁴ that Rural Development (RD), one of USDA’s major component agencies, has made slow progress in improving credit program cost estimates and missed several milestone dates because of a shortage in both the staff and funding resources that are needed to resolve long-standing credit reform weaknesses. Because of this issue, USDA is likely several years away from achieving financial accountability.

Background

Improving financial accountability throughout the federal government has been an area of emphasis since implementation of the Chief Financial Officers (CFO) Act of 1990, which established a CFO structure in 24 major agencies and charged the Office of Management and Budget to provide the necessary financial management leadership and focus. To help instill greater accountability and fix pervasive and costly breakdowns in internal controls, financial statements were required to be prepared and audited, beginning with those for fiscal year 1991, for revolving and trust funds and commercial activities. For 10 agencies—including USDA—audited financial statements were required as part of a pilot program to test this concept for an agency’s entire operations.

Since USDA’s participation in the pilot program in 1991, USDA and several of its component agencies have received a series of unfavorable financial audit reports due to deficiencies in financial reporting that are attributable primarily to weaknesses in the

⁴*Credit Reform: Improving Rural Development’s Credit Program Cost Estimates* (GAO/AIMD-00-286R, Aug. 22, 2000).

agency's financial management systems. USDA's Chief Financial Officer recognizes the seriousness of these problems and has a number of efforts underway to address these issues.

The Government Management Reform Act (GMRA) of 1994 expanded the CFO Act by mandating that (1) major departments and agencies produce annual financial statements subject to independent audit, beginning with those for fiscal year 1996, and (2) the Secretary of the Treasury, in cooperation with the Director of the Office of Management and Budget, prepare financial statements for the U.S. government that are audited by GAO, starting with those for fiscal year 1997.

In addition, the Congress passed the Federal Financial Management Improvement Act (FFMIA) of 1996. FFMIA requires auditors for each of the 24 major departments and agencies named in the CFO Act to report, as part of their audit report on agencies' annual financial statements, whether the agencies' financial management systems comply substantially with three requirements: (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the *U. S. Government Standard General Ledger* (SGL)⁵ at the transaction level. These requirements are critical for ensuring that agency financial management activities are consistently and accurately recorded and promptly and uniformly reported throughout the federal government. Departments and agencies must comply with these requirements in order to maximize their performance and ensure their accountability.

USDA is responsible for a variety of major programs that (1) boost farm production and exports, (2) promote small community and rural development, (3) ensure a safe food supply for the nation, (4) manage natural resources, and (5) improve the nutrition of families and individuals with low incomes. The financial results of these programs are reported in USDA's consolidated financial statements and make up a significant portion of certain components of the consolidated financial statements of the U.S. government. For

⁵The SGL provides a standard chart of accounts and standardized transactions that agencies are to use in all their financial systems.

example, USDA is responsible for managing the nation's largest federal direct loan portfolio, with reported net credit program receivables of about \$70.7 billion as of September 30, 1999. In addition, USDA reported net costs of \$32.7 billion for fiscal year 1999 for its food assistance programs such as the Food Stamp Program and Child Nutrition Programs, which represent a significant portion of income security net cost reported in the U. S. consolidated financial statements.

USDA's fiscal year 1999 audit was conducted by the Office of Inspector General. We reviewed the IG's workpapers between January and February 2000. We conducted our update work for this testimony from September 12 to 25, 2000, in accordance with generally accepted government auditing standards.

Major Accounting and Reporting Deficiencies

USDA faces significant financial management challenges in four major areas: (1) implementing the Federal Credit Reform Act of 1990 and related accounting standards, (2) reconciling its Fund Balance with Treasury accounts, (3) addressing weaknesses in the Forest Service's financial accounting and reporting, and (4) correcting certain other material internal control weaknesses. USDA and its component agencies must resolve these issues to obtain a clean audit opinion and begin to move toward achieving financial accountability. I will briefly discuss the importance of each of these issues and why they represent major challenges to USDA and its component agencies.

Barriers to Implementing Credit Reform

Prior to the implementation of the Federal Credit Reform Act (FCRA) of 1990, credit programs—like most other federal programs—were reported in the budget on a cash basis. Thus, loan guarantees appeared to be free in the budget year, while direct loans appeared to be as expensive as grants. As a result, costs were distorted and credit programs could not be compared meaningfully with other programs and with each other. FCRA and the related accounting standard, together known as credit reform, are intended to more accurately measure the government's costs of federal loan programs and to permit better comparisons both among credit programs and between credit and noncredit programs. As part of implementing credit reform, agencies are required to estimate the

net cost of extending credit, generally referred to as subsidy costs, based on the present value⁶ of estimated net cash flows, excluding administrative costs.

Since 1994,⁷ the IG has reported material weaknesses in the processes and procedures used by USDA's lending agencies to estimate and reestimate loan subsidy costs. In January 1999, we reported⁸ that the agency was unable to make reasonable estimates of the cost of its loan programs because it did not maintain key historical data needed as a basis to estimate future cash flows and that USDA's computer systems were not configured to capture the data needed to make the estimates. USDA's Chief Financial Officer established a task force in March 1999 to assist in resolving the agency's credit reform problems.

Due to the magnitude of RD's credit programs, an unqualified audit opinion on USDA's consolidated financial statements will not be possible without the successful implementation of credit reform. However, as we reported in our March 2000 testimony and again in August 2000, progress in resolving RD's problems in implementing credit reform has been slow because USDA has not provided sufficient resources needed to properly address this problem. We also stated that without sustained top level management commitment and the necessary dedicated staff and funding resources, RD will not be able to improve the quality of its credit program cost estimates in a timely manner. Furthermore, for most of USDA's credit programs, cost estimates based on unreliable data can affect the availability of credit programs to potential borrowers because changes in these estimates can affect the number and amount of loans and guarantees that can be made.

⁶Present value is the worth of a future stream of returns or costs in terms of money paid immediately. In calculating present value, prevailing interest rates provide the basis for converting future amounts into their "money now" equivalents.

⁷1994 was the first year in which agencies were to apply credit reform in their financial reporting, following FASAB's publication of SFFAS No. 2 in July 1993.

⁸*Credit Reform: Key Credit Agencies Had Difficulty Making Reasonable Loan Program Cost Estimates* (GAO/AIMD-99-31, January 29, 1999).

USDA is the largest direct federal lender, with reported credit program receivables of about \$70.7 billion as of September 30, 1999. As these loans are significant to the federal government's financial statements, USDA's inability to make reasonable cost estimates for its loan programs will continue to contribute to our inability to give an opinion on the consolidated financial statements of the U. S. government. This problem also raises questions about the quality of the budget data related to USDA's loan programs since the accounting data under credit reform generally mirror the related budget data. This "mirroring" provides the opportunity to improve the integrity of the budget estimates through the financial statement audit. However, USDA is not in a position to take advantage of this opportunity.

Status of Reconciling Fund Balance With Treasury Accounts

USDA records its budget authority in asset accounts called Fund Balance with Treasury and increases or decreases these accounts as it collects or disburses funds. The Inspector General was unable to fully substantiate the Fund Balance accounts with the U. S. Treasury, which totaled over \$38 billion as of September 30, 1999, because the agency had not reconciled the balance with the amount reported by Treasury. Prior to May 1999, USDA merely adjusted its records to agree with Treasury's without determining which, if either, number was correct, and did not establish or analyze the causes of the differences between its and Treasury's records before reporting its ending balance to Treasury. Since May 1999, USDA discontinued adjusting its records to agree with Treasury's records and began disclosing any differences in its reports to Treasury. Because most assets, liabilities, revenues, and expenses stem from or result in cash transactions, errors in the receipt or disbursement data affect the accuracy of various USDA financial reports, including certain data concerning fiscal year 1999 obligations and outlays that USDA provided for inclusion in the President's Budget.

The Office of the Inspector General first identified unreconciled differences between USDA and Treasury records in its fiscal year 1992 audit. According to the IG, differences in some instances have gone uncorrected for more than 10 years. As of September 30, 1999, the IG reported the unreconciled amount was about \$5 billion. Unreconciled amounts continue to occur because of, among other things, timing differences, missing documentation, input errors, and

the inability of USDA's supporting computerized systems--referred to by USDA as feeder systems--to properly transfer data to the accounting system and/or the accounting system's inability to record transactions in the correct general ledger accounts.

To address the Fund Balance with Treasury reconciliation problem, USDA formed a task force consisting primarily of members representing the Forest Service, the National Finance Center (NFC), USDA's Office of the Chief Financial Officer, and an outside consultant—PricewaterhouseCoopers LLP—to resolve outstanding differences and develop procedures that will prevent this problem from recurring in the future. In addition, the IG and we have monitored this effort for the past year. Until this problem is corrected, the integrity of much of USDA's financial data is questionable.

The IG recently issued a report and a letter to USDA's Chief Financial Officer on the results of its work to monitor USDA's efforts to resolve its Fund Balance with Treasury reconciliation problems.⁹ The report deals with the adequacy of corrective actions taken by USDA to correct its reconciliation problems with its old accounting system. This report concluded that recommendations made by USDA's contractor, PricewaterhouseCoopers LLP, when fully implemented, would resolve this long-standing material weakness. In the letter, however, the IG raised some concerns about USDA's progress in resolving unreconciled balances recorded in the Forest Service's new accounting system, the Foundation Financial Information System (FFIS) implemented on October 1, 1999. This letter stated that the absolute difference between Treasury and the Forest Service general ledger records as of June 2000, was over \$276 million for disbursements, and over \$41 million for collections. This letter also stated that the IG staff had discussed these problems with officials from the USDA's Office of the Chief Financial Officer and the Forest Service who agreed that actions need to be taken and have developed a time-phased plan to address the FFIS cash reconciliation problems.

Forest Service Financial Management Weaknesses

As a major USDA component agency, the Forest Service accounts for a substantial portion of USDA's general property, plant, and

⁹*OCFO Commits to Correct a 10-Year Problem with Its Fund Balance with Treasury Account* (Report No. 11099-14-FM, Sept. 2000) and *FFIS Fund Balance with Treasury* (Letter to the USDA CFO, Sept. 2000).

equipment and almost all of USDA's stewardship land. As of September 30, 1999, the Forest Service reported \$3.1 billion of general property, plant, and equipment—82 percent of USDA's total—and 192 million acres of national forest land and grasslands that the Forest Service holds in stewardship for current and future generations.

Since the first audit of the Forest Service's financial statements, which covered fiscal year 1991, USDA's IG has found serious accounting and financial reporting weaknesses. The IG's February 2000 audit report on the Forest Service's fiscal year 1999 financial statements—a disclaimer of opinion—shows that the agency remained unable to reliably track and report on major assets worth billions of dollars. For example, the IG could not verify the accuracy of the Forest Service's pooled assets, such as roads and trails, valued at \$1.5 billion because the agency lacked sufficient documentation to support their purchase price, date acquired, and related depreciation costs. Furthermore, the independence afforded by the agency's autonomous field structure has hampered efforts to correct accounting and financial reporting weaknesses. These shortcomings mean that the agency and the Congress do not have accurate financial data to track the cost of programs and activities and to help make informed decisions about future funding. They also raise questions about the accuracy of program performance measures and of certain budget data drawn from the same database.

The Forest Service has completed several actions and begun others that, if successfully carried through, represent important steps toward achieving financial accountability. Nevertheless, as we testified in March 2000 and previously in July 1998,¹⁰ major barriers remain, and the Forest Service may need several years to achieve financial accountability. Therefore, in January 1999, we designated the Forest Service's financial management as a high-risk area because of the serious and long-standing accounting and financial reporting weaknesses plaguing its operations. Because of this high-

¹⁰*Forest Service: Financial Management Issues* (GAO/T-AIMD-98-230, July 7, 1998).

risk designation, we have given sustained attention to monitoring the Forest Service's efforts to achieve financial accountability.

Material Internal Control Weaknesses Hamper Accountability

A strong internal control system provides the framework for the accomplishment of management objectives, accurate financial reporting, and compliance with laws and regulations. Effective internal controls serve as checks and balances against undesired actions and, as such, provide reasonable assurance that agencies operate in a safe and sound manner. The lack of good internal controls puts an agency at risk of mismanagement, waste, fraud, and abuse. Furthermore, without strong internal controls, an agency is unable to generate consistent, reliable financial information needed to maintain accountability over its assets on an ongoing basis.

At USDA, several persistent internal control weaknesses contributed to the IG's inability to form an opinion on the agency's fiscal year 1999 consolidated financial statements. Three of these weaknesses—food stamp recipient claims, financial management systems, and accounting for personal property—identified by the IG are discussed below.

Food Stamp Recipient Claims

The IG has reported material internal control weaknesses related to Food and Nutrition Service (FNS) food stamp recipient claims since fiscal year 1991. FNS relies on state agencies to administer the program and collect and report on any overissuance of food stamp benefits. FNS has been working with state agencies to put systems and procedures in place to collect identified overissued food stamp benefits, which were estimated to total \$193 million¹¹ as of September 30, 1999. However, based on a review of the status of state agencies' progress in improving their claim systems, FNS noted that only 24 of the 53 state agencies in June 2000 had claim systems that can report accurate, complete, and supportable information on overissued food stamp benefits and related collections. Of the remaining 29 state agencies, 28 have prepared

¹¹This amount represents USDA's estimate of collectible overissued amounts. However, USDA statistically projected that total overissuance of food stamps could have been as much as \$1.3 billion for fiscal year 1998.

corrective action plans to address reported deficiencies in their systems and only one has not prepared a corrective action plan. FNS has established September 2001 as the deadline for implementation of all corrective action plans. In addition, FNS issued claims regulations in July 2000 that strengthened controls over states' handling of food stamp recipient claims. For example, these regulations created detailed procedures for establishing, processing, and monitoring claims.

While we recognize that these efforts have strengthened controls over recipient claims, additional efforts are needed. FNS must continue to work with state agencies on implementing systems and controls to properly identify and collect overissuances because program funds are lost when claims are not established promptly and pursued vigorously.

Financial Management Systems

Since fiscal year 1997, the IG has reported that USDA's financial systems do not always process and report departmentwide financial information accurately. The IG has reported that many of these systems are not fully integrated with other USDA systems and do not fully comply with federal financial management systems requirements. Among the more serious problems cited by the Inspector General were that USDA

- had a net difference of about \$130 million between its accounting records and the supporting personal property system;
- had a payroll system that contained data dating as far back as 1979 that had not been properly analyzed; and
- lacked controls to ensure that transactions recorded in its old accounting system were accurate and properly authorized.

It is critical that USDA correct these problems by implementing new or revamped systems that are properly designed and implemented to integrate budgetary and cost information with external reporting to provide USDA with the capability to accurately track assets and identify all costs associated with an activity.

USDA's attempts to address this need go back to December 1994 when the Office of the Chief Financial Officer (OCFO) purchased FFIS, a new accounting system, with the goal of replacing the old

Accounting for Personal Property

accounting system USDA-wide. But while USDA has implemented the new system in several component agencies over the past few years, it has experienced delays in agencywide implementation. Current plans call for complete implementation of the system USDA-wide by October 1, 2002. Meanwhile, USDA's CFO has agreed with the IG's recommendation to develop a long-range plan to consolidate, integrate, and/or reengineer the feeder systems.

In its fiscal year 1999 audit report, the IG reported that material internal control problems existed in the accountability and valuation of personal property at agency field offices, headquarters, and the National Finance Center. For example, the IG noted that about 60 percent of approximately 10,000 USDA accountable property officers as of December 7, 1999, were either delinquent in performing physical inventories or had never recorded that an inventory had been taken. In addition, IG staff noted that documentation supporting the purchase price of property was lacking, and numerous errors in the property values were recorded in the system. For example, the staff found a motor vehicle recorded in the system at over \$97 million and a microscope recorded in the system at \$11 million. Until all counts are taken and recorded in the accounting records, USDA does not fully know what assets it has, where they are, and what they are worth. Further, the Congress cannot be assured that USDA requests for additional funds to purchase property and equipment are fully warranted.

USDA Does Not Fully Comply With Certain Key Laws and Regulations

Over the past decade the Congress has passed several important pieces of legislation designed to improve financial accountability in the federal government: the Chief Financial Officers (CFO) Act of 1990, the Government Management Reform Act (GMRA) of 1994, and the Federal Financial Management Improvement Act (FFMIA) of 1996. Generally accepted government auditing standards require auditors to report on whether or not agencies complied with laws and regulations where instances of noncompliance could have a material impact on the agency's financial reporting. Instances of noncompliance include situations in which an agency fails to follow a requirement of a law or regulation or performs an act that is prohibited by a law or regulation. The management of USDA is responsible for complying with laws and regulations that are applicable to the agency. The IG reported some instances in which USDA was noncompliant, including the two discussed below.

First, the IG concluded that USDA had not fully addressed problems related to compliance with the CFO Act. Specifically, the agency had not implemented a fully integrated financial information system. The

current system relies on data from various program and administrative systems throughout the agency in order to prepare USDA's consolidated financial statements. In addition, USDA had not (1) conducted required biennial reviews of the fees, royalties, and other charges imposed by USDA agencies for services and (2) made recommendations on revising those charges to reflect costs incurred by the agencies in providing those services as required by the CFO Act. The IG noted that one agency did not update its user fees for its inspection services for fiscal year 1998 and part of fiscal year 1999. As a result, the agency did not bill for millions of dollars that it was entitled to receive because the fees were not adjusted for salary increases and inflation factors.

Second, the IG noted that some component agencies' financial management systems do not substantially comply with the three requirements of FFMIA. The act requires agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the *Standard General Ledger* at the transaction level. As required by the act, USDA has prepared a remediation plan that includes corrective actions that are scheduled to be completed no later than September 2003.

Status of Efforts to Resolve USDA's Financial Management Problems

To its credit, USDA has achieved some accomplishments this fiscal year in addressing its financial management weaknesses. I would like to highlight the efforts of both USDA and the Forest Service to resolve these problems and work toward financial accountability.

USDA

USDA's 1999 Annual Program Performance Report, issued on March 29, 2000, lists various financial management improvements accomplished by USDA's Office of the Chief Financial Officer. These and other corrective actions identified based on other documents and discussions with USDA's financial managers, follow:

- Increased the number of component agencies receiving an unqualified audit opinion from two to three;

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- Hired a contractor to study USDA's deficient supporting computerized systems--referred to by USDA as feeder systems--to recommend solutions for integrating, consolidating, or reengineering these systems;
 - Implemented USDA's new accounting system in the Risk Management Agency;
 - Substantially increased funding to study and resolve the reconciliation problems with its Fund Balance with Treasury account--as of June 1, 2000, USDA incurred over \$2.8 million dollars, according to the IG, in contract costs, and millions more in direct and indirect personnel costs; and
 - Worked closely with Forest Service financial managers on correcting the Forest Service's financial management problems.

Although USDA has strengthened the involvement of its credit reform steering committee in monitoring the agency's progress, thus far USDA management has been slow in providing the necessary resources to resolve the agency's problems in implementing credit reform.

Forest Service

The Forest Service has completed several corrective actions and begun others that, if successfully carried through, represented important steps toward achieving financial accountability. While the Forest Service has a long way to go to achieve financial accountability, it continues to make progress in addressing its financial management weaknesses. Specifically, the Forest Service has accomplished the following:

- Implemented a new accounting system on October 1, 1999, as scheduled;
- Reorganized and strengthened the Office of Finance at agency headquarters;
- Initiated an assessment of the Forest Service's highly decentralized and autonomous field office financial management structure, with a final report expected this fall;
- Completed and implemented its methodology for valuing road assets with the IG's concurrence;
- Developed 34 financial management performance measures in such areas as debt management and personal property to address weaknesses in financial accountability;

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- Developed and proposed a simplified budget structure for the National Forest System and the Capital Improvement and Maintenance Appropriations;¹²
 - Worked towards addressing problems in reconciling the Fund Balance with Treasury account;
 - Implemented a new concept in October 1999 for charging expenditures based on work performed in addition to a standard set of definitions for indirect costs; and
 - finalized a long-range plan with goals and objectives, timeframes, and measures for attaining financial accountability.

As these accomplishments demonstrate, the Forest Service is making progress in addressing its financial management deficiencies and is on the right track towards financial accountability. However, much work remains, and sustained top management commitment is necessary to ensure that progress continues.

Conclusion

In conclusion, USDA is a large, complex agency with many difficult issues to address before it can be accountable to you, the Congress, and taxpayers for the money provided to carry out its varied missions. Many of the problems are deep rooted and will take time, sustained top management commitment, and substantial resources to correct. Therefore, continued congressional oversight, such as this hearing, are essential to help ensure that USDA focuses adequate attention on resolving its financial management deficiencies.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other Members of the Subcommittee may have.

¹²According to the Forest Service's Office of Finance, the House appropriations subcommittee responded with a variation of the Forest Service's proposal that is expected to be included in the Forest Service's final fiscal year 2001 appropriation.

Contact and Acknowledgements

For information about this statement, please contact McCoy Williams at (202) 512-6906. Individuals making key contributions to this statement included Lou Schuster, Phillip McIntyre, Dan Blair, Carla Lewis, and Maria Zacharias.

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