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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Treasury

First-Year Implementation Of The Federal Managers' Financial Integrity Act By The Department Of The Treasury

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse in federal government operations through annual agency self-assessment of internal controls and accounting systems

This report highlights the progress made and problems encountered by Treasury in its first year of experience with this new act. The report focuses on Treasury's evaluation of internal controls, reviews of accounting systems, and the improvements being made as a result of identified problems. Treasury did not evaluate the internal controls and accounting system of the Exchange Stabilization Fund because Treasury's General Counsel's office concluded the Fund was not subject to the act. GAO disagrees. Until the Fund is evaluated, the Secretary of the Treasury is not in compliance with the Federal Managers' Financial Integrity Act and the Accounting and Auditing Act of 1950 which it amended.

UNITED STATES GENERAL ACCOUNTING OFFICE

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GAO/GGD-84-66
MAY 25, 1984

028930

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

B-202205

The Honorable Donald T. Regan
Secretary of the Treasury

Dear Mr. Secretary:

This report concerns Treasury's initial efforts to implement the requirements of the Federal Managers' Financial Integrity Act of 1982 and Circular A-123. This report highlights the progress made and problems encountered by Treasury in its first year of experience with this new act. The report focuses on Treasury's evaluation of internal controls, reviews of accounting systems, and the improvements being made as a result of identified problems.

We are sending copies of the report to the Director, Office of Management and Budget; the Internal Control Management Officer for each of Treasury's 13 organizational units; and interested committees of the Congress.

Sincerely yours,

W.J. Anderson

William J. Anderson
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARY OF
THE TREASURY

FIRST-YEAR IMPLEMENTATION OF
THE FEDERAL MANAGERS' FINANCIAL
INTEGRITY ACT BY THE DEPARTMENT
OF THE TREASURY

DIGEST

To combat fraud, waste, and abuse in government, the Congress enacted the Federal Managers' Financial Integrity Act of 1982. The act requires (1) each executive agency to establish an ongoing process to evaluate the adequacy of its internal controls relative to standards prescribed by the Comptroller General, (2) the Office of Management and Budget (OMB) to establish evaluation guidelines, and (3) each agency to prepare an annual report to the President and the Congress on the status of its internal controls. Also, each executive agency must report whether its accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements. (See pp. 1 to 5.)

Treasury established separate processes for evaluating its internal controls and accounting systems. Treasury reported on December 27, 1983, that its internal controls met the objectives of the act, and there were no indications of serious problems with the operational integrity of its accounting systems. GAO reviewed both processes that supported the annual report because of the high priority given by the President and the Congress to improving the federal government's internal controls.

PROGRESS WAS MADE BUT PROBLEMS PREVENTED A CONCLUSIVE ASSESSMENT OF INTERNAL CONTROLS

Treasury acted promptly to establish the internal control evaluation process required by the act and its predecessor, OMB Circular A-123 (issued in October 1981, a year before the act). The basic guidance on how federal agencies are to implement the evaluation process is contained in OMB's Internal Control Guidelines. The guidelines set up a phased, sequential process which provides a logical and comprehensive evaluation strategy. Treasury did not effectively implement each phase and its most notable differences from OMB guidelines were in the early phases which are critical to the success of the entire evaluative process.

These differences were, in great part, due to factors beyond Treasury's control. For example, the process was new and there was little relevant experience to draw upon, and Circular A-123 required Treasury to set up its evaluation process and evaluate its internal controls before the September 1982 passage of the act and the December 1982 issuance of OMB's detailed Internal Control Guidelines. These factors created confusion among personnel about how they were to implement the process. (See pp. 6 to 8.)

Treasury differed from OMB's guidelines in the segmentation and vulnerability assessment phases. Segmenting consists of the agency dividing itself into organizational components, programs, and administrative functions for evaluation (called "assessable units"). The susceptibility of each assessable unit to waste, loss, unauthorized use or misappropriation is then considered (called "vulnerability assessments").

Assessable units which are too broad often result in the internal controls of significant functions and activities being inadequately considered or inadvertently excluded from assessment. This is what occurred at Treasury. For example, three bureaus did not identify automatic data processing (ADP) operations and data processing installations in the process and two others did not include all of their data centers. Treasury recognized that resegmentation was needed and reported that the number of assessable units in 1984 will increase from 534 to about 1800--a change of over 300 percent. (See pp. 11 and 12.)

Treasury's vulnerability assessments were also inadequately done for several reasons in addition to those caused by the segmentation problems. First, the quality of the assessments was questionable. Most were not adequately documented, many were done very quickly--sometimes in 15 minutes--and many did not include all three OMB-required steps. Second, most field managers did not participate in the assessments although they should because they have primary responsibility for assuring the integrity of their operations. Third, most of the automatic data processing assessments were incomplete because they did not consider the full range of ADP activities. (See pp. 12 and 13.)

To its credit, Treasury has taken numerous steps to address the identified deficiencies. However, GAO believes Treasury can further improve its approach to evaluating ADP systems.

Treasury has established a new program to assess the adequacy of ADP security and internal controls. Further, it has delegated this program's management to a separate departmental organization. However, it has not provided for coordination with the internal control process. Coordination is needed to ensure that internal control evaluation needs are met and to avoid duplication of ADP review efforts. (See p. 16.)

Although the problems encountered prevented a conclusive assessment of the agency's internal controls, GAO believes Treasury established the foundation for the process and made some notable improvements in internal controls. For example, it improved controls over its processing of securities by wire transfers between various banking institutions and the Bureau of the Public Debt. (See pp. 17 to 19.)

ACCOUNTING SYSTEM EVALUATIONS WERE REASONABLE

Unlike the internal control evaluation process, agencies did not have any guidelines to use in evaluating their accounting systems. Consequently, in August 1983, Treasury developed an evaluation questionnaire and uniform reporting format for evaluating 23 accounting systems. The evaluations were reasonably consistent and, generally, adequately documented. The resulting reports were consolidated into a comprehensive annual report to the President and the Congress which disclosed 163 material instances of nonconformance with the Comptroller General's Accounting Principles and Standards. (See pp. 21 to 26.)

Although Treasury's efforts were reasonable for the first year, improvements are needed to enable Treasury to render a fully supportable opinion concerning the extent to which its accounting systems conform to the principles and standards.

--Several important accounting operations were not included in the evaluations. For example, the Bureau of Government Financial Operations' eight regional disbursing offices which account for $600 billion in disbursements annually were excluded. (See pp. 27 to 29.)

--Few transactions were tested. Transactions must be tested to ensure that an accounting system, including its internal controls, is operating in conformance with the principles and standards. (See p. 29.)

Treasury officials plan to evaluate the omitted accounting operations and to sufficiently test transactions in the second-year evaluations.

Also, the internal controls and accounting systems for the Exchange Stabilization Fund and the Saudi Arabian Deposit Account were excluded from evaluation because Treasury's General Counsel's office concluded they were not subject to the act. The Exchange Stabilization Fund is used to foster orderly international monetary exchange arrangements and a stable system of exchange rates. The Saudi Arabian Deposit Account controls advance Saudi funds which are used to finance procurements of goods and services made on behalf of the Saudi Government. The Exchange Stabilization Fund's exclusion was based on its unique statutory arrangement which grants the

Secretary virtually absolute discretion over the Fund. The Saudi Arabian Deposit Account was excluded because its funds are not United States Government funds.

GAO disagrees with regard to the Exchange Stabilization Fund. Although the Secretary has virtually absolute discretion, the assets of the Exchange Stabilization Fund are United States Government funds. Thus, they are subject to the act. GAO is currently studying whether the Saudi Arabian Deposit Account system is subject to the act. (See pp. 27 to 29.)

AGENCY COMMENTS AND GAO'S EVALUATION

The Department of the Treasury stated that the report should provide considerable assistance in refining its future efforts to comply with the act. Specifically, Treasury stated it is acting to formally coordinate its internal control evaluation process with its new ADP evaluation program as GAO proposed. Thus, GAO deleted the proposal from this report. (See pp. 19 and 20.)

Treasury, however, maintained its position that the Exchange Stabilization Fund is not subject to the Financial Integrity Act or to the Accounting and Auditing Act of 1950 which it amended. Treasury stated that the Department has consistently viewed the Fund as being exempt from standard rules related to government funds, primarily because the Fund's enabling legislation places the Fund under the exclusive control of the Secretary, and specifies that the Secretary's decisions are final and may not be reviewed by another government officer or employee.

It seems that Treasury is incorrectly equating its broad policy discretion over the use of government assets with its ultimate responsibility for properly accounting for and safeguarding the assets. Subjecting the Fund to the requirements of the 1950 act, as amended by the Financial Integrity Act, will not in any way interfere with the exercise of Treasury's discretionary authority. Treasury itself would perform the annual evaluation process. Further, the evaluation would focus on the internal controls over the assets of the Fund to protect against fraud, waste or abuse, rather than on the merits of any decisions on the use of the Fund that the Secretary of the Treasury may make.

GAO finds no explicit statutory provision or other legal basis which would exempt the Fund from the acts in either the Fund's enabling legislation, the Accounting and Auditing Act, or the Financial Integrity Act. The 1950 act requires that agency accounting and internal control systems effectively control and account for all assets for which the agency is responsible. As the Secretary is clearly responsible and accountable for the approximately $13 billion of assets comprising the Fund, the Fund is subject to the Financial Integrity Act's evaluation and reporting requirements. (See pp. 30 to 36.)

Contents

ABBREVIATIONS

ADP	Automatic Data Processing
BGFO	Bureau of Government Financial Operations
BPD	Bureau of the Public Debt
GAO	General Accounting Office
IRS	Internal Revenue Service
OMB	Office of Management and Budget
SBD	Savings Bonds Division
U.S.C.	United States Code

CHAPTER 1

INTRODUCTION

Responding to continuing disclosures of fraud, waste, and abuse among various government operations, which were largely attributable to serious weaknesses in agencies' internal controls,[1] the Congress enacted the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512(b) and (c)). The act strengthened the Accounting and Auditing Act of 1950 which requires executive agencies to establish and maintain systems of accounting and internal control to provide effective control over and accountability for all funds, property, and other assets for which an agency is responsible (31 U.S.C. 3512(a)(3)).

GAO believes that full implementation of the Financial Integrity Act will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agency. To achieve these goals the act requires each agency to:

--Establish and maintain its internal accounting and administrative controls in accordance with the standards prescribed by the Comptroller General to reasonably assure that (1) obligations and costs comply with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.

--Evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency reports to identify material weaknesses and describe plans for corrective action.

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[1]Internal controls are those mechanisms an organization uses to guide its operations and, at the same time, serve as checks and balances to guard against undesirable occurrences such as counterproductive actions, errors, and irregularities.

--Prepare a separate report on whether the agency's accounting systems conform to principles, standards, and related requirements prescribed by the Comptroller General.

The act also requires that:

--The Office of Management and Budget (OMB) issue guidelines for federal departments and agencies to use in establishing a process for evaluating their internal accounting and administrative control systems.

--The Comptroller General prescribe standards for federal agencies' internal accounting and administrative control systems.

This report on the Department of the Treasury is one of 22 GAO reports on federal agencies' efforts to implement the act during the first year.

OMB GUIDANCE PROVIDES FOR A PHASED EVALUATION PROCESS

OMB Circular A-123 initiated the governmentwide process of evaluating internal controls. The circular, issued on October 28, 1981, prescribed policies and standards for establishing and maintaining internal controls. Subsequently, OMB issued in December 1982 its Internal Control Guidelines in compliance with the requirements of the act. The guidelines established an orderly, phased process for federal agencies to follow in evaluating their internal controls. In August 1983, OMB issued a revised Circular A-123 to reflect the additional requirements of the act--complying with the Comptroller General's internal control standards and reporting to the President and the Congress on federal agencies' internal control efforts.

OMB's Internal Control Guidelines specifically require federal agencies to:

1. Organize and assign responsibilities for planning, directing, and controlling the evaluation and improvement of, and reporting on, internal controls.

2. Systematically divide or segment themselves into organizational components, programs, and administrative functions for evaluation, called "assessable units".

3. Assess the susceptibility of each assessable unit to waste, loss, unauthorized use or misappropriation, called "vulnerability assessments".

4. Rank the assessable units according to their assessed level of vulnerability--high, moderate, or low vulnerability.

5. Address problems identified by their vulnerability assessments by either taking corrective action or by making detailed reviews of the internal controls to identify which corrective actions are needed, called "internal control reviews".

6. Report annually by December 31 to the President and the Congress. The report should state:

   a. Whether agency evaluations were conducted in accordance with OMB's guidelines.

   b. Whether agency internal controls comply with the Comptroller General's standards and provide reasonable assurance that the act's objectives have been met.

TREASURY PROVIDED OVERALL DIRECTION TO BUREAUS

The Department of the Treasury was created by the Congress in 1789. Over the years it has been given a wide range of diverse and critical duties. These include (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 various laws related to matters such as firearms and explosives, imports and exports, counterfeiting, and tax evasion. Overall, Treasury accounts for a cash flow of about $6 billion daily and makes an estimated 600 to 700 million payments annually.

Treasury has about 116,000 employees in 13 major bureaus and offices (hereafter referred to as bureaus). Eight of these bureaus have field offices to carry out their responsibilities. The 13 major bureaus are listed below:

--Bureau of Alcohol, Tobacco and Firearms
--U.S. Customs Service
--Bureau of the Public Debt

--Internal Revenue Service
--Office of Revenue Sharing
--U.S. Secret Service
--Office of the Comptroller of the Currency
--Bureau of Engraving and Printing
--Bureau of Government Financial Operations
--U.S. Mint
--U.S. Savings Bonds Division
--Office of the Secretary
--Federal Law Enforcement Training Center

The Office of the Secretary provided central direction and oversight to Treasury's bureaus in the departmentwide effort to evaluate, improve, and report on accounting systems and internal controls. Overall responsibility for directing, coordinating, and reporting on the internal control evaluations was assigned to the Assistant Secretary (Administration) with day-to-day responsibility being delegated to the Deputy Assistant Secretary (Administration).

Departmental guidance was provided to the bureaus who were required to (1) establish their own process including designating internal control officers, and (2) meet established deadlines for complying with OMB guidance (e.g. segmenting and conducting vulnerability assessments). The bureaus had wide latitude in developing and implementing their own evaluation process. For example, each bureau had discretion to determine how best to segment and conduct a vulnerability assessment.

The Assistant Secretary (Administration) and the Fiscal Assistant Secretary were responsible for the evaluations of the administrative and fiscal accounting systems, respectively. Day-to-day responsibility was delegated to a specially created task force which established policies, procedures, and guidelines for evaluating accounting systems and reporting on the results.

On December 27, 1983, Treasury reported that its evaluation process indicated that on the whole, its system of internal controls complied with the objectives of the act. Also, Treasury reported that it found no indication of serious problems with the operational integrity of its accounting systems.

OBJECTIVE, SCOPE, AND METHODOLOGY

We reviewed the Department of the Treasury's implementation of the Federal Managers' Financial Integrity Act because of the high priority given by the President and the Congress to improving the government's internal controls. We did not attempt to independently determine the status of Treasury's internal control systems or the extent to which Treasury's accounting systems comply with the Comptroller General's principles and standards. Our objective was to evaluate Treasury's progress in implementing the act. To accomplish this objective, we identified how Treasury and its bureaus established their internal control evaluation processes and evaluated how well their approaches conformed to OMB's Internal Control Guidelines. Specifically, we

--interviewed the designated internal control officers and their staff in each bureau, Inspector General staff, selected program managers, accounting task force personnel, and representatives of the public accounting firm of Arthur Young and Company (which assisted Treasury in evaluating its accounting systems); and

--examined and analyzed relevant correspondence, directives and procedures, vulnerability assessments, internal control reviews, accounting system evaluations, and their accompanying documentation.

We obtained basic information about the department and its 13 bureaus' efforts to establish an evaluation process. On the basis of our preliminary work, we examined the efforts of four bureaus in more detail: U.S. Customs Service, Bureau of the Public Debt, Bureau of Engraving and Printing, and Bureau of Government Financial Operations (accounting systems audit work only). This work primarily involved the examination of vulnerability assessments, internal control reviews, and accounting system deviations from the Comptroller General's principles and standards. These bureaus were selected because each performs duties representative of Treasury's three broad functions: financial management (Bureau of the Public Debt, Bureau of Government Financial Operations); production (Bureau of Engraving and Printing); and law enforcement/regulation (U.S. Customs Service).

The review was performed in accordance with generally accepted government auditing standards. Audit work was conducted at Treasury and bureau headquarters in Washington, D.C. We also examined the extent and type of field manager involvement at the regional and district offices of the Internal Revenue Service, Bureau of Government Financial Operations, and U.S. Customs Service in New York City; Dallas and Houston, Texas; and San Francisco and Los Angeles, California.

CHAPTER 2

PROGRESS WAS MADE BUT

PROBLEMS PREVENTED A CONCLUSIVE ASSESSMENT

IN 1983

In early 1982, Treasury began its efforts to establish an evaluation process to conform to OMB Circular A-123 "Internal Control System" requirements. However, because of factors largely beyond Treasury's control, its evaluation process substantially differed from OMB's Internal Control Guidelines--which were guidelines required by the act and issued in December 1982.

The differences involved fundamental elements of the evaluation process. They prevented Treasury from effectively conducting the comprehensive assessments detailed in OMB's guidelines. Consequently, Treasury's evaluation process did not produce conclusive results about the adequacy of its internal controls.

To its credit, Treasury has taken numerous steps to address the identified deficiencies in its process. Treasury, however, needs to coordinate its new program for evaluating its computer-based information systems with its internal control process to ensure that the objectives and requirements of both programs are met and that duplicate reviews of ADP operations are avoided. If effectively implemented, the changes should bring Treasury into full compliance with OMB's guidelines and produce more meaningful results in 1984. Further, despite the problems with the process, Treasury has made some notable improvements to its internal controls.

INITIAL EFFORTS: RESPONSIVE BUT HINDERED BY PROCESS EVOLUTION

Treasury acted promptly to meet the requirements of OMB Circular A-123 and the Federal Managers' Financial Integrity Act of 1982. Its efforts began early in 1982 (shortly after issuance of A-123), continued throughout 1982 and 1983, and greatly increased in the last quarter of calendar year 1983.

A number of factors clearly demonstrated Treasury's responsiveness to the governmentwide initiative.

--Treasury issued its internal control directive on March 31, 1982, which was in accordance with an A-123 requirement.

--Treasury bureaus had completed vulnerability assessments before A-123's target date of December 31, 1982.

--Treasury directed its bureaus to make pilot internal control reviews in 1982 and 1983 of their procedures for prompt payment of debts and procurement practices as a learning experience in how to make these reviews. The 1982 review was the first agencywide review and assisted OMB's development of guidelines for making internal control reviews.

--Treasury coordinated its efforts with OMB and helped to develop the assessable unit concept to facilitate segmentation of an agency's activities and the performance of vulnerability assessments and internal control reviews.

--Treasury detailed a senior analyst to work with OMB's oversight staff in assessing other major federal agencies' efforts to establish internal control evaluation processes. Subsequently, the analyst was given a lead role in carrying out Treasury's process.

--Treasury prepared a videotape to orient managers about their internal control responsibilities. It was distributed to the bureaus in January 1984.

Although Treasury was prompt in its efforts to implement the governmentwide internal control evaluation process, several factors largely beyond its control greatly hindered the effectiveness of its evaluations in 1982 and 1983.

--The governmentwide internal control evaluation process was new. There was little relevant experience to draw upon.

--Treasury had to set up a process and evaluate its internal controls before OMB's detailed Internal Control Guidelines were issued in December 1982. For example, A-123 required agencies to issue their internal control directives by March 31, 1982, and to complete their vulnerability assessments by December 31, 1982.

--The evaluation process itself is often conceptual in nature, relying on judgment and experience. There are no specific benchmarks or rules of thumb on matters such as how to segment an agency so that assessable units are of an appropriate size.

--Throughout 1982 and 1983, guidance on the process evolved which affected implementation efforts. For example, OMB circulated its draft internal control guidelines in February 1982; the Federal Managers' Financial Integrity Act was enacted in September 1982; OMB issued its Internal Control Guidelines in December 1982; GAO issued its standards in June 1983; and OMB revised Circular A-123 in August 1983.

All of these factors contributed to confusion among agency personnel about how they were to implement the process. Given these circumstances, it is not surprising that Treasury encountered problems in its implementation efforts.

AN EFFECTIVE INTERNAL CONTROL EVALUATION PROCESS WAS NOT ACHIEVED IN 1983

The basic guidance on how federal agencies are to implement the governmentwide process to evaluate and improve their internal controls is contained in OMB's Internal Control Guidelines. The guidelines detail a phased approach which provides a logical and comprehensive evaluation strategy. Each phase in the approach is built upon and follows the completion of the previous phase. Thus, the initial phases of OMB's approach form the foundation of the process, and proper performance of these phases is critical to the success of the entire process.

Treasury's evaluation process consisted of phases similar to those detailed in OMB's guidelines. Treasury, however, did not effectively implement each phase because of the reasons previously discussed. Its most notable differences were in the crucial early phases--segmentation and vulnerability assessments.

Treasury moderately successful in organizing its evaluation process

Organization is the first phase in OMB's approach. OMB's guidelines state that this phase is "critical", and detail five steps that constitute this phase: (1) assigning responsibilities to appropriate officials, (2) establishing an internal reporting and followup system to monitor the process, (3) documenting performance of the process, (4) committing sufficient resources to supervise the process, and (5) establishing schedules for the performance of necessary tasks.

Overall, Treasury was moderately successful in organizing the process. For the most part, senior agency officials were assigned internal control responsibility in the department and the bureaus. In addition, Treasury formally defined the role of the Inspector General in a manner consistent with OMB's guidelines--as providing technical assistance in developing the process and auditing department and bureau implementation efforts. With regard to internal reporting, Treasury set up internal reporting requirements that addressed most of the elements mentioned in OMB's guidelines and established schedules for completing various tasks (e.g. segmentation, vulnerability assessments) related to the evaluation process. However, Treasury did not address the documentation and supervision aspects of this phase satisfactorily. Also, it did not involve personnel knowledgeable in automatic data processing (ADP) in the organization phase.

First, Treasury did not provide clear guidance for documenting the process. OMB guidance states that there should be adequate documentation to provide a permanent record of the methods used, the personnel involved and their roles, the key factors considered, and the conclusions reached. Treasury did not provide clear direction to its bureaus on needed documentation. As a result, key phases of the process (most notably vulnerability assessments) were not adequately documented.

Second, although two high level officials spent considerable time on developing a departmentwide approach, support staffing was insufficient. The Deputy Assistant Secretary (Administration) estimated he spent about 35 percent of his time from January 1982 through October 1983 in the overall direction and coordination of the evaluation process. In addition, the Deputy Inspector General and a member of his office were involved in providing technical assistance in developing the process. Each estimated they spent about 25 percent of their time in this manner--the former during 10 months of 1982 and the latter from January 1982 through October 1983. However, there was insufficient support personnel to adequately monitor and supervise the progress being made by the 13 bureaus in implementing the process and perform, simultaneously, the wide range of other responsibilities assigned to them.

Between January 1982 and June 1983, Treasury devoted less than 3 staff years to monitoring and supervising the departmentwide effort. In addition, Treasury hindered the effectiveness of the monitoring effort by sporadic staffing.

--From February 1982 to June 1983: 1 person, 50 percent of the time.

--From June 1982 to around December 1982: 1 person (a management intern), full-time 4 months and part-time 3 months.

--From January 1983 to June 1983: 1 person, full-time.

--From July 1983 to September 1983: 2 persons, full-time.

--From September 1983 to December 31, 1983: 9 persons, full-time.

Until July 1983, the staff was also responsible for establishing the evaluation process for the Office of the Secretary (i.e. segmenting and doing vulnerability assessments, etc.). In addition, from February 1982 until July 1983, the staff was involved in matters such as drafting the Treasury internal control directive and working with the Inspector General in providing assistance on conducting a pilot internal control review.

The sporadic staffing coupled with their wide range of responsibilities placed extensive demands on the staff's time. These factors hindered the staff's ability to review the quality of implementation at Treasury's bureaus. The staff was unable to examine whether the 13 bureaus properly organized, segmented, and performed vulnerability assessments in accordance with OMB guidelines. Ultimately, insufficient staffing and monitoring of its process prevented Treasury from identifying problems. It also limited the amount of time available for responding to the problems before preparation of its 1983 report.

Third, Treasury did not involve ADP professionals in the planning and organizing of its evaluation process. The involvement of ADP personnel at this stage was crucial because many of Treasury's activities are highly dependent on automated information systems and related telecommunication networks to collect, disburse, account for, and report billions of dollars in government funds. For example, the Bureau of the Public Debt uses computers to manage over $2.2 trillion in government securities. The omission of ADP personnel from the organization phase contributed to inadequate assessment of ADP matters throughout the subsequent phases of Treasury's evaluation process.

Treasury's segments were too broad for meaningful assessment

The next phase in OMB's approach is segmenting. Segmenting an agency is one of the two most crucial phases in OMB's evaluation process. OMB's guidelines clearly highlight its importance.

> "Federal agencies are large, complex organizations. The most effective way to systematically perform an evaluation of the systems upon which an agency head can submit a statement is to segment the agency .... The individual assessable units should be of an appropriate nature and size to facilitate the conduct of a meaningful vulnerability assessment." (Underscoring added)

Segmenting is, by its nature, a judgmental function which makes it difficult to perform and assess. There are no specific benchmarks or rules of thumb to measure or judge the appropriate size of a segment. The purpose of segmenting is to enable managers to evaluate the internal controls operating in the identified assessable units. However, assessable units which are too broad can result in the internal controls of significant functions and activities being inadequately assessed or inadvertently excluded from assessment. This is what occurred in Treasury's 1982-83 process.

Treasury initially identified 534 assessable units. These units often crossed organizational lines which made it unclear who had responsibility for the assessable unit--an OMB requirement. Furthermore, the assessable units generally appeared to be too broad for meaningful assessment. For example, the Internal Revenue Service (IRS) identified just 28 assessable units. IRS is Treasury's largest bureau. It employs about 70 percent of all Treasury personnel, administers a vast and complex set of tax laws, and handles billions of dollars in receipts and payments each year in the performance of its duties. Our review of IRS' 28 assessable units led us to conclude that they were too broad for meaningful assessment and IRS agreed. IRS' resegmentation for 1984 has identified about 800 assessable units which will be subject to vulnerability assessment. Similar situations occurred at several other bureaus such as the U.S. Customs Service, Bureau of Government Financial Operations, and the U.S. Savings Bonds Division, which have or will substantially increase the number of assessable units for 1984.

Further, despite heavy reliance on ADP, Treasury's segmenting did not fully cover its ADP management and operations. Three bureaus--U.S. Customs Service, Public Debt, and Engraving and Printing--did not identify ADP operations and data processing installations in their processes. In addition, IRS and the Bureau of Alcohol, Tobacco and Firearms did not include all of their data centers in their processes. By not segmenting its ADP functions, Treasury did not consider major information systems and related ADP functions in its vulnerability assessments.

A number of bureaus also omitted other functions (some of which involve large monetary transactions or the use of valuable raw materials) in their segmenting efforts. The Bureau of Alcohol, Tobacco and Firearms omitted a regulatory enforcement function concerning the collection of fines imposed on producers who violate production and sales regulations governing alcohol and tobacco. In another instance, the Bureau of Engraving and Printing did not consider its manufacturing function which involved the use of valuable raw materials.

Treasury recognized that it did not segment properly for 1983. The agency stated in its year-end report to the President and the Congress that segmentation throughout the department was not as uniform as expected, and bureaus were instructed to resegment as necessary. Treasury's resegmentation will increase the number of assessable units in 1984 from 534 to about 1800--a change of more than 300 percent.

Vulnerability assessments inadequately done and/or documented

Along with segmenting, vulnerability assessment is the other crucial phase in the OMB guidelines. The assessments are to pinpoint where problems may exist. If the assessments are not done well, weaknesses needing correction may not be identified and resources will likely be wasted on performing unnecessary internal control reviews. This will ultimately undermine the process by discouraging involved managers if they see the process is not producing any benefits. Treasury did not adequately perform vulnerability assessments in 1982-83 because of several basic problems.

The first problem is directly related to the previous discussion on segmenting: Treasury's assessable units were too broad for meaningful vulnerability assessment.

The second problem with the assessments is that their quality was suspect. Our work at each of the three bureaus we reviewed in detail indicated that most of the assessments (about 75 percent) were not adequately documented and were done rather quickly. For example, some managers told us they took just 15 minutes to make the assessments. Others told us they took 1 or 2 hours to make the assessments. Further, some bureaus' assessments did not include all three basic steps required by OMB's guidelines: (1) analysis of the general control environment, (2) analysis of inherent risk, and (3) a preliminary evaluation of safeguards. This was the case at the U.S. Customs Service, IRS, and U.S. Savings Bonds Division.

Third, OMB's guidelines provide that management throughout the agency should be involved in the evaluation process because they have primary responsibility for ensuring the integrity of their operations. However, five of the eight Treasury bureaus with field operations did not involve their field managers in the assessments. In addition, field personnel generally were unaware of the act's requirements or the established evaluation process. Thus, Treasury's assessments primarily represented a headquarter's perspective.

We were also concerned about the quality of vulnerability assessments for ADP related operations. Overall, it appears that these assessments did not conform to generally recognized methods for examining the controls for ADP operations. Five of the seven Treasury bureaus that identified and considered ADP-related assessable units in their 1982-83 evaluation process did not identify specific ADP application programs and/or specific data centers as distinct assessable units. Although they considered the ADP function as administrative support for various assessable units, they did not consider the propriety of controls for the input, processing and security of data in the ADP systems. In reviewing these vulnerability assessments, it was usually not possible for us to determine the extent that ADP controls were assessed because of inadequate documentation. However, as described below, one of the three bureaus we reviewed in detail had enough documentation to indicate major omissions in the assessments.

Before any assessment of ADP processing reliability or integrity in any application can be complete, both application controls (controls that pertain to data origination, entry, processing, and output) and general controls (such as security, computer access, system design, development, and maintenance) must be evaluated. Generally, the approach taken at Treasury appeared to primarily involve a consideration of the application controls--not the general controls. For example, documentation for some of the Bureau of the Public Debt's vulnerability assessments indicated that application controls were considered. However, the bureau did not have an assessable unit for its ADP systems or facilities and there was no indication that the controls for this portion of the ADP operation were considered. Therefore, Treasury does not have reasonable assurance that critical ADP issues were considered in its vulnerability assessments.

OMB and Inspector General reviews identified similar problems

These same basic problems in the critical early phases were also identified by OMB and the Inspector General during their reviews of Treasury's process. In July 1983, OMB advised Treasury that it was concerned about the lack of specific direction in many critical areas. OMB was particularly concerned about the quality and reliability of segmenting and vulnerability assessments. OMB also pointed out the need for Treasury to consider the vulnerability of its computer systems. The Inspector General's December 1983 report to the Secretary of the Treasury summarized the results of separate audit reports on each bureau's implementation efforts. It raised concerns about these same critical areas. Our analysis of the individual bureau reports revealed that the Inspector General reported 69 problems among the bureaus in the following three phases:

--Organization: There was a general lack of direction and guidance from Treasury to its bureaus on how to perform the process. This lack of direction and guidance largely contributed to the significant number of problems found in the area of training. The Inspector General reported 11 of 13 bureaus with insufficient training. Other reported problems related to insufficient staffing and supervision of the process.

--Segmenting: Bureaus had great difficulty performing this critical element. Most either omitted significant functions that involved control over substantial assets and/or identified units that were too broad for meaningful assessment. The Inspector General reported 9 of 13 bureaus omitted functions from their inventory of assessable units.

--Vulnerability assessment: The assessments were often inadequate because of the broad segmenting and/or superficial evaluations. The most frequently found problem by the Inspector General was that 10 out of 13 bureaus did not have adequate documentation.

Thus, OMB's and the Inspector General's findings are in close agreement with our own: although Treasury established an evaluation process, its efforts were hindered by serious problems in the critical early phases--most notably, segmenting and vulnerability assessments.

CORRECTIVE ACTIONS HAVE BEEN TAKEN TO ADDRESS PROBLEMS

Through briefings, reports, and discussions with OMB, Inspector General and GAO personnel, Treasury became aware of the problems with the implementation of the evaluation process in the latter half of calendar year 1983. To its credit, Treasury has been very responsive to these concerns, has already completed a number of actions, and is considering others to correct identified problems with organization, segmenting, and vulnerability assessments.

Treasury's focal point for addressing deficiencies in its evaluation process is its substantially revised internal control directive. The revised directive was issued on November 7, 1983. It reflects the changes caused by the passage of the Federal Managers' Financial Integrity Act of 1982, the issuance of OMB's guidelines and GAO's Internal Control Standards, the revision of OMB Circular A-123, and the knowledge gained from its initial implementation experience. For the most part, we believe the directive is responsive to the problems Treasury had in each of the three initial critical phases of OMB's guidelines.

First, the directive improves Treasury's organization efforts in several ways. It is more explicit about the responsibilities of the individuals involved in Treasury's process. For example, bureau heads are clearly advised to designate a responsible individual manager for internal controls for each assessable unit and to provide adequate training to managers. The duties of designated bureau internal control officers are now also identified in the revised directive. These include establishing quality control systems to ensure that vulnerability assessments and internal control reviews are conducted conscientiously and are fully documented.

The directive also establishes a formal tracking and followup system to improve the agency's ability to supervise the evaluation process. This system will contain information on both problems and the status of corrective actions for each assessable unit. As designed, it will be a comprehensive tracking system that will comply with OMB's guidelines.

Second, the directive now explicitly states that all bureau program and administrative functions (except policy decisions and policymaking) will be included in the inventory of assessable units. Treasury's previous guidance was not as specific and led to several bureaus omitting significant functions from their inventories. Treasury also has directed the bureaus to examine their inventories and resegment when necessary. As noted in Treasury's 1983 report, the number of assessable units will increase significantly in 1984. This should aid in reaching OMB's goal of identifying assessable units of an appropriate size to allow a meaningful evaluation of its internal controls.

Third, to avoid repeating prior mistakes, Treasury is developing an internal control handbook which includes a section on vulnerability assessments. The revised directive now specifically requires bureaus to follow OMB's guidelines and the handbook in making their assessments. Further, Treasury has directed its bureaus to conduct a new round of vulnerability assessments in the second quarter of fiscal year 1984.

Treasury has also acted to improve its evaluation of the controls over ADP operations. It has a new Information System Risk Management Program which is intended to fulfill the requirements of OMB Circulars A-71[2] and A-123 for ensuring adequate levels of security and integrity for computer-based information systems. The program is under the direction of the Assistant Secretary (Electronic Systems and Information Technology) and thus, is separate from the internal control evaluation process.

The Information Systems Risk Management Program requires a risk analysis (1) to evaluate potential security problems with information systems, facilities, and data and (2) to certify that these information resources are safe for continued operational use. The risk analysis and certification must be made at least once every 3 years. Virtually all major automated systems and data processing facilities are included under the program's broad definition of information systems. According to a Treasury official, the risk analyses and certifications will be the equivalent of internal control reviews for information systems for 1984. Although primarily directed toward ADP security, the standards for these risk analyses address many ADP control techniques.

Our limited review of the Information System Risk Management Program indicates that it will improve reviews of Treasury's ADP activities. However, the directives for this program and the internal control evaluation process do not indicate that the two efforts will be coordinated. Because different organizational units direct these two efforts, we believe coordination is needed to assure that the objectives and requirements of each effort are achieved and to prevent potential duplication of effort in examining ADP operations.

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[2]OMB Circular A-71 TM #1 is primarily concerned with improving the security of ADP systems and facilities.

We believe the above actions address the major problems identified with Treasury's process in 1983. If each action is effectively implemented, we believe they will substantially improve Treasury's compliance with OMB's guidelines and, consequently, make its process for evaluating and improving its internal controls more meaningful in 1984.

INTERNAL CONTROL BENEFITS ACHIEVED IN 1983

Despite problems with the process in 1983, Treasury's evaluation efforts produced some positive results. Overall, Treasury bureaus reported to the Secretary that they had identified 307 operational or program weaknesses.[3] Of these, the bureaus stated 257 were corrected and corrective action was planned for 40 other weaknesses. Of the remaining 10 weaknesses, the status of corrective actions was not indicated for 8 weaknesses and the other 2 weaknesses were still under consideration.

On December 27, 1983, Treasury issued its annual report to the President and the Congress on its evaluation process and status of internal controls. The annual report identified two major categories of departmentwide weaknesses--information systems security and personal property management. Because weaknesses in data processing, office automation, telecommunications, etc., were frequently acknowledged by the bureaus, Treasury's annual report recognized that its overall program of risk assessment and control over ADP resources must be improved. Similarly, Treasury reported that efforts are underway, both on a bureau and department basis, to improve accountability for personal property.

Due to time constraints, we were unable to examine in-depth most of the weaknesses reported by the bureaus. However, some of our work coupled with a review of the bureau reports indicated that Treasury made several significant improvements in its internal controls.

For example, several noteworthy improvements occurred at the Bureau of the Public Debt. Through an internal control review, the bureau identified significant internal control problems in its telecommunications activities--one of its assessable units. The telecommunication transaction process involves the transmission of various government-bearer

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[3]The Bureau of Government Financial Operations reported 245 of these 307 weaknesses (about 80 percent). These weaknesses were primarily identified by reviewing prior audit and consultant reports and not directly associated with the A-123 internal control evaluation process.

securities by wire transfers between the bureau and various banking institutions. Several types of internal control problems were identified and corrected.

The first internal control problem concerned the improper segregation of authorization and verification duties and the failure to account for forms authorizing wire transfers. Essentially, before corrective action was taken, an analyst was responsible for both verifying the propriety of a transaction and authorizing it. After completing these two duties, the analyst prepared a form (without an authorization signature) containing pertinent information about the transfer and gave it to a teletypist. The wire forms themselves were also not accounted for properly.

This operating situation created several potential problems. First, because no one reviewed the accuracy and propriety of the analyst's work, an analyst could make errors or could issue an unauthorized wire without it being detected. In addition, because wire forms were not properly accounted for, a teletypist could also send an unauthorized wire to transfer securities. Also, other personnel with knowledge of the wire process could place unauthorized forms among other teletypist work with little chance of them being detected because the forms were not formally signed by an analyst. Thus, analysts, teletypists, or others could authorize fund transfers with little problem. The bureau corrected these internal control deficiencies shortly after their detection in the internal control review.

A second problem which existed in the area of verification concerned the physical transfer of securities within the bureau. When securities, checks, etc., were transferred from one location to another they were taken in a locked pouch which had a rotary number counter. Each time the pouch was opened the number advanced. This device enabled the receiver of the pouch to determine whether it had been opened while in transit. However, the internal control review disclosed that personnel did not check the counter to determine whether or not the pouch had been opened and tampered with before it reached its final destination. This has since been corrected.

A third internal control problem at the Bureau of the Public Debt concerned the easy accessibility to unprocessed mail by unauthorized persons. Cartons of unprocessed mail, which sometimes contained currency, checks, and securities, were left after working hours and on weekends in an open area. The bureau has taken corrective action to secure all unprocessed mail after working hours and on weekends.

Another bureau, the Office of the Comptroller of the Currency, recognized that its data systems were vulnerable to unauthorized use. This occurred because its systems were expanded without updating procedures for user identification. The office is implementing a formal program for authorizing and monitoring use of its systems to eliminate and prevent unauthorized use.

A third bureau, the U.S. Mint, discovered several internal control problems related to the separation of duties. For example, in their Budget and Finance department, the bureau separated the duties of verification, certification, and disbursement of funds into different entities. Other problems which the Mint plans to correct are

--enhancing controls within the George Washington silver half-dollar program to maintain proper accountability;

--segregating duties and responsibilities related to the receipt, custody, and disposition of special assay coins; and

--limiting access to the ADP area at the Philadelphia Mint by unauthorized personnel.

While definite problems existed in 1983, benefits were nevertheless gained as indicated above. If a review of internal controls had not been conducted and material weaknesses identified, these problems would likely have remained unidentified. The bureaus are attempting to implement corrective action to resolve weaknesses found.

CONCLUSIONS

Treasury was able to establish the foundation for an internal control evaluation process in 1982-83. However, because of factors largely beyond its control, Treasury's process did not produce conclusive results concerning the adequacy of its internal controls. Treasury is working towards resolving the problems it encountered in its evaluation process. However, Treasury's efforts to correct problems would be enhanced by formally coordinating its new Information System Risk Management Program with its internal control evaluation process. If Treasury's corrective actions are effectively implemented, its evaluation process should produce more meaningful results in the coming years.

AGENCY COMMENTS

Treasury commented on this report by letter dated April 16, 1984. (See app. I.) Treasury stated that the report should provide considerable assistance in refining its future efforts to comply with the act. Specifically, Treasury concurred with our proposal that the Secretary should formally coordinate the operation of its Information System Risk Management Program with the internal control evaluation process to ensure that the objectives and requirements of both programs were met and to avoid duplicate reviews of ADP operations. Treasury said it was implementing our proposal and would discuss its progress in the 1984 annual report on internal controls.

Because of the department's efforts to implement our proposal, we deleted it from this report. We will, however, evaluate the effectiveness of its actions to coordinate both programs as a part of our ongoing effort to monitor Treasury's internal control evaluation process.

CHAPTER 3

FIRST-YEAR ACCOUNTING SYSTEM EVALUATIONS:

REASONABLE AND ACCEPTABLE

Treasury's accounting system evaluation efforts were, in our opinion, reasonable for the first year considering the lack of specific guidelines for evaluating accounting systems and Treasury's resultant late start in establishing its process. High-level officials were involved in establishing policies, procedures, and guidelines for making and monitoring accounting system evaluations. An effective evaluation questionnaire and uniform reporting format were developed and used to evaluate 23 accounting systems. The evaluations were done reasonably well, and the resulting reports were consolidated and formed the basis for Treasury's comprehensive annual report to the President and the Congress.

Although Treasury's efforts were reasonable given the circumstances the agency was faced with during the first year of a complex process, we believe improvements are needed in Treasury's 1984 evaluations to enable it to render a fully supportable opinion concerning the extent to which its accounting systems conform to the Comptroller General's principles, standards, and related requirements. Treasury needs to review its inventory of accounting systems to ensure that all systems, subsystems, and operations are identified and evaluated. Several were excluded from the first-year's effort. Also, 1984's evaluations should provide more in-depth reviews of the accounting systems and related internal controls in operation than were done in the first year.

Treasury officials told us that these improvements will be made in their 1984 evaluation process.

ACCOUNTING SYSTEM EVALUATIONS AND REPORTS WERE DONE REASONABLY WELL

The accounting system evaluations, which were done by knowledgeable Treasury and contractor personnel, were reasonably consistent and, in general, adequately documented. The evaluation reports disclosed about 220 instances of nonconformance to the Comptroller General's Accounting Principles and Standards and, for most, noted planned corrective actions. The reports were summarized and consolidated into a comprehensive report to the President and the Congress which identified 163 material instances of nonconformance.

High-level officials were involved in the process

Treasury began establishing its accounting system evaluation process in late June 1983 with the active involvement of the Deputy Secretary and the Administrative and Fiscal Assistant Secretaries.[4] The Deputy Secretary requested and received biweekly status reports on the progress of the evaluations. The Administrative and Fiscal Assistant Secretaries were directly involved in establishing the policies, procedures, and guidelines necessary to ensure compliance with the act.

The Administrative and Fiscal Assistant Secretaries issued memoranda to all bureau heads, beginning in late June 1983, which delegated to them the responsibility for making accounting system evaluations, identifying and scheduling needed improvements, and reporting on the results of the evaluations. The evaluation reports on administrative accounting systems were to be given to the Assistant Secretary (Administration) by October 23, 1983, and the reports on fiscal accounting systems were to be given to the Fiscal Assistant Secretary by November 7, 1983. The memoranda stressed the Assistant Secretaries' support of the process and their expectation of full support from the bureau heads.

The Assistant Secretary (Administration) also initiated action resulting in the creation of a two-member quality assurance team. The team was responsible for monitoring quality and timeliness and reporting on the status of the administrative accounting systems' evaluations. This team helped to ensure that the evaluations were being done adequately and consistently. The Fiscal Assistant Secretary may wish to establish such a team in 1984.

Further, the Assistant Secretary (Administration) initiated action resulting in the hiring of a contractor, Arthur Young & Company, to assist in or make the evaluations. The contractor's services were made available for use by any bureau needing assistance to meet the reporting deadlines. The contractor was responsible for developing a reporting format, consolidating the weaknesses identified in all reports, and determining the material weaknesses to be included in the annual report.

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[4]The Assistant Secretary (Administration) is responsible for 17 administrative accounting systems; the Fiscal Assistant Secretary is responsible for seven fiscal accounting systems. (See app. II.)

On June 27, 1983, the Assistant Secretary (Administration) established a task force to oversee the process and provide daily guidance. She appointed the Director, Office of Budget and Program Analysis in the Office of the Secretary, as the task force director. Each bureau was instructed to designate at least one official as its task force representative. In a July 6 meeting, which included the Deputy Fiscal Assistant Secretary and the task force director, two officials were appointed as full-time task force coordinators--one for administrative systems and one for fiscal systems--who were responsible for providing daily guidance.

Numerous task force meetings were held to discuss the policies, procedures, and guidelines for evaluating accounting systems and reporting on the results. In an early September meeting, a decision was made that accounting system evaluation teams would issue weekly reports on the status of their evaluations to the responsible task force coordinator. These weekly status reports were received from late September until the evaluations were completed and were used by the coordinators to monitor the evaluations.

Treasury's Inspector General was also involved in the accounting system evaluation process. He assigned a senior staff member to provide technical assistance at the department level. He also assumed responsibility for reviewing the process and its results in order to report to the Secretary of the Treasury regarding the adequacy of the evaluations. His auditors provided some technical assistance, reviewed the evaluations, including documentation and the resulting reports, and monitored and provided comments on the entire effort to help ensure that it was done in accordance with Treasury guidelines.

<u>Questionnaire and uniform report format developed</u>

Treasury developed its own guidelines for conducting and reporting on the results of its accounting system evaluations. Treasury officials had expected to use OMB guidelines for these purposes but, after frequent inquiries to OMB during June and July 1983 regarding the status of the OMB guidelines, they realized that the guidelines would not be available for the current year's evaluation efforts. Consequently, during August, they developed a questionnaire to be used in evaluating the accounting systems. Shortly thereafter, in concert with Arthur Young & Company, a uniform format for the evaluation reports was developed.

Treasury's questionnaire, a 51-page document containing about 400 questions, was based on the Comptroller General's April 18, 1983, Statement of Accounting Principles and

Standards for Federal Agencies. It also contained questions from a 1979 questionnaire which GAO used for reviewing accounting system design documentation for conformance to the Accounting Principles and Standards.

During a September 9 meeting, the questionnaire was discussed with and given to Treasury personnel responsible for evaluating accounting systems (evaluators). The evaluators were told to use the questionnaire to evaluate their accounting systems. All questions were to be answered either "yes," "no," or "not applicable," and each answer was to be adequately documented. The questions were phrased so that a "yes" answer indicated conformance to the Accounting Principles and Standards and a "no" answer indicated nonconformance. To answer the questions, the evaluators were to examine relevant documents, test transactions, conduct interviews, and observe operations.

Treasury's reporting format was discussed with and given to the evaluators during an October 7 meeting. They were told to prepare a separate report for each evaluated system. The report was to consist of a cover page and three appendices. The cover page was to include an opinion concerning the accounting system's conformance to the Comptroller General's Accounting Principles and Standards. Appendix A was to contain all instances of nonconformance (a "no" answer to any question in the questionnaire) to the Accounting Principles and Standards, corrective actions taken or planned, and the estimated time frames for correcting the weaknesses noted. Appendix B was to contain general information about the accounting system, including a narrative description of major system problems. Appendix C was to be the completed questionnaire.

Evaluations were reasonably done

The evaluations were reasonably consistent and, in general, adequately documented.

Using the questionnaire and reporting format, Treasury evaluated 23 accounting systems for conformance to the Comptroller General's Accounting Principles and Standards. Treasury identified 25 systems (see app. II) which account for all of its appropriations and funding sources; however, two were ruled not subject to the act by Treasury's General Counsel's office.

The evaluations were done by knowledgeable in-house personnel and contractor personnel. The evaluators were generally bureau financial management personnel who designed and/or operated the accounting systems. Contractors assisted with or did 12 evaluations. About 17,000 Treasury and contractor staff hours were spent on the evaluations at a total cost of about $541,000, as follows:

	Hours	Cost
Treasury personnel	9,144	$162,786
Contractor personnel	8,145	378,076
Total	17,289	$540,862

The evaluators completed the questionnaires primarily by reviewing design and other systems documentation. In addition, most developed lists of weaknesses previously identified in GAO, Inspector General, Internal Audit, contractor/consultant, and internal reports. The evaluators also reviewed related policies, procedures, and other guidance from Treasury, OMB, and GAO and observed some systems' operations but performed little testing of the systems. The evaluations and resulting reports generally met the due dates established by the Assistant Secretaries.

The evaluations disclosed about 220 instances of nonconformance to the Comptroller General's Accounting Principles and Standards. These pertained primarily to weaknesses in reporting (63 instances), property accounting (54 instances), and accounting for receivables (35 instances). In addition, 22 instances of nonconformance resulted from a lack of accrual accounting.

Material instances of nonconformance were summarized and consolidated by Arthur Young & Company and task force officials into a comprehensive annual report to the President and the Congress. The report identified 163 material instances of nonconformance pertaining to the 23 evaluated systems for which corrective actions and time frames were generally shown. Most of the deviations are to be corrected by systems modifications. The report also stated that corrective actions will be monitored by a committee chaired by the Deputy Secretary.

Our analysis of the weaknesses identified in the accounting system evaluation reports and the 163 material instances of nonconformance included in the annual report reveals that five systems, in particular, have significant problems. These five systems and the number of material instances of nonconformance are shown below.

System	Material instances of nonconformance
U.S. Customs Service:	
Administrative System	18
Revenue System	16
Alcohol, Tobacco and Firearms:	
Administrative System	15
Government Financial Operations:	
Central Accounting System	7
Public Debt:	
Fiscal System	28
Total	84

The five systems appear to have major systemic weaknesses. For example, the evaluation report on the Customs administrative accounting system noted that key areas of nonconformance included property accounting, accrual accounting, and labor distribution. These same weaknesses prevented us from approving this system in 1981 when it was submitted for our consideration. Although Alcohol, Tobacco and Firearms' new administrative accounting system, which was implemented on October 1, 1983, is a modified version of the Customs system, it contains weaknesses similar to those of the Customs system.

The accounting system problems noted in the annual report indicate that much needs to be done to fully conform Treasury's systems to the Comptroller General's Accounting Principles and Standards and related requirements.

1984's ACCOUNTING SYSTEM EVALUATIONS NEED TO BE IMPROVED

Although Treasury's efforts were reasonable given the circumstances the agency faced during the first year of the process, we believe that improvements are needed in its 1984 evaluations to enable Treasury to render a fully supportable opinion concerning the extent to which its accounting systems conform to the Comptroller General's principles, standards, and related requirements. Treasury needs to include all major systems, subsystems, and accounting operations in its evaluation process. Some of these, such as the accounting system of the eight regional disbursing offices, were not evaluated in the first year.

Also, 1984's methodology for evaluating accounting systems should provide for in-depth reviews of the systems in operation, including sufficient testing of transactions and determinations of the adequacy of internal controls. Such reviews were not done the first year because of lack of time.

Several important accounting operations were not evaluated

During our review of the first year's evaluation effort, we identified several systems, subsystems, and accounting operations which were not evaluated. The most significant exclusion was the accounting system of the eight regional disbursing offices. This Bureau of Government Financial Operations (BGFO) system annually accounts for over $600 billion in disbursements made for Treasury and other federal agencies. The system should have been evaluated and is of such significance that it also should have been included in Treasury's list of accounting systems.

Also excluded from evaluation were:

--BGFO's check processing and reconciliation subsystem. This subsystem records data on checks issued and payments made and reconciles all checks drawn on the U.S. Treasury.

--The Savings Bonds Division's (SBD) system. This system accounts for allotments received from the Bureau of the Public Debt (BPD). Although BPD's administrative accounting system accounts for SBD's appropriation, SBD's system accounts for obligations and disbursements from the initiation of the transactions through monthly reports to BPD.

--All accounting systems in field locations (except for BPD's lone field office system which was evaluated).

Treasury officials told us they plan to evaluate the check processing and reconciliation subsystem and the SBD system in 1984. They also said they plan to evaluate a representative number of regional disbursing office and field location accounting systems on a cyclical basis beginning in 1984.

In addition, because Treasury's General Counsel's office determined that the Exchange Stabilization Fund and the Saudi Arabian Deposit Account were not subject to the act, neither their internal controls nor their accounting systems were evaluated.

In a memorandum dated October 25, 1983, Treasury's General Counsel's office concluded that the Exchange Stabilization Fund, which the Secretary of the Treasury uses to foster orderly international monetary exchange arrangements and a stable system of exchange rates, is not subject to either the Financial Integrity Act or the Accounting and Auditing Act of 1950, which it amended. Treasury based its position on the Fund's unique statutory arrangement which grants the Secretary virtually absolute discretion over the Fund. The office also concluded that the Saudi Arabian Deposit Account, which controls Saudi funds advanced to finance procurements of goods and services made on behalf of the Saudi Government, is not subject to the act because the funds are not United States government funds.

We disagree with Treasury's General Counsel's office as to the Exchange Stabilization Fund. The Financial Integrity Act amended the Accounting and Auditing Act of 1950 for the express purpose of strengthening the internal control requirements of the 1950 act. The 1950 act (31 U.S.C. 3512) states that an agency's accounting and internal control systems shall provide "effective control over, and accountability for, assets for which the agency is <u>responsible</u>. . . " (31 U.S.C. 3512(a)(3))(emphasis added). The Financial Integrity Act in turn requires that each agency shall establish internal controls that reasonably assure that, among other things, ". . .<u>all assets</u> are safeguarded against waste, loss, unauthorized use, and misappropriation. . ." (31 U.S.C. 3512 (b)(1)(B))(emphasis added). Given the comprehensive coverage of this legislation, by its terms applying without qualification to assets for which an agency is responsible, all government funds and other assets should be considered subject to the Financial Integrity Act unless there is a clear statutory basis for not applying the act's requirements.

The Exchange Stabilization Fund consists of approximately $13 billion of government funds and other assets. The Secretary of the Treasury, together with the Treasury officials involved in the operation of the Fund, clearly are responsible and accountable for these government assets. Further, there is no explicit statutory provision exempting the Fund from the requirements of the Accounting and Auditing Act of 1950, specifically section 3512(a)(3) cited above.

The central basis of Treasury's position that the Fund is not subject to the requirements of the 1950 act is that the act applies only to "normal" government funds, which does not encompass those funds for which the Secretary of the Treasury has virtually absolute discretion. We find no such distinction in either the terms or the legislative history of the 1950 act. Therefore, we think Treasury cannot rely on this distinction as a basis for exempting the Fund.

For the above reasons, we believe Treasury is responsible for the assets of the Exchange Stabilization Fund within the meaning of section 3512 and therefore the Fund is subject to the Financial Integrity Act. Consequently, Treasury should include the Exchange Stabilization Fund in its 1984 evaluation process.

We are currently reviewing Treasury's position that the act does not apply to the Saudi Arabian Deposit Account.

More testing of systems in operation needed

Treasury needs to make more in-depth evaluations of its accounting systems and internal controls in operation. In the first-year's effort, the evaluations consisted of a limited review of systems in operation. There was almost no determination of the adequacy of internal controls in operation and little testing of transactions. Transactions must be tested to ensure that an accounting system, including its internal controls, is operating in conformance to the Comptroller General's principles and standards.

Treasury's accounting system evaluations included little testing of transactions. Treasury's guidelines required that the questionnaires be completed by reviewing documentation, testing transactions, and using other techniques to evaluate the systems in operation. However, because of lack of time, task force officials did not expect the evaluators to adhere to the guidelines and make in-depth reviews of the accounting systems and related internal controls in operation. Consequently, the evaluators completed the questionnaires by primarily reviewing design and other systems documentation.

Monitoring system needed

Treasury also needs to develop a system to monitor and follow up on weaknesses identified during the evaluation process to help ensure that each weakness is adequately corrected in a timely manner. A system is planned, but not yet approved, which will track identified accounting system weaknesses until each is corrected. The Systems Review Committee, under the chairmanship of the Deputy Secretary, is responsible for assuring that needed corrective actions are taken.

1984 evaluations to be more comprehensive

In August and September 1983, we discussed the agency's accounting systems evaluation approach and methodology with Treasury officials. We told them we considered it reasonable and acceptable considering it was the first year of a complex process. We also said that Treasury will need to make more comprehensive evaluations of its accounting systems and related internal controls in 1984 to render a fully supportable opinion concerning the extent to which the systems conform to the Comptroller General's principles and standards.

Treasury officials have acknowledged the limitations in the first year's effort and have stated that in-depth internal control reviews of accounting systems in operation will be done in 1984.

CONCLUSION

Treasury's accounting system evaluation efforts were reasonable and acceptable for the first year. Treasury evaluated 23 accounting systems and prepared a comprehensive annual report which disclosed 163 material instances of nonconformance with the Comptroller General's Accounting Principles and Standards. However, Treasury did not evaluate the accounting system and internal controls of the Exchange Stabilization Fund because its General Counsel's office incorrectly concluded that the Fund was not subject to the act.

To improve the process in 1984, Treasury officials plan to evaluate all major systems, subsystems, and accounting operations, except for the Exchange Stabilization Fund and the Saudi Arabian Deposit Account Fund systems. They also plan to make in-depth reviews of the systems and internal controls in operation, including sufficient testing of transactions. Further, they are developing a monitoring system to help assure that accounting system instances of nonconformance are corrected.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on this report (see app. I), Treasury maintained its position that the Exchange Stabilization Fund is subject neither to the Financial Integrity Act nor to the Accounting and Auditing Act of 1950, which the Financial Integrity Act amended. Treasury reiterated its previously cited central premise that the two acts apply only to "normal" government funds and that, because the Secretary has virtually absolute discretion over the Exchange Stabilization Fund, standard rules relating to government funds do not apply to the Fund.

We continue to disagree with Treasury's position. The Accounting and Auditing Act of 1950 requires that agency accounting and internal control systems effectively control and account for assets for which the agency is responsible. Thus, subject to an explicit statutory exemption, all government funds and other assets for which an agency is responsible are subject to the requirements of the 1950 act. The Exchange

Stabilization Fund was not specifically exempted from the 1950 act. Further, the Secretary of the Treasury is clearly responsible and accountable for the approximately $13 billion of government funds and other assets comprising the Fund. Therefore, we can reach no other conclusion but that the Exchange Stabilization Fund is subject to the requirements of the 1950 act. As the Financial Integrity Act is an amendment to the 1950 act, we must similarly conclude that the Exchange Stabilization Fund is also subject to its requirements.

Treasury also provided several other reasons to support its position that the Fund is exempt from the requirements of the two acts. We believe these reasons do not provide a legally sufficient basis for exempting the Fund.

First, Treasury stated that

--the Fund's operations often are based on judgment in highly sensitive, emergency financial circumstances, making it virtually impossible to assess the effectiveness of Fund operations, and

--the Fund's governing legislation specifies that the Secretary's decisions are final and may not be reviewed by another government officer or employee.

While we take no exception to these statements, we find that they are not relevant to the issue in question. The Financial Integrity Act is not designed to authorize us--or others--to question the Secretary's judgments or decisions concerning Fund operations. Rather, it requires that the Secretary (or his representatives) assess the adequacy of existing internal controls over the assets of the Fund. Specifically, the Financial Integrity Act requires the head of an agency to prepare an annual statement concerning whether the agency's systems of internal accounting and administrative control provide reasonable assurance that: (1) obligations and costs are in compliance with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for. Section 4 of the act also requires agency heads to prepare an annual statement concerning whether the agency's accounting system(s) conforms to the Comptroller General's accounting principles, standards, and related requirements.

It seems that Treasury is incorrectly equating its broad policy discretion over the use of government assets with its ultimate responsibility for properly accounting for and safeguarding the assets. Subjecting the Fund to the requirements of the 1950 act, as amended by the Financial Integrity Act, will not in any way interfere with the exercise of Treasury's discretionary authority. Treasury itself would perform the annual evaluation process. Further, the evaluation would focus on the internal controls over the assets of the Fund to protect against fraud, waste, or abuse, rather than on the merits of any decisions on the use of the Fund that the Secretary of the Treasury may make.

Second, Treasury stated that the Fund is currently subject to tight statutory control, including not only an annual report to the Congress but also a detailed monthly financial and operations statement to the cognizant committees.

The Fund's congressional reporting requirements are not a substitute for the evaluation and reporting requirements of the Financial Integrity Act. The reporting requirements specifically applicable to the Fund require disclosure of the financial status and the financial transactions of the Fund during a given period. They do not require, as mandated by the Financial Integrity Act, an evaluation of the internal controls that are in place to protect against fraud, waste, or misuse of government funds and other assets. Further, reporting, be it annual or monthly, is only one element of internal control. For example, reporting, in and of itself, does not provide assurance that key duties and responsibilities in authorizing, processing, recording, and reviewing Fund transactions have been properly separated among different individuals to minimize the risk of waste, loss, or misappropriation or that transactions and other significant events are being authorized and executed only by persons acting within the scope of their authority.

Third, Treasury stated that the Fund's accounting system differs from those used by other government accounts, in that it is based on commercial--rather than Comptroller General--accounting standards, thus exempting it from the provisions of section 4 of the act.

We disagree with Treasury's conclusion that because the Fund's accounting system is based on commercial accounting standards it is not controlled by the provisions of section 4 of the act. The Comptroller General's accounting principles, standards, and related requirements are certainly not inconsistent with the generally accepted accounting principles promulgated by the Financial Accounting Standards Board for use by the commercial accounting sector. Further, effective internal controls are a requirement of any accounting system. Consequently, we see no merit to Treasury's position.

In conclusion, we believe that the reasons Treasury has given do not provide a legally sufficient basis for exempting the Fund from the requirements of the Accounting and Auditing

Act of 1950, and hence the Financial Integrity Act. This comprehensive legislation applies without qualification to government assets for which an agency is responsible, and Treasury is clearly responsible and accountable for the $13 billion of government assets comprising the Fund. In the absence of a clear statutory basis for exempting the Fund from this comprehensive legislation, which in our opinion is not present, we must conclude that the Fund is subject to the Financial Integrity Act's requirements. Consequently, until the Fund is evaluated, the Secretary of the Treasury is not in compliance with the evaluation and reporting requirements of the Federal Managers' Financial Integrity Act.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

APR 16 1984

Dear Mr. Anderson:

By a letter of March 13, 1984, you provided the Department of the Treasury with a draft report entitled, "First Year Implementation of the Federal Managers' Financial Integrity Act by the Department of the Treasury." You asked for our review and comment prior to final issuance. This response constitutes the Department of the Treasury's comments.

The draft report represents an exhaustive review of the Department's first year efforts to implement the Act. As such, it is a highly useful document which should be of considerable assistance to the Department in refining our future efforts to comply with the Act's mandate. Consequently, we wish to acknowledge the assistance you have rendered in this regard.

The draft report contains two specific recommendations for improving the Department's internal control processes. The first of these relates to a suggestion that we more formally coordinate the operation of the new ADP evaluation program with the internal control evaluation process. We concur with this recommendation, and are taking action to implement this proposal. We will include our progress in implementing this proposal in our annual report required by the Act.

The second specific recommendation relates to the Department's Exchange Stabilization Fund (ESF). This recommendation states that ESF is covered by the Act, and as such should be evaluated pursuant to the Act's mandate. In reaching this conclusion, you rejected an opinion of the Department's Office of General Counsel to the effect that ESF was not subject to the Federal Managers' Financial Integrity Act and OMB Circular A-123.

It is the Department's position that the opinion of our General Counsel's Office accurately reflects the legal status of ESF and is entirely consistent with the Department's interpretations concerning the Fund over its roughly half-century of existence. ESF operations often must be based on judgment in highly sensitive, emergency financial circumstances as to what may or may not occur if ESF resources are used. Under such circumstances the effectiveness of ESF operations is virtually impossible to assess. This is recognized in the legislation governing the ESF which places the ESF under the exclusive control of the Secretary, subject to approval of the President, and specifies that decisions of the Secretary are final and may not be reviewed by another officer or employee of the Government. The Department has consistently viewed ESF as being exempt from standard rules related to Government funds, including the Budget and Accounting Act and the Antideficiency Act. Since the Federal Managers' Financial Integrity Act is an amendment to the Budget and Accounting Act to improve its operation--but not extend its scope--it is apparent that if ESF was not previously subject to the Budget and Accounting Act it is still not so subject and equally is not subject to the Federal Managers' Financial Integrity Act.

Moreover, the ESF is currently subject to tight statutory control including not only an annual report to Congress, but a detailed financial and operations statement <u>each month</u> to the cognizant committees. These controls are much more stringent than those imposed by the Financial Integrity Act. In addition, the accounting system utilized by ESF is not the same as that used by other Government accounts. Rather, ESF accounting is the equivalent to commercial accounting, incorporating accounting standards of the Financial Accounting Standards Board (FASB). Such a system is not controlled by the provisions of section 4 of the Federal Managers' Financial Integrity Act.

The GAO has been kept fully abreast of the accounting system employed for the ESF and has expressed its agreement with the system being used. In the Comptroller General's letter to the Treasury of August 23, 1978, following consultations concerning the presentation of certain items in ESF financial statements, the GAO noted that it had been Treasury practice to present the ESF annual report in accordance with generally accepted accounting principles. The GAO advised that as long as Treasury maintains this practice then GAO agreed that Treasury is correct in applying Financial Accounting

Standards Board Statement No. 8. We request that you reconsider the position taken in the draft report that the Department's Exchange Stabilization Fund is subject to the Federal Managers' Financial Integrity Act. As discussed above, we believe that the better position is that ESF, given its unique statutory arrangement and detailed statutory controls and reporting requirements, is not subject to the Federal Managers' Financial Integrity Act.

Sincerely yours,

T C Golden

Terence C. Golden
Assistant Secretary (Administration)

Mr. William J. Anderson, Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

LISTING OF DEPARTMENT OF THE TREASURY ACCOUNTING SYSTEMS

Bureau/Office system	Type of system: Administrative[a]	Fiscal[b]
Office of the Secretary		
--Administrative Accounting	X	
--Exchange Stabilization Fund[c]		X
--Office of Revenue Sharing	X	
--Saudi Arabian Deposit Fund	X	
--Treasury Payroll/Personnel Information System	X	
--Working Capital Fund	X	
Alcohol, Tobacco and Firearms		
--Administrative Accounting[d]	X	
Comptroller of the Currency		
--Administrative Accounting	X	
Customs Service		
--Administrative Accounting	X	
--Revenue Accounting		X
Engraving and Printing		
--Administrative Accounting	X	
Federal Law Enforcement Training Center		
--Administrative Accounting	X	
Government Financial Operations		
--Administrative Accounting	X	
--Central Accounting for Cash Operations		X
--Investment Accounting Operations		X
--Central Accounting for Foreign Currency		X
Internal Revenue Service		
--Administrative Accounting	X	
--Tax Lien Revolving Fund	X	
--Revenue Accounting		X
--Treasury Payroll/Personnel System (IRS Application)	X	

Bureau/Office system	Type of system: Administrative[a]	Fiscal[b]
Mint		
--Administrative Accounting	X	
--Bullion and Monetary Accounting		X
Public Debt		
--Administrative Accounting	X	
--Public Debt Accounting		X
Secret Service		
--Administrative Accounting	X	

[a]These systems account for appropriated funds. The Assistant Secretary (Administration) is responsible for these systems.

[b]These systems primarily account for revenues. The Fiscal Assistant Secretary is responsible for these systems (except the Exchange Stabilization Fund).

[c]Salaries and Expenses are paid out of and accounted for by the Office of the Secretary's Administrative Accounting System. The Under Secretary (Monetary Affairs) is responsible for the system.

[d]System implemented October 1, 1983.

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WASHINGTON, D C 20548