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Transition Series

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Treasury Issues



Comptroller General
of the United States

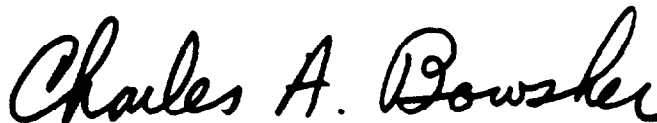
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November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of the Treasury

This report is one of a series outlining critical issues confronting Congress and the new Administration. As a leader in formulating economic policy, improving financial management, and regulating financial institutions, the new Secretary must help address many daunting challenges. These include (1) restoring stability to a shaken financial services industry; (2) developing policies to address the pressing U.S. trade deficit; and (3) enhancing reform efforts to improve the government's second-rate accounting systems. These challenges are discussed in detail in separate transition reports issued by GAO and listed in the back of this summary.

The new Secretary also must address serious problems within Treasury. Significant internal control weaknesses are undermining the Department's effectiveness in controlling trillions of dollars. There is a critical need to monitor the progress of major new information systems such as IRS' total redesign of the tax processing system.



Charles A. Bowsher

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Restoring Stability to a Troubled Financial Services Industry

As detailed in our transition report entitled **Financial Services Industry Issues**, (GAO/OCG-89-4TR), our nation's financial institutions and markets are in a period of dynamic change. The new Secretary of the Treasury, working in conjunction with other key members of the Administration, will be confronted with an array of critical issues. These include deciding how to:

- finance the billions of dollars that will be needed to restore financial stability to insolvent institutions;
- allow banks and other financial businesses to merge while still protecting the unique and vital functions they perform for the public with effective regulation;
- interject regulatory controls to enable financial markets to better cope with any repetition of the October 1987 stock market crash; and
- assure effective regulation of international financial markets.

A summary of our suggested actions follows.

Dealing With
Insolvent
Institutions

The Secretary should actively support a regulatory strategy aimed at closing insolvent institutions as quickly as possible.

The thrift industry's self-insured system is too weak to solve the problem alone. The solution must be funded by all who have a stake in the industry. The sharing of costs should be based on the principles that 1) funds contributed by the thrift industry should not significantly weaken healthy institutions, 2) funds raised from other depositories should not adversely affect their competitive position, and 3) funds provided by the public should be accompanied by controls to protect the public interest.

Regulating the
Banking Industry

Without fundamental changes to the way the thrift industry is regulated, there is little to prevent a recurrence of today's problems. New controls are needed to strengthen the capital base of the industry, improve oversight and supervision to manage risk-taking and limit losses, and provide incentives for insured institutions to control their own risk-taking. Additionally, the schizophrenic position of the Federal Home Loan Bank Board as both an industry advocate and safety and soundness regulator must be eliminated.

The deregulation of banks also must be thoughtfully managed. Limits on banks' powers are being progressively relaxed outside of the existing statutory framework, yielding a hodgepodge of banking

and other functions that could threaten the soundness of the banking system.

This uneven expansion of powers is potentially destabilizing, and new ground rules must be legislated quickly. First, regulatory restraints must be relaxed in stages keyed to the pace at which regulatory agencies are staffed and otherwise equipped to assure adequate oversight. Second, the holding company structure should be required for any institution that proposes engaging in both banking and nonbanking lines of business. Third, new legislation should impose and firmly enforce rigorous standards for the adequacy of capital at both the bank holding company and bank levels. Fourth, banks should be permitted to extend credit to securities affiliates only under controlled circumstances, such as providing liquidity in a market emergency. And finally, new legislation should expand the regulatory role of the Federal Reserve to assure effective oversight of integrated financial services firms.

Coping With a
Volatile Market

The unpredictability of financial markets, the extent to which separate markets are now intertwined, and the resulting dangers for the national economy were underscored by the October 1987 crash. The new

Administration must decide how to regulate the linked markets and better prepare for a future crisis. Some changes which should be implemented immediately include 1) improving contingency planning between different regulators, 2) improving coordination of the rules and regulations that would be critical in an emergency, and 3) retaining the Financial Market Working Group as a mechanism to assure continued attention to the problems that emerged in the crash.

Operating in an
Increasingly
International Arena

U.S. financial markets are linked not only with each other, but also with markets in other nations. The new Administration must insure harmonized U.S. and foreign regulatory approaches and a coordinated international response to financial crises.

Initially, we must get our own regulatory house in order by resolving the future structure of the U.S. financial services industry (i.e. the banking powers issues), and the regulatory issues already noted concerning the securities markets. We should simultaneously, in our leadership role, develop means for ensuring prompt exchange of critical information and developing reliable procedures for international coordination in time of emergency.

Formulating Economic Policies to Address the Trade Deficit

The magnitude and duration of the U.S. trade deficit and the transformation of the United States from a creditor to a debtor nation have generated concern that the U.S. economy is in long-term decline.

The trade deficit and the fact that the United States is a debtor nation are both principally attributable to U.S. macroeconomic policy decisions and how these policies differed from decisions made elsewhere. These issues are discussed in our transition report entitled International Trade Issues, (GAO/OCG-89-5TR).

As a principal advisor to the new Administration on economic policy issues, the new Secretary will help formulate policy measures to address the trade deficit. The new Secretary should support measures that will gradually reduce the U.S. budget deficit through the application of fiscal and monetary policies which recognize the interdependent nature of the world's economies.

Ensuring Financial Management Reform

Although the government has an annual cash flow of about \$1 trillion dollars, it continues to rely on second-rate financial management systems. Many are antiquated and in disrepair. They produce information that is incomplete, untimely, and unreliable. Nevertheless, important deficit reduction decisions are based on the data produced by these systems.

We have long urged the need for broad-based reform. A full discussion of the governmentwide financial reform issue is provided in our transition report entitled Financial Management Issues, (GAO/OCG-89-7TR). As a key leader in the financial management area, the Secretary should play a central role in this reform effort to: conduct better long-range financial systems planning; maintain strong internal control systems; and produce timely, complete, and reliable financial data.

Managing Treasury's Critical Information Technology Challenges

Treasury relies heavily on automated information systems to carry out many of its critical responsibilities, including tax administration, debt management, and governmentwide accounting operations. Treasury's 1988 commitment to the information technology area is substantial, involving over a billion dollars in obligations and over 8,700 workyears. Treasury's overall expenditures in this area will grow 21% from 1986 to 1988, giving it the second highest growth rate for all Cabinet Departments.

Within the next few years, major new systems or enhancements to existing systems are planned for all of Treasury's major bureaus. In addition, enhancements are planned for major Departmentwide systems including payroll, personnel, and telecommunications. Two Treasury systems, IRS' Tax System Redesign and the Treasury's Financial Management Services (FMS) System 90, were designated as Presidential Priority Systems by the Office of Management and Budget. They represent long-term initiatives that affect substantial portions of the public and/or a major infrastructure in the federal government.

The new Secretary must effectively oversee the redesign of IRS' tax administration

system. The new system will have to handle billions of dollars worth of revenues annually and deal with sensitive financial data provided by millions of taxpayers. The redesign costs will likely run into the billions before the entire concept is operational. IRS' current system is woefully out-of-date and not expected to meet growing workload demands much longer.

Treasury and IRS have struggled with this initiative for years. The first three approaches did not proceed beyond the conceptual phase, partly because leadership changes within IRS and Treasury hampered redesign attempts. Full implementation of the target design has slipped from 1995 to 1998. As a result, IRS will have to contend with the problems in its current system for several years longer than expected.

IRS has now developed a basic plan for the redesign which calls for incremental improvements over time. While Treasury officials approved the overall direction set forth in this plan, many critical milestones and actions lay ahead that will require aggressive monitoring. In particular, the development of a defensible set of cost/benefit analyses will be critical as will justifying the system design and implementation before Congress.

A second key challenge for the new Secretary will be to effectively monitor Treasury's Financial Management Service's (FMS) System 90, which will upgrade the FMS computer systems and expand FMS involvement in governmentwide financial management. FMS currently processes 750 million payments annually totaling \$900 billion. Groups relying on FMS for payments include 39 million Social Security beneficiaries, 90 million households receiving tax refund payments, 4.4 million veterans or their dependents, and 4.2 million people receiving Supplemental Security Income payments. OMB estimates that FMS' current system loses \$50 million annually due to theft and takes 45 days to process benefit payments.

System 90 is a key element in FMS's goal to integrate the various components of the government's \$2 trillion in annual financial activities into a secure processing and reporting network. However, the new system is still in the design stage. Given its importance, it is imperative that the Department aggressively monitor its implementation to ensure that the goals of more timely and accurate payments and improved credit management by FMS are achieved.

The new Secretary should

- Recruit high quality managers experienced in information system design and implementation for all critical senior management positions involving information systems within the Department and Bureaus.
- Ensure that all major Treasury information systems are tied into clearly articulated long-range strategic program plans.
- Monitor the redesign of the tax administration system, focusing initially on (a) the development of cost/benefit analyses to use in assessing the total effort; and (b) the establishment of clear management accountability for the project.
- Evaluate the Financial Management Service's System 90 upgrade to insure that the intended objectives of faster and more accurate payment processing and better monitoring of government credit practices are achieved.

Addressing Treasury's Serious Internal Control Problems

In fiscal year 1987, Treasury's accounting systems were responsible for keeping track of

- Over \$2 trillion of U.S. public debt activity;
- Over \$885 billion collected in taxes; and
- Government payments totaling \$900 billion.

Given these enormous responsibilities, the new Secretary must make a strong, on-going commitment to maintaining financial systems that have strong internal controls. Treasury has made progress in addressing major weaknesses, but major challenges remain. In 1987, Treasury's Bureaus reported 75 material internal control weaknesses, of which 37 were in the financial management area and another 15 were in the automated data processing area. Other weaknesses extended into such important areas as personnel management, cash management, and procurement.

For example, we recently reported on major financial management and internal control problems facing two important Treasury Bureaus—IRS and Customs. At IRS, our October 1988 management review found serious and long-standing problems

in the financial management area. IRS' accounting systems are outdated, incompatible, and labor intensive. Significant internal control weaknesses exist in key systems that annually handle billions of dollars. Accurate and timely financial information is not available to key IRS managers. In response to the report, IRS has agreed to a long-term plan of action to address these serious issues. Treasury oversight is essential.

Over the past 3 years, we also have reported on major internal control problems facing the Customs Service's efforts to effectively identify, seize, and dispose of millions of dollars worth of assets from drug traffickers and organized crime figures. These included a "substandard" accounting system for seized property, no national inventory of millions in seized cash, and a lack of clear management accountability throughout the program. Delays in depositing seized cash cost the government millions of dollars in lost interest. While many of these problems are being addressed, Customs still needs to bring its Forfeiture Fund accounting into conformance with GAO standards as required by the Federal Managers' Financial Integrity Act.

Maintaining strong internal controls throughout Treasury will continue to be an ongoing process. Constant changes in systems, people, and procedures require a strong, continual commitment on the part of the Secretary to ensure that Treasury's vital financial systems experience no significant disruptions. To carry out these important responsibilities, the new Secretary should:

- Monitor the timely correction of all material accounting system weaknesses reported by Treasury's Federal Managers' Financial Integrity Act process and require that its process be rigorously applied in the future.
- Recruit high quality financial managers, experienced in financial system design and implementation, for all critical senior level financial management positions within the Department and Bureaus.
- Support IRS' efforts to strengthen and modernize its financial management systems by monitoring IRS' implementation of the GAO management review recommendations.
- Ensure that the Customs Forfeiture Fund accounting system is brought into conformance with GAO standards as required

by the Federal Managers' Financial Integrity Act.

Working With the New Inspector General

While Treasury's critical accounting, information, and internal control systems must be well designed and operated, their effectiveness and reliability must be assessed through periodic audits and evaluations. This can provide critical feedback to agency managers on how well these systems are achieving their intended objectives.

In October 1988, Congress enacted legislation to establish a new Presidentially-appointed Inspector General in Treasury. The new Secretary needs to ensure that the Inspector General's organization becomes operational in accordance with the recent legislation and to support this effort so that the Inspector General's office can carry out its responsibilities independently and objectively.

Related GAO Products

Managing IRS: Actions Needed to Assure Quality Service in the Future, (GAO/GGD-89-1, Oct. 14, 1988).

Computer Capacity: IRS Must Better Estimate its Computer Resource Needs, (GAO/IMTEC-87-5BR, Nov. 4, 1986).

Computer Support for Tax Processing Needs Continuing IRS Attention, (GAO/T-IMTEC-87-1, Feb. 6, 1987; GAO/T-IMTEC-88-1, Feb. 23, 1988).

ADP Modernization: IRS' Redesign of Its Tax Administration System, (GAO/IMTEC-88-5FS).

ADP Modernization: IRS' Tax System Redesign Progress and Plans for the Future, (GAO/IMTEC-88-23BR, Nov. 9, 1987).

Asset Forfeiture Programs: Progress and Problems, (GAO/T-GGD-88-41, June 23, 1988).

Managing the Costs of Government, (GAO/AFMD-85-35 and 35A, Feb. 1985).

Federal Financial Management Reform, (GAO/T-AFMD-88-18, Sep. 22, 1988).

Budget Reform for the Federal Government, (GAO/T-AFMD-88-13, July 7, 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

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