United States General Accounting Office 131673

GAO

Report to the Secretary of the Treasury

November 1986

INTEGRITY ACT

Treasury's Annual Reporting Needs Improvement

131673

037464

GAO/GGD-87-16

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-216946

November 26, 1986

The Honorable James A. Baker III
Secretary of the Treasury

Dear Mr. Secretary:

This report discusses the inadequacy of Treasury's report on its internal controls under section 2 of the Federal Managers' Financial Integrity Act of 1982. Our report (1) disagrees with Treasury's conclusion that its internal control systems, as a whole, provided reasonable assurance that internal control objectives were achieved and (2) discusses several shortcomings in the presentation of Treasury's report.

The report contains recommendations to you on page 24. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of the report to the Director, Office of Management and Budget, and interested committees of the Congress.

Sincerely yours,

W. J. Anderson

William J. Anderson
Assistant Comptroller General

Executive Summary

Purpose

The Department of the Treasury manages the public debt, collects taxes, and makes millions of payments annually for billions of dollars. Because of the importance of the various systems used to control these functions and safeguard assets, GAO reviewed the accuracy and completeness of Treasury's fiscal year 1985 Integrity Act report on the adequacy of its control systems.

Background

The Federal Managers' Financial Integrity Act (P.L. 97-255) requires executive agencies to evaluate their internal control systems to determine whether the controls comply with standards set by the Comptroller General of the United States and provide reasonable assurance that obligations and costs comply with applicable law; funds, property, and assets are safeguarded; and revenues and expenses are properly accounted for. Under section 2 of the act, agency heads must prepare annual statements to the President and the Congress on whether their internal control systems fully comply with the act's requirements. If the systems do not fully comply, material weaknesses in their systems must be identified, together with plans and schedules for correcting the identified weaknesses.

Results in Brief

GAO believes Treasury's report inaccurately portrayed the adequacy of the agency's internal controls, for two reasons.

- Treasury's fiscal year 1985 report states that, except for material weaknesses in tax processing and automated operations, its internal control systems, as a whole, provided reasonable assurance that internal control objectives were achieved. GAO disagreed with Treasury's overall reasonable assurance conclusion because of the materiality of internal control weaknesses in two of its most important bureaus, the Internal Revenue Service (IRS) and the Financial Management Service, and in two departmentwide functions, automated data processing (ADP) and personal property management. (See pp. 12 to 22.)
- Because the report lacked specificity and was incomplete, it obscured the seriousness of existing weaknesses. (See pp. 22 and 23.)

Principal Findings

Reasonable Assurance Questionable

Treasury's fiscal year 1985 weaknesses were in multi-billion dollar programs and activities crucial to the success of a large part of Treasury's mission. For example, during 1985, IRS processed 178.2 million tax returns which generated net internal revenue collections of $658 billion in fiscal year 1985. Deficiencies in controls caused widespread and well-publicized problems such as untimely processing of returns; issuance of erroneous taxpayer delinquent notices; and an additional $15 million in interest paid by IRS because of delays in issuing tax refunds. (See p. 15.)

Similarly, material weaknesses existed in the Financial Management Service which makes over 700 million payments annually and processes a daily cash flow of $2.7 billion. The Service's Commissioner reported that the Service could not assure that its systems of internal controls fully achieved the objectives of the Integrity Act. The Service identified 171 material weaknesses in 1985, including control weaknesses in the Service's Treasury Financial Communications System which processed $300 billion in fiscal year 1985. (See pp. 15 to 17.)

Weaknesses also existed in Treasury's computer security program required by the Office of Management and Budget (OMB) to safeguard personal, proprietary, and other sensitive data. For example, the Financial Management Service lacked computer security risk analyses of major computer facilities. Also, the Office of the Inspector General reported that 13 of the 16 Office of the Comptroller of the Currency systems were not reviewed and certified as required. Furthermore, other material ADP weaknesses existed in at least 5 of the 13 bureaus. (See pp. 17 to 19.)

Finally, the personal property management material weakness reported in 1983 continues to be a problem. Treasury does not have the departmentwide system it said it needed to manage personal property, valued in the hundreds of millions, and the agency was experiencing other related problems. (See pp. 19 to 22.)

Incomplete Reporting

Treasury's report incompletely portrayed the adequacy of its internal controls and the progress being made in correcting material weaknesses. For example, the report did not mention the conclusion by the Commissioner of the Financial Management Service that the Service could not assure that its systems of internal control fully achieved the objectives of the act. Nor did the report identify any of the Service's 171 material weaknesses. (See pp. 22 and 23.)

Furthermore, although Treasury reported "automated operations" as a material weakness, its report did not identify specific ADP deficiencies or the bureaus in which they existed. Although the reported ADP corrective actions dealt with actions being taken to implement the agency's risk management program, the report did not discuss the weaknesses in the ADP systems themselves and the actions being taken to correct them. (See p. 22.)

Finally, personal property management was not reported as a material weakness and the report did not discuss unresolved problems in warehousing and excess property management which had been reported in the fiscal year 1983 and 1984 Integrity Act reports. (See p. 23.)

Recommendations

GAO recommends that, when preparing Treasury's next Integrity Act report, the Secretary of the Treasury

- give greater recognition to the serious internal control issues in bureau reports, including bureau conclusions that their internal control systems do not provide reasonable assurance that Integrity Act objectives are met;
- report all previously identified material weaknesses in the annual Integrity Act report as material until they are substantially corrected; and
- more specifically describe material weaknesses and the plans and schedules for correcting them. (See p. 24.)

Comments From Treasury

Treasury essentially agreed with GAO's recommendations and said it has corrected or plans to correct the reporting problems GAO identified. For example, Treasury said it is reexamining its reporting processes, the reporting practices of other federal agencies, and relevant OMB guidance. Treasury believes these actions will lead to improved clearance and decision processes as well as to addressing GAO's concerns. (See pp. 24 and 25.)

Treasury also said it did not intend its report to convey that previously identified deficiencies, such as personal property accountability, were substantially corrected. Treasury said its fiscal year 1985 report referred to efforts to improve previously reported weaknesses but that, in hindsight, including this information in the material weaknesses section of the 1985 report may have been more appropriate. (See p. 24.)

Finally, Treasury noted that, in consolidating bureau information, it may have erred on the side of brevity. Treasury said it amended its year-end reporting requirements to comply with recently revised OMB instructions to gain more specificity in agencies' reports. (See p. 24.)

Treasury, however, disagreed that its overall reasonable assurance conclusion was questionable. Treasury believes that it correctly followed OMB guidance in reaching its conclusion. However, given the significance of the weaknesses in internal controls discussed in this report, GAO continues to believe that Treasury's reasonable assurance conclusion was questionable. (See pp. 25, 31, and 32.)

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Abbreviations

ADP	Automatic data processing
FMS	Financial Management Service
GAO	General Accounting Office
IRS	Internal Revenue Service
OMB	Office of Management and Budget

Introduction

The Congress enacted the Federal Managers' Financial Integrity Act (P.L. 97-255) in September 1982, in response to continuing disclosures of fraud, waste, and abuse in many government operations and to concern over the inadequacy of government internal control and accounting systems. The goal of this legislation is to reduce fraud, waste, and abuse and to improve federal management by strengthening internal control and accounting systems. Under the act, agency heads must report to the President and the Congress by December 31 each year (beginning with 1983) whether their systems fully comply with the act. Treasury issued its fiscal year 1985 report on February 25, 1986.

The act has two primary sections. Section 2 requires that agency internal administrative and accounting control systems comply with standards prescribed by the Comptroller General and provide reasonable assurance that certain statutory objectives are achieved. Section 4 provides that agencies report whether their accounting systems conform to accounting principles, standards, and related requirements set by the Comptroller General. This report discusses the accuracy and completeness of the Department of the Treasury's fiscal year 1985 reporting under section 2 of the Integrity Act.

Background

Treasury has diverse and critical duties ranging from (1) formulating domestic and international financial, economic, and tax policy; (2) serving as the financial agent of the government; (3) manufacturing coins and currency; (4) managing the public debt; (5) collecting federal revenues through various taxes; and (6) enforcing laws related to such matters as firearms and explosives, imports and exports, counterfeiting, and tax evasion. Treasury makes an estimated 700 million payments totaling about one trillion dollars annually. Treasury has about 116,000 employees in the following 13 organizations (hereafter referred to as bureaus):

- Bureau of Alcohol, Tobacco and Firearms.
- Bureau of Engraving and Printing.
- Bureau of the Public Debt.
- Federal Law Enforcement Training Center.
- Financial Management Service (FMS).
- Internal Revenue Service (IRS).
- Office of Revenue Sharing.
- Office of the Comptroller of the Currency.
- Office of the Secretary.
- U.S. Customs Service.

- U.S. Mint.
- U.S. Savings Bonds Division.
- U.S. Secret Service.

Objective, Scope, and Methodology

Our objective was to analyze Treasury's fiscal year 1985 Integrity Act report for accuracy and completeness. To identify reported and unreported material weaknesses and the status of corrective actions, we reviewed Treasury's 1983, 1984, and 1985 Integrity Act reports and each of the 13 bureau's letters sent to the Secretary of the Treasury summarizing the results of the bureau's internal control evaluation for those years; Office of Inspector General audits of Treasury's Integrity Act implementation; and Inspector General and our reports in related areas. We interviewed Treasury headquarters officials in automatic data processing (ADP); property management; the Office of Inspector General; IRS; Customs Service; Secret Service; Office of the Secretary; and the Office of Management and Organization within the Office of the Assistant Secretary of the Treasury for Management, which was responsible for implementing the Integrity Act.

In assessing Treasury's report, particularly its conclusion that, as a whole, Treasury's internal control systems provided reasonable assurance that internal control objectives were achieved, except for material weaknesses in ADP controls and IRS tax processing, we considered the following criteria: (1) the significance of weaknesses disclosed and (2) the status of corrective actions. In examining Treasury's control weaknesses, we also considered whether the material weaknesses existed in systems central to Treasury's operations and whether planned corrective actions had been completed for previously reported material weaknesses. These criteria are consistent with the Office of Management and Budget's (OMB) October 23, 1985, guidance to agencies, which directs agency heads to consider all available information in reaching an overall conclusion whether the objectives of internal controls were achieved for the agency as a whole. OMB specified that this information include the seriousness of existing weaknesses, assurances given by agency officials that the control systems are working as intended, and system improvements made in recent years.

We did not review the process by which Treasury implemented the act. For example, we did not review the extent or quality of Treasury's vulnerability assessments or internal control reviews. Nor did we look at the extent to which Treasury's control systems complied with the Comptroller General's principles and standards. The review was performed between January 1986 and May 1986 according to generally accepted government auditing standards.

Treasury's Reporting on Internal Controls Was Less Than Satisfactory

OMB and our office have provided reporting guidelines to agencies to assist them in determining whether their internal control systems meet the Integrity Act's objectives. After considering these guidelines, we believe Treasury's portrayal of the adequacy of its internal controls was less than satisfactory, for two reasons. The report's reasonable assurance conclusion was questionable given the scope and materiality of existing weaknesses, and the report's lack of specificity and completeness obscured the seriousness of existing problems.

Basis for Questioning Treasury's Reporting

The Integrity Act requires that agency heads prepare annual reports to the President and the Congress on whether their internal control systems fully comply with the act's requirements. The act requires that the systems be established according to standards the Comptroller General prescribes and that the systems provide reasonable assurance that

- obligations and costs comply with applicable law;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- agency revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

If the agency head reports that internal control systems do not fully comply with the act's requirements, the annual report must identify any material weaknesses in the systems and describe plans and schedules for corrective action.

OMB and our office have provided additional guidance for agencies to consider in reporting on internal controls under the Integrity Act. Among this guidance are OMB's October 23, 1985, memorandum to agencies on reporting on internal controls and our second governmentwide report on the Integrity Act.[1] Both provided information to help agencies identify material weaknesses and to help them determine whether their internal control systems provide reasonable assurance that the act's objectives have been met.

OMB and our guidance on identifying material weaknesses conveyed substantially the same message. OMB emphasized that candor in reporting material weaknesses to agency management and in reporting them to

[1] Financial Integrity Act: The Government Faces Serious Internal Control and Accounting Systems Problems (GAO/AFMD-86-14, Dec. 23, 1985), pp. 37-39 and 64.

the President and the Congress is of utmost importance. OMB agreed with the House Committee on Government Operations' advice to include as material weaknesses those matters that could:

"- Impair fulfillment of the agency's mission;
- Deprive the public of needed government services;
- Violate statutory or regulatory requirements; or
- Result in a conflict of interest."[2]

Our guidance is consistent with the items above and defines two additional matters as material weaknesses:

- A problem which warrants the personal attention or awareness of the agency head or high management.
- Adverse publicity or embarrassment to the agency which would diminish credibility or reputation.

With respect to determining reasonable assurance, OMB said agency heads should consider all available information in reaching their overall conclusion, including:

"—Internal control evaluations;
—Audits by the Inspector General, GAO, and others;
—Internal reviews, inspections, management studies, etc., made by agency staff or contractors to assess operations;
—The control system weaknesses found, corrected, or being corrected;
—Seriousness of the existing weaknesses and extent that the control systems are believed to be working as intended;
—The assurances given by agency officials that the control systems are working as intended; and
—The system improvements made in recent years."[3]

Our report elaborated on two points OMB listed above. Agencies should consider among other things, the significance of the weaknesses disclosed. If systems central to agency operation have material weaknesses, the agency should not state that it has reasonable assurance for its systems, taken as a whole. Another consideration is the status of corrective actions. The needed evaluations and corrective actions may take several years to complete. An agency may be making good progress toward that goal, but may not yet be at a point where reasonable assurance can be

[2]"Financial Integrity Act Reports," memorandum for heads of executive departments and agencies, Office of Management and Budget, Oct. 23, 1985.

[3]"Financial Integrity Act Reports," OMB, Oct. 23, 1985.

provided. While full disclosure of material weaknesses and planned corrective actions are important, they do not by themselves provide the justification for an agency to conclude that its internal control systems, taken as a whole, meet the act's objectives.

The House Committee on Government Operations provided additional clarification on the concepts of reasonable assurance and material weakness.[4] Although this commentary was made in August 1986, after agencies' fiscal year 1985 reports were issued, it illustrates the importance to the Congress of accurate and clear reporting. Therefore, we have included some of the Committee's comments here.

Regarding reasonable assurance:

"Most agencies cannot, and should not, claim to have reasonable assurance without qualification because of the many material weaknesses at those agencies. The 'taken as a whole' formula becomes meaningless when it is known that major material weaknesses exist within agency components including administrative, financial, and program offices. Agencies, however, can have and report reasonable assurance about some systems and not others. Included in the others would be systems that fail to meet testing requirements or which have not yet been tested and examined in detail. It is also important to put both categories of systems in perspective by reporting what amount of outlays of the total annual budget are represented by both categories. This fuller disclosure will put the President and the Congress in the position of knowing how an agency is doing 'as a whole.'"

Regarding material weaknesses:

"Agencies seem to be reporting only matters which they determine to be significant to the President and the Congress. They are doing this in response to OMB's guidelines which call for a 'senior official' to determine whether any of the material weaknesses reported by agency managers warrant reporting to the President and the Congress. . . .

"The committee believes that if a problem is significant to a program or individual agency component, it should be considered a major problem for the department or agency, and should be reported. . . .

"The committee believes that full and clear disclosure of material weaknesses by the agencies is essential to achieve the improved internal controls throughout the executive branch anticipated by the Act. The committee also believes that material weaknesses for which corrective actions were begun, or are in progress, should be included in reports even though those material weaknesses were first identified in a previous report."

[4]Implementing The Federal Managers' Financial Integrity Act—Three Years Later, forty-second report by the House Committee on Government Operations (H.R. 99-744) Aug. 5, 1986, pp. 12-17.

Treasury's Reasonable Assurance Conclusion Was Questionable

Treasury reported in fiscal year 1985 that its internal control systems, as a whole, provided reasonable assurance that internal control objectives were achieved, except for material weaknesses in tax processing and automated operations. The scope and magnitude of Treasury's material weaknesses make Treasury's reasonable assurance conclusion questionable.

Material Weaknesses Exist in Systems Central to Treasury's Operations

Material weaknesses exist in multi-billion dollar programs and activities crucial to the success of much of Treasury's mission. These include two major Treasury bureaus—IRS and the Financial Management Service—and two departmentwide functions—ADP and personal property management.

Tax Processing Material Weakness

Treasury reported IRS tax return and document processing as a material weakness in 1985. IRS is, by far, the largest Treasury bureau, and tax return and document processing is, in essence, a major mission of IRS. During the 1985 filing season, IRS processed 178.2 million returns which generated net internal revenue collections of $658 billion. The number of returns filed in the 1986 tax season is expected to increase to 185 million.

The well-publicized weaknesses that existed in 1985 created a situation in which inefficiency and costs to the government grew. For example, IRS' 10 service centers did not process tax returns promptly, had difficulty controlling the flow of tax returns moving through the processing system, and had difficulty keeping nonreturn case inventories at a manageable level. As a result, problems arose, including the following:

- More refunds were delayed in 1985 than in the past, and interest payments totaled $42.8 million—a 56 percent increase over the $27.3 million paid in 1984.
- Overtime costs increased.
- Many taxpayers had to file duplicate returns.
- Numerous erroneous taxpayer notices were issued.
- Correspondence and other inventories grew.
- Telephone calls from taxpayers increased.
- Productivity of service center personnel decreased.

Material Financial Management Service Weaknesses

Numerous, serious internal control weaknesses in the Financial Management Service were identified by FMS itself, Treasury's Inspector General, and our office in fiscal year 1985. The FMS Commissioner also concluded in fiscal year 1985 that FMS did not have reasonable assurance that FMS' internal controls met the objectives of the act. FMS is a bureau central to Treasury's operations, and potential losses due to weak controls could run in the millions and impair Treasury's ability to fulfill its fiscal obligations.

FMS is responsible for the government's central fiscal operations. It issues over 700 million payments annually and processes a daily cash flow of about $2.7 billion. FMS processes claims on lost, stolen, and forged checks; provides accounting services for the government, including maintenance of the central accounts concerning appropriations, receipts, and expenditures for the government as a whole; provides checking account facilities to government disbursing officers; and compiles and publishes financial reports.

In complying with the Integrity Act, FMS identified 171 material weaknesses in fiscal year 1985. These ranged from weak theft controls for negotiable returned checks, to lack of monthly reconciliation of trust and deposit funds, to unresolved audit findings, to lack of security check procedures for contractor employees. A total of 450 weaknesses were identified during fiscal years 1984 to 1985, including 195 material weaknesses.

The FMS Commissioner reported to the Secretary of the Treasury that, although FMS had made progress toward improved controls, FMS could not assure that the Integrity Act's objectives had been fully achieved in fiscal year 1985. FMS reported particular concerns about automated operations related to (1) the Treasury Financial Communications System, (2) controls over capital assets, (3) the quality assurance function not being operational, and (4) computer security risk analyses not being done at major FMS facilities and software not being properly certified.

Treasury's Inspector General reported in July 1985 that, since 1982, FMS had not "institutionalized the concept of adequate security to protect its sensitive data bases and has not committed sufficient resources to combat fraud, waste and abuse." In December 1985, the Inspector General reported that FMS could not assure that the objectives of its systems of internal control had been fully achieved in fiscal year 1985 because of continuing problems in automated operations. Security risk analyses had not been done at major FMS computer facilities, and software applications had not been certified as required.

We reported in September 1985[5] and testified before the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, in March 1986 that the Treasury Financial Communications System, which processed $300 billion in transactions in fiscal year 1985, did not have controls adequate to prevent unauthorized payments from being made or to ensure proper accounting for all payments. For example:

- Unauthorized Treasury personnel could make improper payments at one of two financial centers examined, and Treasury did not have controls to prevent a similar occurrence at other centers.
- FMS had no controls to prevent duplicate payments.
- Erroneous payment data could be entered into the system because of weaknesses in procedures for ensuring the accuracy of payment information.

Material ADP Weaknesses

Material weaknesses existed in ADP internal controls and information systems security programs in fiscal year 1985. Treasury had over 305 operational ADP systems and subsystems identified in its fiscal year 1984 long-range ADP plan. ADP procurement in fiscal year 1984 was about $72 million. Many Treasury functions and bureaus depend upon these computer systems to fulfill their mission, or their operations would be seriously impaired without them.

Both IRS and FMS reported material weaknesses in their implementation of Treasury's risk management program. This is a program required by OMB to ensure the security of sensitive agency ADP systems, facilities, and data.[6] These weaknesses and examples of other problems with Treasury's risk management program include the following:

- IRS reported as a material weakness in fiscal year 1985 that it did not comply with OMB Circular A-71. We confirmed IRS' concerns,[7] reporting that the lack of tested, certified contingency plans and the failure to

[5]Improved Controls Needed in the Treasury Financial Communications System (Official Use Only) (GAO/AFMD-85-40, Sept. 30, 1985).

[6]Required by OMB Circular A-71, Transmittal Memorandum No. 1, Security of Federal Automated Information Systems, which was superseded by OMB Circular A-130, Management of Federal Information Resources, in December 1985. The new circular did not change the requirements in A-71 for ADP contingency plans and periodic risk analyses.

[7]Computer Security: Contingency Plans and Risk Analyses Needed for IRS Computer Centers (GAO/IMTEC-86-10, Mar. 27, 1986), p. 8.

conduct periodic risk analyses were significant control weaknesses, because of IRS' heavy dependence on ADP support to achieve its mission. To illustrate this dependence, IRS has over 40 large computer systems in 10 service centers and the National Computer Center that process millions of tax returns. IRS spends about 25 percent of its operating budget on ADP support.

- Due to budget constraints, IRS believed the risk analyses of major data processing centers scheduled for completion in September 1987 would be delayed.
- FMS reported as a material weakness in fiscal year 1985 that the Commissioner's security policy directive was not fully implemented, that most of its ADP security officers were unfamiliar with their roles during risk analysis, and that it did not maintain a priority security review schedule to ensure that periodic risk analyses were made.
- The Office of the Inspector General in September 1985 expressed concern that 13 of 16 Comptroller of the Currency systems would not be reviewed and certified by the end of fiscal year 1986.
- A Treasury directive requires that a central repository of completed risk analyses be maintained. However, Treasury was unable to provide us a list of completed risk analyses until May 1986—4 months after we requested the list.
- Treasury's risk management program provided primarily for a review of some, but not all, general controls, such as physical security. It should also provide for reviewing controls affecting sensitive data and systems integrity to ensure compliance with OMB A-71. As of October 1986, the directive concerning the program was being revised.
- Treasury had designated risk management program responsibility to both the Office of the Inspector General and the Office of Telecommunication Management, rather than to one focal point as OMB requires. As of October 1986, Treasury policy was being revised to relieve the Inspector General of program responsibility.

Several bureaus reported 1985 material ADP weaknesses in areas other than implementing the risk management program. For example, Customs Service reported deficiencies in ADP communications, information, and physical security; lack of procedures to ensure the accuracy of data entered into the southeast region's ACCEPT system, which could result in improper inspection of merchandise; and inadequate criteria in the automated Cargo Selectivity module in the Automated Commercial System.

Public Debt reported that the Master File Compare Exception Report contained errors, requiring 49 days to resolve the bad format. Eight pages of outstanding exceptions on the report included items over a year old.

FMS reported, among other weaknesses, that the ADP procurement process and systems development methodology lacked sufficient security considerations; software storage/documentation at the Kansas City Regional Finance Center was inadequate; responsibility for system acceptance testing was not assigned to parties independent of the development process; procedures to ensure that contractor employees had required security checks were not complied with; and the systems acceptance testing plan omitted audit tests and regression tests, which detect adverse impacts on other systems.

The Office of the Comptroller of the Currency reported that an unauthorized user could access and alter the office's automated data base; disaster/contingency plans for automation were inadequate; automated systems documentation was inadequate; and formal safeguards over microcomputers used by field examiners were lacking.

In all, Treasury's major bureaus reported 58 ADP material weaknesses in fiscal years 1983 to 1985. About half of the related 99 planned corrective actions had been completed.

Personal Property Management Weakness Is Material

In its fiscal year 1983 Integrity Act report, Treasury identified personal property management as a material weakness. Treasury is responsible for hundreds of thousands of personal property items which in 1984 were valued at over $700 million. Treasury reported that the lack of standardized, centralized information had limited its ability to exercise desired control and to make proper planning and budgeting decisions. In addition, the department appeared to have duplicate warehousing operations and, at the same time, was experiencing shortages in available space to store excess property awaiting transfer to the General Services Administration for disposal. Treasury reported that a departmentwide review of warehousing in the Washington, D.C., area was underway to determine whether its warehousing configuration was optimal in terms of preventing waste of government resources.

Although Treasury has taken actions since 1983 to implement its two departmentwide personal property management initiatives, the basic problems reported in 1983 continue uncorrected. A uniform property management system is not in place and will not be for a few years; a pilot, consolidated warehouse had not been tested and will not be in place until the spring of 1987, at the earliest; and excess property storage problems continue.

IRS' Capitalized Assets Management System, which was newly developed to improve IRS' property management, was selected in 1984 as the best property management system to convert into a departmental system. As of February 1986, however, IRS anticipated that it would not complete its entry of inventory information into its Capitalized Asset Management System until September 1986. Treasury plans to do this before the IRS system is converted to the departmental property management system. In addition, as of April 1986, Treasury management had not funded the conversion of the IRS system software to departmental system software. Software conversion will take about 18 months after the funding decision. Thus, 1988 is the earliest a departmental system might be available.

Regarding duplicative warehousing, five bureaus in the Washington, D.C., area operate their warehouses independently. A Treasury official described them as outdated, understaffed, and inefficient. Two studies, done in July and December 1984, recommended consolidating warehousing for these bureaus. The more recent study suggested that consolidating warehousing in other regions had enormous potential for cost savings and management efficiencies.

Since the recommendations in 1984, price quotes to operate a consolidated warehouse have been requested. Treasury will review the cost estimates to determine if a state-of-the-art consolidated warehouse would be more economical than the current manual operations. Although no milestones for implementing a pilot warehouse have been set, pending the decision to fund the warehouse, a Treasury official estimated that the pilot's earliest operational date would be in the spring of 1987.

Regarding excess property storage, a Treasury official said bureaus' automation of their individual property management systems and the pending implementation of the departmental property management system will facilitate proper identification of excess property and property transfers among bureaus. This, in turn, should ease the amount of excessed property. This is important because of the shortage of excess property storage space at Treasury and the General Services Administration.

Despite these efforts, the storage shortage is getting worse, according to a Treasury official, due to factors beyond Treasury's control. These included (1) OMB's requirement to reduce space, including offices and warehouses, by 10 percent Treasury-wide each year from 1985 to 1988; (2) the consolidation of General Services Administration's 17 Washington, D.C., area disposal centers into 1 center by June 1986, causing agencies to require a larger inventory of storage space than in the past; and (3) delays in General Services Administration's permission to dispose of some excess property, such as vehicles and ADP equipment.

Personal property material weaknesses continued in the bureaus in areas other than the need for a uniform property management system or warehouse consolidation. Since fiscal year 1983, the bureaus reported 77 personal property weaknesses and identified 121 corrective actions to resolve those weaknesses. A little over half of the actions were completed.

Examples of other personal property material weaknesses the bureaus reported in fiscal year 1985 included:

- Inadequate internal controls over Customs Service's seized property. Customs seized over $645 million in nondrug seized property in 1985.
- Receipt and release of securities without appropriate authorization at the Bureau of the Public Debt.
- Inadequate security over checks held in FMS' Birmingham center's staging area before mailing.
- Accessibility of U.S. Mint die blanks to employees.

We grouped the bureaus' personal property weaknesses according to the Comptroller General's standards for internal control. They fell into the following categories: (1) physical security or custody of items; (2) documentation or accounting for receipt, storage, transfer, or disposal of personal property; (3) inventory or reconciliation; (4) separation of duties; and (5) supervisory procedures or accountability. Three bureaus reported no personal property weaknesses—the Secret Service, Bureau of Engraving and Printing, and the Office of Revenue Sharing. The number of bureaus with weaknesses in the areas above, as well as the number of weaknesses at least partially corrected, are shown in table 2.1.

Table 2.1: Categories of Bureau Personal Property Weaknesses

Category	Number of bureaus reporting weaknesses in this area	Number of weaknesses	Number and percent of weaknesses at least partially corrected: Number	Percent
1. Physical security inadequate	7	26	13	50
2. Documentation inadequate	9	29	21	72
3. Inventory inadequate	7	14	6	43
4. Separation of duties absent	1	3	2	67
5. Supervision inadequate	3	6	4	67
Total		**78[a]**	**46**	**59**

[a]One weakness was divided for purposes of this schedule.

Reporting of Material Weaknesses and Corrective Actions Lacked Specificity and Was Incomplete

Treasury's fiscal year 1985 report obscured the seriousness of existing problems. The magnitude of the weaknesses and plans and schedules of corrective actions were not addressed in some cases or only partially or inaccurately addressed in some cases.

Treasury reported that "Treasury's systems of internal control, as a whole, provided reasonable assurance internal control objectives were achieved, except for material weaknesses and deviations defined in Enclosure 2." Enclosure 2 presented two areas of material weaknesses: "deficiencies in ADP internal controls" and "deficiencies within systems of internal control in those assessable units dealing with Returns and Documents Processing." These descriptions omitted important information and were too general for the reader to know what was wrong, where the deficiencies were, or their expected duration.

For example, the report made no mention of the FMS Commissioner's conclusion that FMS could not assure that its systems of internal control fully achieved the objectives of the Integrity Act nor did the report identify or discuss any of the 171 material weaknesses FMS identified in 1985. (See p. 16.)

Treasury officials said that the FMS weaknesses were covered under the ADP weakness. However, this coverage was not evident in the report. Although Treasury reported "automated operations" as a material weakness, its report did not identify specific ADP deficiencies nor the bureaus in which they existed. In addition, the reported ADP corrective actions described what was being done to implement Treasury's risk management program. The report did not address the fundamental weaknesses or deficiencies in ADP controls and systems reported in fiscal years 1983 to 1985. Therefore, the report did not provide the reader with a basis to know that (1) the FMS weaknesses existed, (2) were associated with the ADP material weakness, and (3) were serious enough for the Commissioner to conclude that the Service could not assure that its systems fully achieved the Integrity Act's objectives.

Also, the report did not present personal property management as a continuing material weakness, and it omitted discussion of unresolved problems reported in prior Integrity Act reports. Although the fiscal year 1985 report stated that "positive steps are being directed toward correcting existing deficiencies," it also said "specific actions taken . . . include . . . establishment of automated inventory and accountability systems. . . ." This implies that action was completed. However, as discussed on page 20, neither the IRS nor the departmental system was operational as of April 1986. Furthermore, the earliest availability of the departmental system would be 1988. Also omitted was any reference to continuing problems in developing a pilot, consolidated warehouse and the excess property concerns mentioned as part of the fiscal year 1983 report.

Treasury officials said that the personal property weakness was covered in the narrative accompanying the report. The report discussed some personal property management corrective actions in enclosure 1, entitled "Department of the Treasury Description of the FY 1985 Internal Control Process." However, enclosure 2, which listed Treasury's material weaknesses, did not include personal property. This makes it unlikely that the reader would conclude that personal property management was a material weakness.

Treasury's report discussed some corrective actions for the ADP, IRS, and personal property weaknesses. These discussions were in general terms, and no projected completion dates were given, although the Integrity Act requires plans and schedules for correcting material weaknesses to be reported. Because the weaknesses were also described in general terms, the sufficiency of the actions to correct the problems could not be gauged from the report.

Conclusion

Treasury's fiscal year 1985 report inaccurately portrayed the adequacy of its internal control systems because (1) the scope and magnitude of existing weaknesses make Treasury's overall reasonable assurance conclusion questionable and (2) the magnitude of the existing weaknesses was not apparent.

Recommendations

We recommend that, when preparing Treasury's next Integrity Act report, the Secretary of the Treasury

- give greater consideration to the serious internal control issues in bureau reports, including bureau conclusions that their internal control systems do not provide reasonable assurance that Integrity Act objectives are met;
- report all previously identified material weaknesses in the annual Integrity Act report as material until they are substantially corrected; and
- more specifically describe material weaknesses and the plans and schedules for correcting them.

Comments From Treasury and Our Evaluation

In commenting on our report (see app. I), Treasury essentially agreed with our recommendations and has agreed to take or has taken actions to correct the reporting problems we identified. For example, Treasury said that:

- It is reexamining its reporting processes, the reporting practices of other federal agencies, and relevant OMB guidance. Treasury believes these actions will lead to improvements in its clearance and decision processes in addition to addressing our concerns. (See pp. 29 and 30.)
- It has and will continue to report material weaknesses until they are substantially corrected. Treasury did not intend for its report to convey that previously identified deficiencies, such as personal property accountability, were substantially corrected. Its Integrity Act report referred to the efforts being taken to improve the weaknesses reported in Treasury's earlier reports, but, in hindsight, it may have been more appropriate to have included this information in the material weaknesses section of the 1985 report. (See p. 29.)
- It was not Treasury's intent to prepare a report which obscured the seriousness of existing problems. In consolidating the information received from the bureaus, Treasury may have erred on the side of brevity. Treasury has amended its year-end reporting requirements to comply with OMB instructions which were recently revised to provide for more specificity in agencies' reports. Treasury anticipates that the new OMB requirements and Treasury's greater specificity in reporting material

weaknesses, along with the plans and schedules for correcting them, will satisfy the objections we raised. (See pp. 28 to 30.)

While agreeing with our recommendations, Treasury disagreed that its overall reasonable assurance conclusion was questionable, and it said that bureau assessments were adequately considered when its fiscal year 1985 Integrity Act report was prepared. We support Treasury's efforts to take the corrective actions contained in its comments. However, we continue to believe that Treasury's overall assurance conclusion was questionable, and we disagree that Treasury adequately considered bureau assurance reports in reaching its conclusion, for the reasons discussed on pages 12 to 22. See pages 31 and 32 for additional comments.

Because Treasury's comments were lengthy, this report does not include the enclosure, which primarily restates (1) departmental and bureau material weaknesses we reported and (2) subsequent actions designed to correct those weaknesses. A copy of the enclosure is available from us upon request.

Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

September 26, 1986

Dear Mr. Anderson:

This letter responds to your request of August 28, 1986 for our review and comments on the General Accounting Office's (GAO) Draft Report, "Integrity Act: Treasury's Annual Reporting Needs Improvement." We appreciate the opportunity to comment on the draft report's findings, conclusions, and recommendations. The GAO's suggestions for improving the format and contents of the report will receive serious consideration by the Treasury and, where necessary, appropriate measures will be taken to ensure future reports more fully depict the status of internal controls within the Department.

Following are general comments on the GAO report. The enclosure provides detailed responses on each point made by GAO.

<u>REPORT SETTING</u>

Instituting and maintaining a sound system of internal controls is one of the highest priorities within the Treasury. The Department requires its managers to effectively evaluate and identify deficiencies in controls and to take actions immediately to correct them. Where deficiencies continue to exist in systems of internal control, Treasury expects full disclosure by managers in order to ensure reasonable action is being taken to remedy the deficiencies.

See comment 1.

To ensure corrective actions are taken on reported deficiencies, the Department and the bureaus use monitoring and reporting systems to track the progress being made by managers to correct deficiencies. Both the Financial Management Service (FMS) and the Internal Revenue Service (IRS) have recently reported significant improvements in those operations which were the subject of concern in the GAO draft report.

For example, the IRS has revised procedures and programs for monitoring tax returns processing. This contributed to the successful 1986 filing season. IRS also completed risk analyses of seven service centers, the data center in Detroit, and the National Service Center.

Similarly, FMS is making progress in upgrading the quality assurance and security programs of the Service's information

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systems. Specific actions have been taken to implement ADP controls in Disbursing Centers. Regarding FMS's Risk Management Program, security guidelines and standards are about 70% complete.

REASONABLE ASSURANCE QUESTIONABLE

See comment 2.

GAO takes issue with Treasury's FY 1985 assurance statement that the Department's systems of internal control met the objectives of the Federal Managers' Financial Integrity Act (FMFIA). GAO believes that the scope and seriousness of weaknesses reported by the Internal Revenue Service and the Financial Management Service make Treasury's judgement questionable. Treasury disagrees.

See comment 3.

Because of the differences of opinion between GAO and OMB, Treasury, among other agencies, has experienced difficulty in reaching a judgement on the issue of reasonable assurance that would gain the approval of both of these agencies. Thus, Treasury has adhered to the reporting requirements outlined by the OMB Internal Control Guidelines and other instructions it has received from the OMB in developing its assurance statement and report to the President and the Congress.

For example, OMB has not established minimum evaluation criteria for agencies to achieve before reasonable assurance statements can be written. OMB's approach has been to require that "all information available to agency management be considered in making the reasonable assurance determination for use in the year-end statement." Following this instruction, the Department considered the reports and assurance statements received from Treasury bureaus, the annual audits conducted by the Inspector General, analyses conducted by Departmental Offices, and other counsel before determining reasonable assurance.

See comment 4.

Although the Financial Management Service did not provide reasonable assurance, the remaining organizations, except for the Departmental Offices which provided limited assurance, furnished the Secretary with reasonable assurance that systems of internal control met FMFIA objectives. The Internal Revenue Service was among those reporting reasonable assurance.

See comment 5.

The Inspector General, in his FY 1985 audit report to the Secretary, said that "in our opinion, the processes used by the Department to evaluate, improve, and report on its internal control and financial management/accounting systems were generally in accordance with the Act, the Circulars, and the Guidelines." These factors and the knowledge that significant corrective actions were being undertaken by IRS

See comment 6.

and FMS to correct identified material weaknesses were influential in the Department's decision to provide the President and the Congress with a positive statement on the status of Treasury's system of internal control.

In retrospect, our decision to provide reasonable assurance was an appropriate one, based upon the information that was available to the Department at the time. However, because of the dialogue with GAO on this issue, we are re-examining our existing reporting processes. We are also examining the reporting practices of other Federal agencies and reviewing guidance from representatives of the Financial Integrity Task Force at OMB. We believe these actions will lead to improvements in our clearance and decision processes during future reporting periods in addition to addressing GAO concerns.

Discussed on pps. 24 and 25.

LACK OF SPECIFICITY IN REPORTING

GAO also alleges that the report obscured the seriousness of existing problems. Clearly, this was not Treasury's intent.

Treasury endeavored to present a succinct and readable report to the President and the Congress. The report made explicit those facts which we believed provided the President and the Congress with a meaningful understanding of the Department's internal control improvement process.

To accomplish this, the Department consolidated the information it received on the internal control process from the bureaus into a single Departmental document for submission to the President and the Congress. Similarly, bureau reports were summaries of regional office or district office reports. For example, the deficiencies reported by the IRS in several service centers were summarized and reported to the Department as a bureau-wide material weakness. On the other hand, the deficiencies in ADP internal controls in FMS and other Treasury bureaus were reported to the President and the Congress as a Department-wide material weakness. Our approach, which has a decreasing level of detail in reporting as information is passed upward through the decision making hierarchy, avoids unnecessary paperwork for managers, unwieldy record-keeping, and a cumbersome review process for policy-makers.

Treasury in no way tried to obscure the internal control situation at Treasury. GAO and OMB have access to all of the Department's detailed information on internal controls. For example, we have made policy directives, handbooks, Department and bureau internal control reports, and other information available to both of these agencies. This increased level of detail is clearly available upon request, but is too voluminous to be useful for a report to the President and the Congress.

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In preparing our report on internal controls, we may have erred on the side of brevity, but we attempted to approach the report from a management perspective. The Department expends significant resources in preparing the annual report. For example, in FY 1984, the year data was collected on this issue, it was estimated that in preparing the report, both at the bureau and Department levels, a total of 794 pages of text were produced in 75 separate locations at a cost of 489 staff days.

RECOMMENDATIONS

GAO makes several recommendations in its draft report, including giving greater recognition to bureau internal control issues, reporting on previously identified material weaknesses, and providing more specific information on material weaknesses in systems of internal control.

With regard to the first two recommendations, we believe we have taken bureau assessments of internal control issues and processes into consideration when making judgements on the status of internal controls within the Department. We, therefore, have no objection to GAO's recommendation. In addition, we have and will continue to identify material weaknesses in the annual report until they are substantially corrected.

It was not our intention to convey to the reader that previously identified deficiencies, such as personal property accountability, were substantially corrected. For example, in the section of the FY 1985 annual report entitled "Addressing Vulnerabilities and Correcting Weaknesses", Treasury did refer to its continuing efforts to improve the two Department-wide weaknesses it listed in its FY 1983 annual report and carried over in FY 1984. We reported that these deficiencies had occurred "in the Department's personal property accountability systems and ADP internal control systems."

In hindsight, it may have been more appropriate to have included this information in the material weaknesses section, Attachment 2, of the FY 1985 annual report. However, there was no intent to mislead the reader into concluding that personal property management was no longer a material weakness.

With regard to additional specificity in the report, the Office of Management and Budget has revised its existing reporting instructions in an attempt to gain more specificity in the reports received from the agencies. We have amended our year-end reporting instructions to fit the OMB requirements. Additionally, we will be more specific in our reporting on material weaknesses and the plans and schedules for correcting them. We anticipate that the new

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OMB requirements and the expanded treatment of material weaknesses will satisfy the objections raised by the GAO in its report.

Sincerely,

John F. W. Rogers
Assistant Secretary of the
Treasury (Management)

Enclosure

The following are GAO's comments on the Department of the Treasury's letter dated September 26, 1986.

GAO Comments

1. The information Treasury describes in this section relates to its upcoming fiscal year 1986 Integrity Act report.

2. We questioned Treasury's reasonable assurance conclusion because of the magnitude and scope of weaknesses in ADP and personal property, in addition to the IRS and FMS weaknesses. (See pp. 12 to 22.)

3. Although Treasury maintains that differences between OMB's and our guidance created difficulty for it in satisfying both OMB and our requirements, the guidance on determining reasonable assurance and assessing material weaknesses are similar, as shown on pages 12 to 14 in our report. OMB and we agree that the nature and extent of weaknesses and corrective actions should be considered in arriving at a reasonable assurance conclusion.

4. Treasury's point that all bureaus except FMS reported reasonable assurance ignores the overall cumulative effect that bureau material weaknesses have in determining whether Treasury, as a whole, has reasonable assurance. The FMS Commissioner's conclusion that FMS could not provide reasonable assurance is particularly noteworthy, given the nature of the weaknesses and the importance of its operations—over 700 million payments annually and a daily cash flow of $2.7 billion. Treasury should have reported that it did not have reasonable assurance at FMS. Also, Treasury's largest bureau, IRS, reported tax return and document processing—probably the most important aspect of IRS' operations—as a material weakness. Finally, because bureau assurance reports identify weaknesses for that particular bureau, only at the department level could the crosscutting weaknesses be identified. For example, from fiscal year 1983 through fiscal year 1985, the bureaus reported 135 personal property management and ADP weaknesses and about 220 corrective actions. Only at the department level could the effect of these bureau weaknesses on Treasury's overall reasonable assurance conclusion be assessed.

5. We see no inconsistency in the Inspector General's opinion and our conclusion that Treasury's overall reasonable assurance conclusion was questionable, given the scope and magnitude of Treasury's material

weaknesses. The Inspector General's opinion was based on his evaluation of the processes used by Treasury's bureaus, and it was the weaknesses that these processes identified and reported to the department which formed the basis for our questioning Treasury's report to the President and the Congress. For example, FMS, IRS, ADP, and personal property weaknesses were reported to the department by the bureau processes. In our view, Treasury's reporting problems were attributable to inadequacies in its analysis and consolidation of weaknesses and in drafting its report to the President and the Congress, rather than to deficiencies in the bureaus' processes.

6. Although significant corrective actions may have been underway, the weaknesses were material during the time covered by Treasury's report, and some weaknesses may continue to be material for several more years. For example, the personal property material weakness was identified in the first Integrity Act report, and corrective actions have been in process since that time and are continuing. However, because the fundamental problems remain, personal property management is still a material weakness. (See pp. 19 to 22.)

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