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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

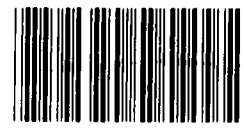
Implementation Of The Federal Managers' Financial Integrity Act: First Year

GAO recently issued reports on each of 22 federal agencies' implementation of the Federal Managers' Financial Integrity Act. The act is intended to help reduce fraud, waste, and abuse in the federal government through annual assessments by each agency of its internal control and accounting systems

GAO concluded that the agencies satisfactorily began their assessments, that they have demonstrated a strong management commitment to implementing the act, but that each agency needs to improve the quality of its self-assessments

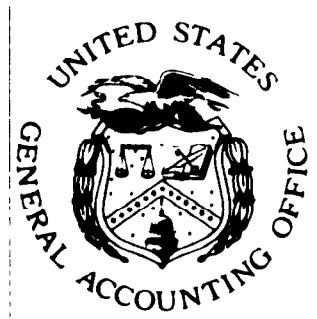
In their first annual statements, agencies disclosed internal control and accounting system material weaknesses that need prompt attention. The reported weaknesses covered the spectrum of government functions and programs

Agencies must begin developing and implementing comprehensive plans to correct these weaknesses and thus realize the potential for saving billions of taxpayer dollars. Correction of the problems is the "bottom line" of the act and will require a sustained high-priority commitment



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D C 20548

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The President of the Senate and the
Speaker of the House of Representatives

This report summarizes the results of our governmentwide review of agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b) and (c)), which is aimed at strengthening internal control and accounting systems in federal agencies. The review assessed the progress and problems encountered in 22 federal agencies' efforts to implement the act during the first year. Separate reports were issued to the heads of the 22 agencies. (See app. III.)

We are sending copies of this report to the Director of the Office of Management and Budget. Because the report discusses information that should be useful to all agencies in implementing the act, we are also sending copies to the heads of all federal agencies.

Charles A. Bowser

Comptroller General
of the United States

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ABBREVIATIONS

ADP	Automated Data Processing
DOT	Department of Transportation
GAO	General Accounting Office
GSA	General Services Administration
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IG	Inspector General
NASA	National Aeronautics and Space Administration
OMB	Office of Management and Budget
OPM	Office of Personnel Management
SBA	Small Business Administration
VA	Veterans Administration

D I G E S T

The Congress enacted the Federal Managers' Financial Integrity Act of 1982 in response to continuing disclosures of waste, loss, unauthorized use, and misappropriation of funds or assets across a wide spectrum of government operations. It is generally recognized that good internal control and accounting systems would have prevented, or made more difficult, the previous abuses. The goal of this legislation is to help reduce fraud, waste, and abuse, as well as to enhance management of federal government operations through improved internal control and accounting systems.

The act places with management the primary responsibility for adequate internal control and accounting systems. It requires agency heads to report annually on the status of these systems and provides for disclosure and correction of material weaknesses.

The act provides, for the first time, the necessary governmentwide discipline to identify and remedy long-standing internal control and accounting system problems that hamper effectiveness and accountability, potentially cost the taxpayer billions of dollars, and erode the public's confidence in government. (See p. 1.)

Ensuring successful implementation of the act is one of the General Accounting Office's (GAO's) priorities. As a result, GAO comprehensively reviewed the progress and problems in implementing the act at 22 departments and agencies which account for over 95 percent of all federal expenditures. (See pp. 4-5 and app. III.)

This report summarizes GAO's findings and suggestions for improvement, which were contained in individual reports sent to each agency. This report also addresses the need for additional guidance in evaluating automated data processing (ADP) and for better criteria in preparing annual reports required by the act.

FIRST-YEAR PROGRESS

Agencies made a good start in the first year in assessing their internal control and accounting systems, and have demonstrated a management commitment to implementing the act, with top agency and Office of Management and Budget (OMB) managers becoming involved.

Agencies are establishing a systematic process to evaluate, improve, and report on their systems, and GAO observed that federal managers were more aware of the need for good internal control systems and improved accounting systems. OMB played an active role, providing guidance and central direction to the program. Though the nature and extent of participation varied, most inspectors general also played a major role in the first year.

The first-year effort has been a learning experience, and much remains to be done to complete the evaluation process and correct identified problems. Agencies' first-year reports under the act, however, have disclosed material internal control and accounting systems problems that need prompt attention. (See pp. 6-10.)

MATERIAL WEAKNESSES REPORTED

In their first annual statements, virtually every major agency disclosed material weaknesses in internal control and accounting systems which cover the spectrum of government functions and programs. Together the reported weaknesses demonstrate that poor internal controls and ineffective accounting systems, involving billions of dollars, represent a serious problem in the federal government. Many of the material weaknesses identified in the agencies' first-year reports are long-standing and have been the subject of prior GAO and inspector general reports. As agencies continue to implement and perfect their evaluation processes, additional weaknesses will be identified for corrective action.

As shown in the following chart, reported material weaknesses can be generally categorized into eight areas. While GAO's review covered 22 agencies, 17 agency reports were analyzed for categorizing the reported weaknesses because the 6 agencies in the Department of Defense were covered by a consolidated report for all Defense operations.

CATEGORIES OF REPORTED
WEAKNESSES

<u>Category</u>	<u>Number of agencies</u>
Accounting/financial management systems	16
Procurement	14
Property management	13
Cash management	12
Grant, loan, and debt collection management	12
Automated data processing	10
Personnel and organizational management	9
Eligibility and entitlement	8

Brief discussions of the weaknesses reported in the eight categories follow.

First, 16 agencies reported material weaknesses in accounting and financial management systems. For instance, major weaknesses were reported in the overall accounting systems at the Departments of State, Housing and Urban Development, and Defense, as well as the General Services Administration. Other reported weaknesses include those of the Interior Department's systems to account for and to collect royalties in the multibillion dollar oil and gas royalty program. Prior GAO reports indicate the existence and long-standing nature of these reported weaknesses. (See p. 12.)

Second, eight agencies reported material weaknesses in eligibility and entitlement determinations. For example, the Department of Agriculture reported that it needs to increase the detection and collection of overissuances in its \$11-billion food stamp program, an area where GAO previously reported the need for better internal controls. (See pp. 12-13.)

Third, 12 agencies reported material weaknesses in grant, loan, and debt collection management. For instance, the Department of Education, which reported \$2.5 billion in delinquent debts at the beginning of fiscal year 1983, cited material

weaknesses in debt collection management in its first-year report. This agency has had long-standing problems in this area. (See pp. 13-14.)

Fourth, 14 agencies reported procurement weaknesses. The Department of Defense, whose procurement appropriation is \$86 billion for fiscal year 1984, cited ineffective controls over spare parts procurement and the need to reduce cost growth in weapons systems procurement. The Congress and the public have become concerned by Defense's systematically paying excessive amounts for some spare parts and by continued cost growth of billion-dollar weapons systems. (See p. 14.)

Fifth, 13 agencies reported material weaknesses in property management, with the General Services Administration reporting problems in its \$800-million annual leasing program. (See pp. 14-15.)

Sixth, 10 agencies reported material weaknesses in automated data processing. The Department of Health and Human Services reported 19 material ADP weaknesses, including shortcomings in its contingency planning in the event that the Social Security Administration's ADP facility were destroyed or became inoperative for a long time. (See p. 15.)

Twelve agencies reported material weaknesses in the seventh category, cash management. Included were the long-standing problems of allowing grantees to draw down funds prematurely and not being able to assure that timely payments are made to government contractors as required by the Prompt Payment Act. (See p. 15.)

Finally, nine agencies reported problems in personnel and organizational management, such as misclassifying personnel and poor position management practices as well as problems in training and hiring employees. (See p. 16.)

NEED TO IMPROVE IMPLEMENTATION EFFORTS

While progress occurred in the first year, a number of problems with agencies' implementation of the act--problems that one would expect in a new program--still exist. GAO has made suggestions to help correct problems with individual agency implementation efforts.

One of the major implementation problems was all programs and functions were not included in the evaluation process. For example, Treasury excluded

the \$13-billion Exchange Stabilization Fund. The fund is used to foster monetary exchange arrangements and a stable system of exchange rates. GAO concluded, however, that the fund is subject to the requirements of the act. Treasury disagrees with GAO's position. (See pp. 19-21.)

Another example was the Veterans Administration, which did not develop a comprehensive inventory of assessable units or assign responsibility to assess cross-cutting and common functions. As a result, some areas (such as medical care eligibility and telecommunications) were not assessed while other areas (such as ADP, travel, and time and attendance) were not consistently assessed agencywide.

Other areas also needing improvement can benefit from the following actions:

- Provide adequate instructions so managers have a good understanding of what is required of them. (See pp. 18-19.)
- Prepare adequate documentation of work performed and results obtained. (See pp. 21-23.)
- Better train managers to implement a largely unfamiliar process. (See pp. 23-24.)
- Ensure that the adequacy of ADP internal controls is considered in evaluations. (See pp. 24-26.)
- Encourage a positive attitude among managers and hold them accountable for the effective implementation of the process. (See pp. 26-27.)
- Test transactions to assure accounting systems are in conformance with the Comptroller General's principles, standards, and related requirements. (See pp. 27-29.)

Agencies have agreed to take these measures as part of their second-year implementation.

Also, to improve the second-year effort, GAO has recommended that OMB provide additional guidance in the areas of ADP and year-end reporting. Regarding year-end reporting, agencies are required by the act to report annually whether or not their internal control systems provide reasonable assurance that the act's objectives are attained. The act also provides for the identification of any material weakness in internal control, together with plans for corrective action. GAO found that although agencies disclosed many material weaknesses under the act in the first-year reports, OMB

needs to reexamine its reporting criteria for the second year. A clear, consistent understanding of what is meant by the terms "material weakness" and "reasonable assurance" is essential to assuring that future reporting will be complete and meaningful. GAO provided additional factors for agency consideration in determining whether a control weakness is material as well as an alternate approach to the present language used for reporting on reasonable assurance. While not included in the draft report provided to OMB for comment, GAO discussed the recommendations in the areas of ADP and year-end reporting with OMB officials and addressed the underlying problems in the draft. OMB officials said they would consider the need for further guidance. (See pp. 29-34.)

CONTINUED COMMITMENT IS VITAL

Now that the initial work in implementing the act has been accomplished, agencies need to develop comprehensive plans to correct the material weaknesses identified. Correction of problems represents the "bottom-line" of the act. The Congress, by requiring agency heads to report annually on the state of its internal control and accounting systems and to detail plans to correct identified material weaknesses has provided needed accountability and discipline. Recognizing the importance of corrective actions, OMB requires that agencies establish a formal follow-up system to help assure that recommendations for corrective action are implemented as scheduled.

As indicated earlier, many of the weaknesses identified to date are long-standing. They did not develop overnight, and their solutions will not be easy. It will take a sustained, high-priority commitment. While GAO's first-year review concentrated on agency efforts to establish a process to implement the act, the second-year review will focus more on agency actions to address the weaknesses identified, and on the accuracy and completeness of agency reports to the Congress.

The executive branch has demonstrated its commitment towards improving internal controls and accounting systems. In beginning the task of correcting the many material weaknesses in the internal control and accounting systems, the commitment should be channeled toward a common goal of rebuilding and strengthening the government's financial management structure.

Problems in the basic financial management structure cannot be resolved in a piecemeal manner; they

are too intertwined. Successful reform will require a comprehensive, long-term, integrated approach. This effort should be governmentwide in scope, serving the needs of both the Congress and the executive branch, by ensuring that consistent data are available across agency and department lines. The effort should stress (1) strengthened accounting, auditing, and reporting, (2) improved planning and programming, (3) streamlined budget process, and (4) systematic measurement of performance. (See pp. 35-37.)

AGENCY COMMENTS

In commenting on GAO's draft report, OMB agreed that a long-term commitment to improving internal control is necessary and that weaknesses identified in the first year must now be corrected. (See page 56.)

CHAPTER 1

INTRODUCTION

The Congress, in September 1982, enacted the Federal Managers' Financial Integrity Act of 1982 in response to continuing disclosures of waste, loss, unauthorized use, and misappropriation of funds or assets across a wide spectrum of government operations. The goal of this legislation is to help reduce fraud, waste, and abuse, and improve management of federal operations. The act provides for the first time the necessary governmentwide discipline to identify and remedy long-standing internal control and accounting systems problems that hamper effectiveness and accountability, potentially cost the taxpayer billions of dollars, and erode the public's confidence in government.

The act perpetuates the concept first embodied in the Accounting and Auditing Act of 1950--the primary responsibility for adequate systems of internal control and accounting rests with management. The Congress has taken a major step forward by requiring for the first time that the agency heads report annually on the status of their internal control and accounting systems and by holding managers publicly accountable for correction of weaknesses.

REQUIREMENTS OF THE ACT

Section 2 of the act requires that agency systems of internal accounting and administrative control must comply with internal control standards prescribed by the Comptroller General and must provide reasonable assurances that:

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

Agency heads are required to prepare annual statements on whether their internal control systems fully comply with the act's requirements. The act provides for the identification of any material weaknesses in their systems together with plans for corrective actions.

Section 4 of the act further requires that the agency heads' annual statements also include a separate report on whether the

agency's accounting system conforms to the Comptroller General's accounting principles, standards,¹ and related requirements.

The entire act is included in appendix I.

FRAMEWORK ESTABLISHED
FOR IMPLEMENTING THE ACT'S REQUIREMENTS

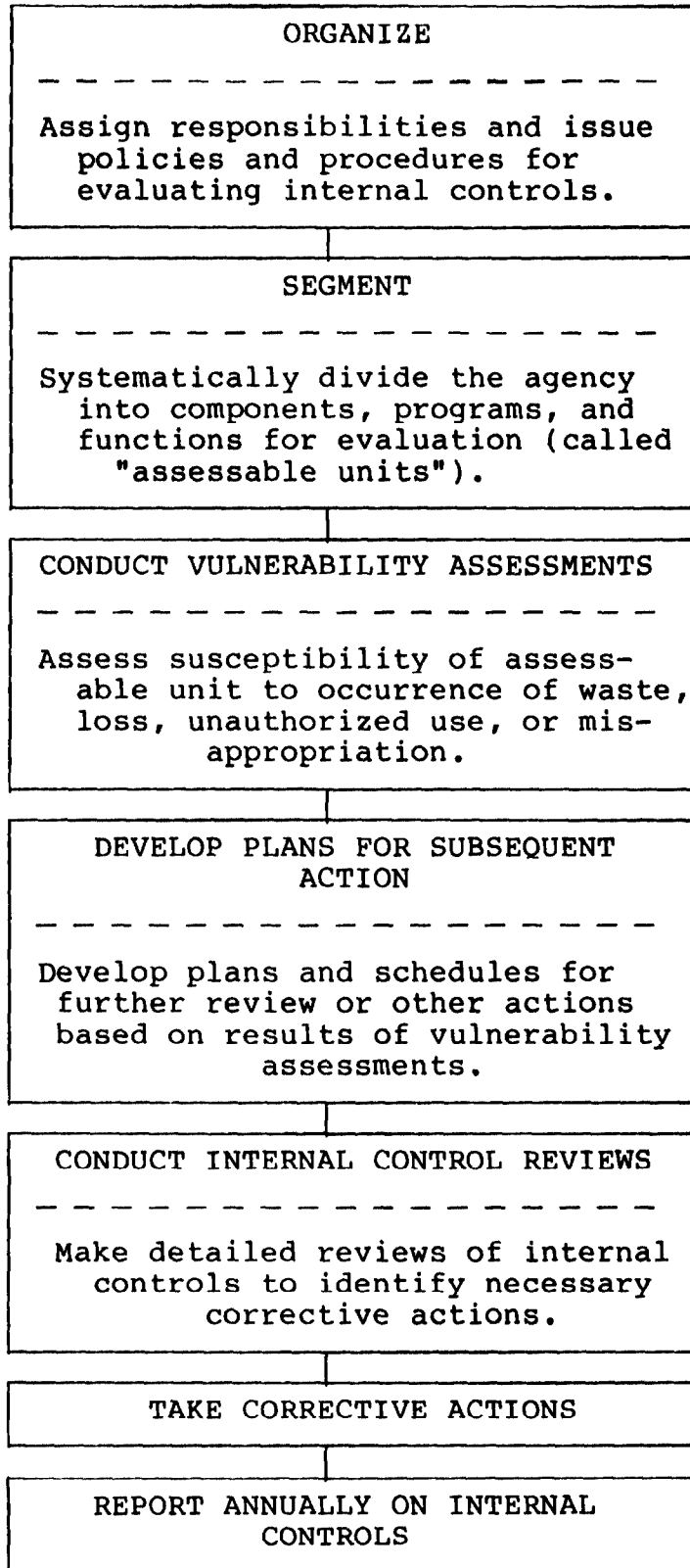
To provide the framework for implementation, as prescribed by the law, the Comptroller General issued standards for agencies to meet in establishing their internal control systems. The standards, which are summarized in appendix II, apply to program management as well as to traditional financial management areas and encompass all operations and administrative functions. In publishing the standards, the Comptroller General emphasized:

"The ultimate responsibility for good internal control rests with management. Internal controls should not be looked upon as separate, specialized systems within an agency. Rather, they should be recognized as an integral part of each system that management uses to regulate and guide its operations. In this sense, internal controls are management controls. Good internal controls are essential to achieving the proper conduct of government business with full accountability for the resources made available."

The Office of Management and Budget (OMB), in consultation with GAO, established guidelines for agencies to use in evaluating, improving, and reporting on their internal control systems. In short, OMB's guidelines provide that agencies segment their programs and functions into assessable units, evaluate the controls in each unit, identify and report all material control weaknesses, and take corrective actions. The OMB process is more fully presented in the following chart:

¹The GAO Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, while titles 4, 5, 6 and 7 specify requirements governing claims; transportation; pay, leave and allowance; and fiscal procedures, respectively. Also, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements such as Treasury Fiscal Requirements Manual and OMB Circulars.

OMB PROCESS TO EVALUATE
INTERNAL CONTROLS



OBJECTIVES, SCOPE, AND
METHODOLOGY

Assuring successful implementation of the Financial Integrity Act is one of GAO's priorities. As a result, we undertook a comprehensive review of efforts to implement the act at 22 federal departments and agencies, which account for over 95 percent of all federal expenditures. We have issued individual reports to each of the agencies included in our review, and this report summarizes our overall observations on the first-year implementation of the act. In addition, the report contains our observations and views regarding the need for better reporting criteria for preparation of annual reports required by the act and the need for financial management reform.

At each department and agency, our overall review objectives were to

- assess the process for evaluating and improving systems of internal accounting and administrative control,
- review progress toward assessing accounting systems conformance to the accounting principles, standards, and related requirements prescribed by the Comptroller General, and
- analyze the annual reports required by the act, paying particular attention to the material internal control weaknesses and the accounting system noncompliance.

Appendix III lists the 22 departments and agencies included in our review and the reports we issued.

The review was conducted between July 1983 and March 1984 at department and agency headquarters in Washington, D.C., and at various field offices throughout the country. Our review was made in accordance with generally accepted government auditing standards. We obtained official agency comments from OMB regarding the results of our review and from the 22 departments and agencies on the individual reports issued.

In reviewing the completeness of agency first-year reports, we considered the problems identified in the internal control and accounting system evaluation process of agency components as well as those identified in prior GAO and inspector general (IG) reports. The 22 agencies included in our reviews issued 17 reports to the President and the Congress. The 17 reports consisted of the reports issued by the heads of 16 departments and agencies and a single report by the Secretary of Defense, consolidating the results of all Defense organizations including the six Defense components (Office of the Secretary of Defense, Army, Navy, Air Force, Defense Logistics Agency, and Defense Mapping Agency). Throughout the review, we worked cooperatively with officials from the 22 departments and agencies, OMB, and the inspectors general.

The methodology for our evaluation involved

- assessing how the agencies organized and segmented the internal control program, which enabled us to determine whether complete coverage of all programs and functions was being achieved and whether adequate overall direction was being provided,
- reviewing guidance, instructions, vulnerability assessments, internal control reviews, and other records which documented the internal control evaluation process, and
- examining the component and agency reports on the status of internal controls to evaluate whether the reports accurately described the process used to assess internal controls, identified all known internal control weaknesses, and provided plans for implementing corrective actions.

We also reviewed the agencies' methods used during 1983 to identify and report on accounting systems and the material deficiencies in those systems as well as their compliance with the Comptroller General's accounting principles, standards, and related requirements. We interviewed responsible agency personnel to determine plans for developing specific policies and procedures for inventorying, testing, evaluating, and reporting on their accounting systems in the future.

During our review, we discussed specific suggestions on improvements needed in each agency's process with appropriate personnel and included these in our reports to agency officials.

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Chapter 2 of this report discusses progress made in the first year to implement the act and summarizes the material weaknesses reported by agency heads in their first-year statements. Suggestions for strengthening the process for detecting and reporting material internal control and accounting system weaknesses are discussed in chapter 3, while chapter 4 presents the need to for a sustained long-term effort to improve financial management throughout the government.

CHAPTER 2

AGENCIES MADE PROGRESS IN THE

FIRST YEAR IN IDENTIFYING WEAKNESSES

IN INTERNAL CONTROL AND ACCOUNTING SYSTEMS

In the first-year implementation of the Financial Integrity Act, OMB and agency officials committed themselves to establishing a systematic process for evaluating and improving their internal control and accounting systems. Federal managers in all 22 agencies included in our review became increasingly aware of this need and made important progress in this area. However, this first-year effort has been a learning experience, and much remains to be done to complete the evaluation process and to correct the wide range of material internal control and accounting system problems reported by agencies that need prompt attention.

OMB IS PROVIDING LEADERSHIP AND DIRECTION

One of the keys to progress in the first year was the emphasis the administration, through the OMB, placed on the act. OMB took a number of steps to help ensure federal agencies made prompt, consistent efforts to meet the act's requirements. As called for in the act, OMB published guidelines which provide a structured process for evaluating internal control systems and reporting their results. These guidelines are critical to help ensure a focused and consistent governmentwide approach to address the act's internal control requirements.

In addition, OMB actively provided central direction to the program by establishing a task force to assist the agencies in implementing the evaluation process. Throughout the first year, OMB arranged for meetings and seminars to discuss the guidelines and to prompt interaction among the agencies in resolving implementation and reporting problems. The task force also

- provided technical assistance on the evaluation process for internal control systems,
- monitored agency progress,
- facilitated the exchange of information among the agencies about promising evaluation methods and techniques, and
- counseled agency heads in preparing year-end statements on internal controls.

In the second year, OMB review teams also plan to be actively involved in the implementation process by monitoring progress and consulting with agency managers. OMB is working closely with the

Office of Personnel Management (OPM) in developing relevant training on all aspects of the internal control evaluation and reporting processes. Finally, OMB has issued draft guidelines for use in evaluating the compliance of accounting systems with the Comptroller General's principles, standards, and related requirements. As discussed further in chapter 3, guidelines in the accounting system area were not issued in the first year.

AGENCIES MADE PROGRESS IN REVIEWING THEIR INTERNAL CONTROL AND ACCOUNTING SYSTEMS

Problems as serious and long-standing as those faced by the government in strengthening agencies' systems of internal control and accounting are not overcome in one year. Evaluating agency internal control and accounting systems and correcting the problems identified are multiyear projects, which may require creating new systems, enhancing existing ones, or changing operational practices. In the first year, agencies demonstrated a commitment to moving forward so that the act will ultimately meet its objectives. Further, they made progress in reviewing their internal control and accounting systems.

Management commitment has been key

Agency heads expressed their commitment to the act through speeches, memoranda, and letters to employees, as well as through revised policies and directives. At most agencies, overall responsibility for implementation was assigned to top officials, usually at the assistant secretary level.

These officials, in turn, established internal control steering committees and other working groups, and issued internal control directives to focus agency efforts. The process required assigning responsibility not only at headquarters levels, but also at operating levels throughout the agency where daily program activities take place. In the larger agencies, thousands of managers and employees participated in carrying out the act's requirements. Widespread participation and accountability were, in our view, important to encourage the prompt and substantial efforts required.

At the Department of Health and Human Services (HHS), for example, the Assistant Secretary for Management and Budget served as the internal control manager, with authority to issue directives, monitor and evaluate performance, and advise the Secretary on the status of internal controls. The Assistant Secretary appointed an internal control steering committee which included representatives from the Office of Inspector General and the Office of the Assistant Secretary for Personnel Administration.

The committee determined the overall departmentwide approach for implementing the internal control requirements of the act and provided advice and technical assistance. Assigned staff provided quality control through monitoring and evaluation, and developed a

computerized system for tracking progress. The Secretary also made the head of each operating and staff division responsible for assuring that internal controls are employed in all aspects of the organization. Each operating and staff division head then appointed an internal control officer to see that internal control directives were properly implemented. Other agencies which established internal control committees included the Departments of Education, Housing and Urban Development (HUD), the Interior, and Labor.

In another example, at the General Services Administration (GSA), the Director of the Office of Oversight was assigned responsibility for ensuring adequate internal control systems. Within that Office, the Office of Program Oversight reviewed internal control systems and provided leadership. At the time, the Office of Oversight Director was the senior-level official reporting to the Administrator with a wide range of responsibilities, including reviewing program management. In August 1983, the Director was named Associate Administrator for Policy and Management Systems, retaining the Office of Oversight's responsibilities. This gave him a more prominent role in the organization and put him in an even better position to provide central leadership for internal controls. In addition, the concept of internal control was further strengthened in March 1983 when the Administrator directed that each GSA management official's performance plan (expectations) include internal control objectives and performance criteria. As of September 30, 1983, all 112 members of GSA's Senior Executive Service and 75 percent of its 1,952 merit pay officials had internal control statements in their performance plans.

Agencies begin determining vulnerability to fraud, waste, and abuse

In the first year, agency managers and their staffs made progress in assessing their internal control systems. As provided for in OMB's guidelines, vulnerability assessments are designed to measure quickly the risk of fraud, waste, and abuse, as well as to enable federal managers to establish priorities for detailed internal control reviews of high-risk areas. Agencies generally assessed the vulnerability of their operations in the first year.

Managers also began to undertake detailed internal control reviews. These reviews are designed to determine the adequacy of specific internal control objectives and techniques.

Agency first-year reports also detailed areas where actions to strengthen controls were taken during the year. For example, the Army reported it saved \$1.6 million by improving cash control procedures, avoided an estimated \$3.3 million in costs by more effective use of assets, and corrected \$71 million of accumulated errors in Civil Service Retirement Fund financial records.

Part of the Army's success in more effective use of resources may have been attributed to the active support of the Assistant

Secretary for Installations, Logistics, and Financial Management and of the Vice Chief of Staff. Further, top-level managers in major commands and staff offices were held accountable for, and were progressively more involved with, the program during the first year. Widespread endorsement of the program by these senior officials was important in the Army because of its very decentralized management/command structure.

Agency emphasis in the first year was on internal control evaluations. We noted various implementation problems which affected the usefulness of the vulnerability assessments and internal control reviews performed in the first year. As discussed more fully in chapter 3, efforts to evaluate their accounting systems were limited.

The types of implementation problems noted are not surprising given the size of the job and the newness of the program for many federal managers. Internal control and accounting system problems as serious and long-standing as those in many agencies are not entirely overcome in one year. While plans can be developed, top management commitment enlisted, and task forces appointed in a relatively short time, evaluating internal control and accounting systems and correcting identified weaknesses require much more time and effort.

Nevertheless, progress can be expected, and, for the 22 agencies we reviewed, progress has been made during the first year. We are encouraged that a systematic evaluation has been initiated but caution that agencies will need to sustain their commitment beyond the near future if the most serious obstacles to good internal control and accounting systems are to be overcome.

THE INSPECTORS GENERAL PLAY AN IMPORTANT ROLE

By virtue of their training and experience, inspectors general² (IGs) should play an important role in making the Financial Integrity Act work. OMB recognizes this in its guidelines and encourages IGs not only to evaluate internal controls as part of their normal reviews and audits of agency functions and operations but also to provide technical assistance in the agency effort to strengthen internal control systems.

Though the nature and extent of participation varied, the IGs generally played major roles in the first year's progress. They provided technical assistance, helped devise and conduct training programs, and consulted on internal controls. For example, the HUD

²In this context, the term inspector general refers to statutory as well as nonstatutory audit organizations. For example, the Army does not have a statutory Inspector General but has a non-statutory Auditor General.

IG who was heavily involved in assuring implementation of the act, provided technical assistance to the HUD Internal Control Officer in the development of the agency's internal control evaluation methodology and in implementing instructions.

The IGs also reviewed the evaluation process, made recommendations for improvement, and gave the agency heads their opinion on the first annual reports. The HHS IG, for example, pointed out in a December 12, 1983, memorandum that the agency had omitted some programs and activities from the evaluation process and that improvements were needed in performing vulnerability assessments and internal control reviews. The IGs now plan to include internal controls in their future audits. For example, the Defense IG informed his auditors that all reviews must address the internal controls that relate to the program or function being audited.

Agencies have benefited from active IG involvement. We worked closely with the IGs in the first year and plan to do so in the future. Their active involvement in overseeing the process and in providing technical support to agency management is important to the success of the FIA program.

AGENCIES REPORT A WIDE RANGE
OF INTERNAL CONTROL AND ACCOUNTING
WEAKNESSES

The first-year effort was a learning experience, and much remains to be done to comply with the act. Agencies' first-year reports disclosed serious and extensive material internal control and accounting systems problems needing prompt attention. Reported weaknesses covered the spectrum of government functions, programs, administrative activities, and accounting systems. Many of the material weaknesses identified are long-standing and have been the subject of prior GAO and IG reports.

In the aggregate, the year-end reports represent the first overall assessment of the federal government's systems of internal control and accounting and highlights the seriousness of the areas as shown in the following chart and discussed below.

CATEGORIES OF REPORTED MATERIAL WEAKNESSES
(AS OF DEC. 31, 1983)

AGENCY	Automated data processing	Eligibility and entitlement	Accounting/financial management systems	Grant, loan & debt collection management	Personnel and organizational management	Procurement	Property management	Cash management
Agriculture	X	X	X	X	X	X	X	X
Commerce		X	X	X			X	
Defense ¹	X		X	X		X	X	X
Education		X	X	X	X	X		X
Energy			X			X	X	
GSA	X		X			X	X	
HHS	X		X	X	X	X	X	X
HUD		X	X	X	X	X		X
Interior	X	X	X	X	X	X	X	X
Justice			X	X	X	X	X	X
Labor	X	X	X	X		X	X	X
NASA ²	DID NOT REPORT ANY MATERIAL WEAKNESSES							
SBA	X	X	X	X	X	X		X
STATE			X		X	X	X	X
Transportation	X		X	X		X	X	X
Treasury	X		X				X	
VA	X	X	X	X	X	X	X	X
TOTAL	10	8	16	12	9	14	13	12

¹Six Department of Defense agencies (Office of the Secretary of Defense, Army, Navy, Air Force, Defense Logistics Agency, and Defense Mapping Agency) were included in one report to the Congress and the President.

²Although the National Aeronautics and Space Administration (NASA) did not report any material weaknesses, GAO believes that some of the problems disclosed in NASA's evaluation process may indicate material weaknesses. NASA has agreed to improve its reporting process.

Accounting and financial management systems

Sixteen agencies reported material weaknesses in accounting and financial management systems in their first annual reports to the President and the Congress. Timely, accurate information from agencies' accounting and financial management systems should provide federal managers with sound financial data to analyze program operations and make decisions on how to conserve, control, protect, and use resources wisely. However, agencies' first-year reports show this is not the case in many agencies.

The Department of State, for example, reported that its accounting systems are weak, and it is now developing new worldwide systems for general budgeting and accounting, as well as real estate, property, and cost accounting. HUD reported that its systems are cumbersome, costly to change or enhance, error prone, and difficult to control. GSA stated that one of its major accounting systems did not provide timely, accurate, or reliable reports to users. The Interior Department reported material weaknesses in its multibillion dollar oil and gas royalty program, and the Department of Defense identified a wide range of financial management problems including weaknesses in its yearly \$15-billion foreign military sales program.

Defense, in reporting on the compliance of its accounting systems with the Comptroller General's principles, standards, and related requirements, also pointed out that 98 of 154 systems, or systems segments, did not comply and had deficiencies in such areas as general ledger control and reporting, property accounting, cost accounting, accrual accounting, military pay entitlements, in-transit property accountability, system documentation, and interfaces between accounting system segments.

Prior GAO reports confirm the existence and long-standing nature of the above weaknesses. For example, both GAO and HUD's IG have issued a series of reports over the years, pointing out that HUD's accounting systems had received little attention or the funding necessary to keep them timely, accurate, and sufficiently automated to meet the agency's needs (for example, GAO/RCED-84-9, Jan. 10, 1984). We have issued numerous reports dating back 25 years addressing problems in accounting and collecting for all oil and gas royalties (for example, FGMSD-79-24, Apr. 13, 1979; AFMD-82-6, Oct. 29, 1981; and GAO/AFMD-83-43, Jan. 27, 1983). Also, GAO and Defense auditors have issued numerous reports citing problems in cost recovery and accounting for Defense's Foreign Military Sales Program (for example, GAO/AFMD-84-12, Dec. 12, 1983).

Eligibility and entitlement determinations

In order to assure that only individuals and organizations who are entitled to or eligible for funds, resources, or services under

government programs receive them, federal agencies need to establish controls to assure that prerequisites such as age, income limits, and military service are met. Eight agencies reported material weaknesses in this area.

The Department of Agriculture reported that it needs to increase the detection and collection of overissuances in its \$11-billion food stamp program. GAO found the need for greater efforts to recover costs of food stamps obtained through errors or fraud and noted in a report issued last year that of \$2 billion in food stamp overissuances in a 2-year period, only \$20 million, or 1 cent of each overissued dollar, was subsequently recovered (GAO/RCED-83-40, Feb. 4, 1983). The net drain on program resources could have provided benefits to about 1.7 million needy people for 2 years.

The Veterans Administration (VA) reported that it did not have adequate control over who received services under some of its medical care programs. In this regard, we previously reported that the VA, by not maintaining a central control file of individuals ineligible for medical benefits, had incurred \$15 million in costs (HRD-81-77, July 2, 1981).

The Department of Labor reported that controls in the Black Lung Program and the administration of the Federal Employees Compensation Act needed modification to reasonably assure that (1) payments to medical providers are accurate and timely, (2) medical providers engaging in illegal activities are debarred, and (3) charges by providers for medical services are reasonable.

Grant, loan, and debt collection management

Twelve agencies reported material weaknesses in the area of grant, loan, and debt collection management. For example, the Commerce Department's first-year report cited material weaknesses in the management of the Economic Development Administration's business grants and loans. Problems identified included (1) the failure to meet program objectives to create or maintain jobs and (2) a high rate of loan defaults and delinquencies caused by inadequate efforts to ensure loans are made on a sound basis and by poor loan servicing. This is confirmed by a February 1984 Commerce IG report which disclosed that approximately \$465 million, or 46 percent, of the \$1-billion business loan portfolio is delinquent or in default.

In another example, the Small Business Administration (SBA) reported that its personnel did not sufficiently analyze loan application packages and document the rationale behind loan approvals. Consequently, loans could be approved for ineligible applicants. The Department of Education cited an insufficient degree of assurance that only eligible institutions receive funds from the National Direct Student Loan Fund.

Billions of dollars are at stake in the debt collection area. While the government has made strides in recent years to strengthen

debt collection, problems still remain. For example, Education, which reported \$2.5 billion of delinquent debt at the beginning of fiscal year 1983, has had long-standing problems which have been reported by GAO (GAO/AFMD-83-57, Apr. 28, 1983).

Procurement

Sound controls over agency procurement processes can help assure that only goods and services needed are ordered, prices paid are reasonable, and goods purchased meet quality standards. Fourteen agencies reported weaknesses in this area.

The Department of Defense, whose procurement appropriation was \$86 billion for fiscal year 1984, cited several weaknesses in its first-year report. Included were disclosures of ineffective controls over spare parts procurement, the inability to control the cost growth rate of weapon systems procurement, lack of competition and sources for supplies, and inadequate verification procedures for material shipments. Audits by GAO, Defense's IG, and the military service internal auditors have all confirmed the need for improvement in the Defense procurement program (PLRD-82-104, Aug. 2, 1982). As a result, the public becomes concerned by reports of Defense paying excessive amounts for some of its spare parts and of the escalation of prices for major weapons systems.

The Department of Energy cited problems in the business and administrative aspects of managing the multibillion dollar Strategic Petroleum Reserve project. The problems experienced involved oversight and monitoring of contractor accounting systems, cost controls, contractor management systems, and prime contract administration.

Property management

Thirteen agencies reported material weaknesses in property management. GSA, for example, reported material weaknesses in its \$800 million annual leasing program. In this regard, last year GAO reported that GSA incurred \$16 million in overpayments, overcharges, waste, and improper accounting attributable to control weaknesses in leasing office space, nonrecurring reimbursable work, and investments in operating equipment (GAO/AFMD-83-35, Jan. 4, 1983).

Justice reported inadequate internal control for millions of dollars of seized assets (such as yachts, airplanes, expensive foreign automobiles, and a wide range of legitimate businesses). GAO and Justice's internal auditors previously reported problems in this area, particularly in the custody and disposition of seized property (GAO/PLRD-83-94, July 15, 1983). Among the problems were the deterioration of the assets before they were sold (vehicles selling for only 58 percent of their value at seizure, boats for 43 percent, and aircraft for 35 percent).

Defense reported that its controls over property need strengthening and that the lack of these controls has adversely impacted the management of all property held by the Department or furnished to contractors. The Department of Transportation's (DOT's) Urban Mass Transportation Administration identified grantees with real property in excess of project needs. Most excess property was not needed for the projects when acquired while other property was acquired for approved purposes but never utilized. DOT reported that at two major grantees, the excess real property had an estimated market value of \$46.8 million.

Automated data processing

Ten agencies reported material weaknesses in automated data processing (ADP). The agencies we reviewed have over one hundred major automated systems which control billions of dollars of assets, receipts, and expenditures, such as, \$289 billion in income security payments; \$600 billion in revenues from tax administration; and over \$68 billion in salary and benefits for active and retired military personnel. Further, many of these systems perform a critical role in federal operations, such as air traffic control, and military command control and communications.

A frequent problem agencies reported was system security, including protecting automated information, and controlling the automated resources that process, maintain, and disseminate it. For example, HHS reported 19 material weaknesses in the automated data processing area, including contingency planning in the event that the Social Security Administration's ADP facility was destroyed or became inoperative for an extended period of time. GAO reported in 1980 that federal agencies have not practiced effective risk management and have not developed adequate ADP systems to maintain continuity of operations in emergency situations (AFMD-81-16, Dec. 18, 1980).

Cash management

The government has long had cash management problems such as prematurely disbursing funds, thereby increasing its borrowing costs. It is, therefore, not surprising that 12 agencies' first-year reports identified material weaknesses in cash management.

HHS reported that grantees were permitted to maintain excessive cash balances resulting in unnecessary interest costs to the government, which has been a long-standing problem. Also, HUD reported a material weakness in the use of lump-sum drawdowns in connection with its Community Development Block Grant program, which may result in grantees drawing funds prematurely. The HUD IG had previously questioned over \$42 million in costs because of excessive drawdowns and ineffective use of these funds. Also, two agencies (Defense and VA) reported the need to improve controls to assure that payments are made more timely (neither early nor late) as required by the Prompt Payment Act.

Personnel and organizational management

Nine agencies reported problems such as misclassifying personnel and poor position management practices which caused the government to incur unnecessary costs. Agencies also reported problems in the training and hiring of employees as well as organizational problems.

CHAPTER 3

STRENGTHENING THE PROCESS FOR DETECTING AND REPORTING

INTERNAL CONTROL AND ACCOUNTING SYSTEM WEAKNESSES

While important progress occurred in the first year, our review identified certain problems with implementation of the act--problems that one would expect in a new program. We worked closely with the agencies and OMB, and have made suggestions and recommendations to help correct problems in individual agency implementation efforts. Generally, agencies have taken or plan to take corrective actions.

To strengthen the evaluation and reporting process in the second year, agencies need to

- strengthen the process for detecting material internal control weaknesses,
- perform more effective evaluations for detecting accounting system weaknesses, and
- improve year-end reporting of internal control weaknesses.

STRENGTHENING THE PROCESS FOR DETECTING MATERIAL CONTROL WEAKNESSES

For a number of reasons, agency internal control evaluations, including vulnerability assessments and internal control reviews, needed improvement. As a result, all material internal control weaknesses may not have been identified. To help strengthen the quality of the process for detecting material internal control weaknesses, departments and agencies must

- provide adequate instructions so that managers will have a better understanding of what is required of them,
- assure all organization functions and units are subject to the evaluation process,
- prepare adequate documentation,
- better train managers to implement a largely unfamiliar process,
- ensure that the adequacy of ADP internal controls are considered in evaluations, and
- encourage a positive management attitude and hold managers accountable for the effective implementation of the process.

All of these actions are interrelated, thereby requiring that departments and agencies take a comprehensive rather than a piecemeal approach to devising and implementing an effective process for detecting material internal control weaknesses.

Departments and agencies need to provide adequate instructions

While most departments and agencies issued instructions implementing the OMB guidelines, improved instructions would enhance the internal control evaluation process by providing a better understanding of managerial responsibility. To evaluate effectively internal control systems, agencies should provide managers with definitive instructions on such matters as (1) the role of the manager in assuring the quality of the evaluation process, (2) the type and amount of documentation required, (3) the content and schedule for training, (4) scheduling of the evaluation process, and (5) internal reporting and follow-up systems established to monitor the performance of the various tasks that make up the evaluations.

As shown in the examples below, problems with department and agency instructions varied widely.

- In performing vulnerability assessments, organizational units at the Department of State were allowed to follow either of two sets of guidelines State had developed, or any other methodology if results could be reported in conformance with a prescribed format. The criteria in the two sets of guidelines were not fully consistent. For example, one set of guidelines did not consider policies and procedures as a factor for assessing a program's or function's vulnerability, and neither provided for an assessment of compliance with the Comptroller General's internal control standards. Therefore, ranking the vulnerability assessment results was difficult.
- The Department of Energy did not have written procedures to help its managers review the quality of vulnerability assessments. Guidelines did not specify who should review the assessments or what methods should be used to check the quality of the work.
- In the absence of strong central guidance, the four Justice components (the Bureau of Prisons, Federal Bureau of Investigation, Drug Enforcement Administration, and Immigration and Naturalization Service) generally interpreted OMB guidance independently and established their own procedures without a departmentwide perspective. This resulted in differences in the quality and usefulness of internal control reviews. For example, the only internal control review completed at the Drug Enforcement Administration placed too great an emphasis on future operations rather than an evaluation of current ones. At the Immigration and Naturalization Service, the results of seven internal control reviews

were consolidated, and from available documentation it could not be determined which offices had the internal control weaknesses. We observed that the Bureau of Prisons, whose internal control reviews were the most useful, had specifically developed detailed instructions for conducting the reviews. Also, the internal control officer assisted in training personnel involved in the reviews and closely monitored the review results.

--Problems with guidance adversely affected the Army's internal control evaluation process. Guidance varied because OMB and Army guidance were published at various times during the 18-month period in which evaluations were done. Once guidelines were published, distribution to managers was slow. Also, the Army regulation provided suggested formats but did not require standard documentation, and it did not contain specific step-by-step instructions for performing evaluations. Further, detailed guidance for evaluating ADP activities was not issued. We noted, and Army officials agreed, that the lack of specific guidance resulted in the vulnerability assessments and internal control reviews being performed inconsistently or inadequately. The Army is developing more specific internal control guidance and training for managers.

--DOT did not develop written procedures for implementing the internal control evaluation process. Instead, it delegated full responsibility for implementing the process to its offices and administrations who devised inadequate and inconsistent procedures.

In general, departments and agencies agreed to take needed corrective action to devise adequate instructions for the second year's implementation.

Ensuring adequate coverage of all activities and functions

The initial step in the internal control evaluation process is to divide the entire organization into appropriate units of manageable size for evaluating, thus laying the foundation for the vulnerability assessments and the internal control reviews. Unless the entire organization is accounted for, regardless of how well the rest of the process is performed, a complete assessment of an organization's controls will not result.

We found that departments and agencies did not include all of their functions and activities in the evaluation process.

Coverage of all functions and operations required

OMB's guidance specified that the process of dividing and subdividing the organization should result in units--commonly referred

to as assessable units--of an appropriate size and composition for performing meaningful and efficient evaluations. Should an assessable unit be too large, or contain dissimilar operations, its overall vulnerability cannot be readily classified.

Because of the diverse nature of federal operations, their organization, and their execution, the OMB did not determine a specified way to segment an agency. The guidelines, instead, provide an overall framework suggesting an approach to the process whereby agencies first segment themselves into organizations or components, and then further divide each of these into the program or administrative functions within each segment.

Complete coverage not attained
in the first year

For a variety of reasons, the segmentation process at many agencies was not fully effective, and, in some cases, functions and activities were knowingly excluded.

--The Department of the Treasury excluded from the evaluation process the \$13-billion Exchange Stabilization Fund, which it uses to foster orderly international monetary exchange arrangements and a stable system of exchange rates. Treasury's Office of General Counsel concluded that the fund is subject to neither the Financial Integrity Act nor the Accounting and Auditing Act of 1950, which the former act amends, because of a unique statutory arrangement which grants the Secretary virtually absolute discretion over the fund. We disagree with Treasury. The assets of the fund are United States government funds, and Treasury officials clearly are responsible and accountable for them. Thus, the fund is subject to the requirements of the Financial Integrity Act given the comprehensive coverage of this legislation, which by its terms applies without qualification to the assets for which an agency is responsible. Treasury recently reaffirmed its disagreement with us.

--The Department of Labor's Internal Control Policy Board did not specifically prescribe to organizational units how an inventory of assessable units should be developed. Organizational units, therefore, developed their own definitions. As a result, determining whether all functions within the organizational units were adequately covered was difficult. The department agreed that it needs to develop a better inventory of assessable units, and it is taking action to ensure such an inventory.

--VA did not develop a comprehensive inventory of assessable units or assign responsibility to assess cross-cutting and common functions. As a result, some areas (such as medical care eligibility and telecommunications) were not assessed while other areas (such as ADP, travel, and time and attendance) were not consistently assessed agencywide.

--Programs and functions used for segmenting the Navy (for example, financial, supply, and maintenance, repair and overhaul) were found by managers to be too broad to permit meaningful vulnerability assessments. As a result, the assessments were of limited value in identifying specific programs and functions to review for internal control weaknesses. In addition, many Navy activities were not included in the first-year implementation. Some of the more prominent examples are the 63 field activities under the Naval Sea Systems Command, all operational forces, including ships and aircraft squadrons, and most parts of the headquarters of the Office of the Chief of Naval Operations. The Navy indicated it would take corrective action.

Agency officials have generally recognized the problem of including all significant functions and activities and properly segmenting them for evaluations. Several agencies already have plans underway to revise and improve their segmentation. Also, in March 1984, OMB conducted a seminar and work session with a number of federal agencies to share lessons learned from the first-year experience.

Need to document work
performed and its results

Agencies did not adequately document the evaluations they completed in the act's first year. Not maintaining adequate documentation diminishes the usefulness of the internal control evaluation efforts.

Adequate documentation is
essential for the process
to be effective

OMB's internal control guidelines specify that federal agencies should maintain adequate documentation for all phases of their evaluation process. Such documentation should at a minimum provide a permanent record of (1) what functions and activities were assessed, (2) how and by whom assessments were performed, and (3) what the rationale for conclusions was. This information is needed to document accomplishments to date and, even more importantly, to provide a basis for future efforts. Documentation of work accomplished is needed to provide a reliable basis for

- determining how well evaluations were accomplished and whether personnel performed effectively,
- evaluating whether conclusions reached are valid and reasonable,
- familiarizing new employees and managers with the status of their organization's internal control systems,
- planning future work by showing areas already reviewed and effective evaluation methods, and

--developing meaningful corrective actions specifically designed for the problem areas identified.

In short, good documentation is essential in achieving the act's objectives, both in terms of maximizing the benefit from work already performed and in planning corrective actions and future evaluations.

Most federal agencies did not sufficiently document the first year's process

Although the agencies we reviewed made some attempt to document their first year's work under the act, in most cases their documentation did not include the amount and depth of information needed to support the organizations' conclusions regarding the adequacy of their internal control systems. The documentation we examined was vague and overgeneralized, lacking specifics on such matters as assessable units, functions and characteristics evaluated, methods used to carry out assessments and reviews, or factors considered in reaching conclusions.

An exception to this was the Bureau of Prisons. In conducting its vulnerability assessments, the bureau adequately described the scope of its assessable units and documented its assessment of management attitude and evaluation of safeguards. The assessments we reviewed appeared to be useful to Bureau of Prisons managers.

Shortcomings in documentation encompassed the segmentation, vulnerability assessment, and internal control processes.

--Department of Agriculture agencies varied considerably in the extent and quality of documentation of their vulnerability assessments and internal control reviews. Six of the 11 components we reviewed used questionnaires or checklists to prepare their vulnerability assessments. For these agencies, we were usually able to determine the methods used and the support for conclusions. The remaining five components used a more subjective evaluation process which usually resulted in less documentation for conclusions. Similarly, we noted weaknesses in documentation for the 10 internal control reviews we examined. We found instances in which the criteria for findings and conclusions were not always described, and it was not always clear how the review results were to be used. Therefore, the accuracy and completeness of these assessments and reviews could not be easily evaluated by departmental officials or independent reviewers. The department needs to stress the importance of maintaining adequate supporting documentation in its guidance to its components. The department has taken corrective action to improve the quality and extent of documentation.

--While acknowledging the need for documenting its vulnerability assessments, DOT did not prescribe what documentation it considered necessary. The result was a general lack of and

inconsistency in the documentation of the assessment process among the DOT offices and administrations, and an inability on the part of DOT management to review the effectiveness of assessments made.

- The SBA did not adequately document the segmentation and vulnerability assessment phases of its internal control evaluation process. For example, the SBA ranked as moderate the vulnerability of its \$16-billion loan portfolio management. Although the ranking may be appropriate, no documentation supported the rationale for reaching this conclusion.

Federal departments and agencies can remedy these weaknesses by addressing documentation more specifically in their instructions and training. In this regard, the question often arises as to "how much documentation is enough." One useful rule of thumb is that the amount and depth of documentation should be sufficient so that others, in reviewing an evaluation, could determine the basis for the conclusions.

Need to expand training efforts

Agencies we reviewed provided some training for performing vulnerability assessments and internal control reviews. Though the training was generally helpful, in our view its effectiveness was limited because a relatively short time was available in the first year to develop and conduct training programs. Also, the lack of familiarity with the processes in meeting the act's evaluation requirements hampered identification of specific kinds of necessary training. However, the experience gained in the act's first year will provide agencies with a better basis to identify and provide for their training needs.

Problems encountered in first-year training

Our review noted numerous problems which hampered the effectiveness of agencies' training efforts. These included (1) not training employees charged with actually performing reviews and assessments, (2) conducting training after key elements of the process had already begun, and (3) providing training which did not address the specifics of how to identify and evaluate internal controls.

- The DOT training program had weaknesses including a lack of timeliness, comprehensiveness, and attendance by those needing training. Training was scheduled after the segmenting and vulnerability assessment processes had been completed, and the training primarily dealt with the internal control review process. While the department's training program established a good awareness of the internal control program, many staff members doing the assessments had never been trained.

- The Department of the Interior's IG recommended that bureaus and offices train their staffs to conduct and document internal control reviews. The IG found that bureau and office personnel had not adequately performed internal control reviews. For example, the IG noted that the internal control review completed on the Bureau of Land Management's onshore oil and gas inspections program did not identify potential risk or levels of acceptable risk. Also, the staff did not test controls to ensure they were in use and operating as planned.
- Training efforts by the Department of Justice were limited in scope and duration. The department's two training sessions focused on developing inventories of office functions subject to internal controls and on performing vulnerability assessments. The meetings were directed at high-level officials and appeared to be more informative than instructive. Moreover, the training did not provide instruction on performing internal control reviews.
- In a letter to the Secretary of Education, the IG stated,

"We found that ICR's [internal control reviews] . . . were performed with varying degrees of compliance with OMB and departmental guidelines. This may have been due in part to the fact that 45 percent of the participating ICR team members did not receive ICR training."

Such problems may well have been unavoidable given the wide range of new efforts undertaken by agencies in the act's first year. The agencies agreed they needed improved training approaches for future work under the act.

OMB has arranged with the OPM for five separate training sessions during 1984 to include the following topics: (1) segmenting, (2) conducting vulnerability assessments, (3) conducting internal control reviews, (4) defining the requirements of sections 2 and 4 of the act, (5) taking corrective actions, and (6) reporting to the President and the Congress. OMB is also working with agencies and contractors to develop "how to" training for department and agency personnel.

Because the first-year problems varied widely, each organization's training needs may differ. However, all agencies should, at a minimum, consider the problem areas this chapter discusses in assessing training needs.

Need for greater emphasis on controls over automated data processing

Computers are used for a wide range of functions, from preparing health and welfare payments to exploring space. ADP operations often control large amounts of money such as \$289 billion

in income security payments from HHS, \$600 billion in tax revenues, and \$68 billion in salary and benefits to active and retired military personnel. Further, many of these systems perform a critical role in federal operations, such as air traffic control, and military command control and communications. Clearly, good ADP controls should be an integral part of a strong system of internal control. However, agencies did not give full consideration to their ADP functions.

We identified deficiencies in the following areas:

- Major ADP functions were ignored in the evaluation process, or large portions of the agency were excluded from ADP evaluations.
- Confusion existed about who was responsible for making ADP evaluations, with the result that none were done or that they were not properly done.
- Where ADP controls were evaluated, the work did not fully address general controls which affect the quality of services rendered to ADP users and of application controls over the quality of data input, processing, and output.
- Many of the staff knowledgeable in ADP internal controls had only a limited role in the internal control evaluation process, and training provided to staff making the evaluations did not cover ADP internal controls.

Examples where agencies did not give full consideration to their ADP functions follow.

- Education's internal control directives did not define a specific role for the agency's ADP organizations (ADP management, systems security officers, and inspector general ADP audit personnel) in developing policy and monitoring implementation of the act. Education's directives establish an Internal Control Steering Committee to develop policy guidance for the agency's internal control process; however, none of the eight senior-level managers appointed to the steering committee were from the ADP organizations. Also, none of the original 23 internal control staff members overseeing the day-to-day implementation of the act through completion of the vulnerability assessments were from Education's ADP organizations. Although managers performing assessments were asked to identify ADP systems used by their units, they were not required to assess the ADP controls for those systems in the vulnerability assessment process. Education's internal control review reports also indicate a general absence of the ADP control assessment. As a result, serious control weaknesses may not have been detected. Education plans to take corrective action by forming a team to develop specific criteria relating to ADP controls for use in internal control reviews.

--State's guidelines neither included certain important ADP controls as assessment factors nor did they provide details on how to assess ADP vulnerability. Staff performing assessments limited their consideration of ADP controls to factors included in the guidelines. Also, State's vulnerability assessment training did not include details on how to assess ADP vulnerability, and three of the six individuals performing ADP assessments in the Bureau of Administration received no training. Further, backup documentation, which may have shown the factors considered in assessing ADP controls, was discarded. By not adequately assessing ADP controls, State may not have identified as vulnerable, or schedule reviews for, programs or functions where internal control systems may have material weaknesses. For example, a consultant's risk analysis study of State's Foreign Affairs Data Processing Center, performed several months after the vulnerability assessments, uncovered several risks not previously mentioned. Based on this analysis, the center was found to be vulnerable to (1) willful damage by malicious intruders, (2) accidental damage from environmental factors, and (3) extended periods of inoperability because of electrical or mechanical problems. State has developed a plan which it believes will result in more adequate ADP assessments.

Agencies must better evaluate ADP controls. As discussed in our June 21, 1984, letter to the Director of OMB (appendix IV), we believe most if not all of the problems we noted in the evaluation of ADP controls can be improved if OMB provides additional guidance.

Managers should be held accountable

Since management has the basic responsibility for the establishment and maintenance of control systems, it should be held accountable for assuring effectively performed control systems evaluations.

OMB guidelines provide that all agency management should be involved in the evaluation process, and recognize that each manager should be held accountable. The guidelines also provide that administrators should initiate procedures to evaluate performance in assessing and reviewing internal controls, and require that fulfillment of the internal control responsibilities be included in the performance agreements of all senior employees with significant management responsibility. We found that

- departments and agencies need to help ensure that managers have a positive attitude in implementing the act,
- managers must better ensure the quality and effectiveness of the evaluation process,
- more managers in field offices should be included in the process, and

--procedures should be instituted to hold managers accountable through the formal review process.

Given its broad scope, the act will take time to implement fully and effectively. Agencies must, therefore, continuously maintain a positive management attitude toward the program. Some Navy personnel seemed skeptical of and disenchanted with implementing an internal control program with limited guidance, inadequate training, and shortages of support personnel. A key implementing official at one component told us he hoped the program would "die out" before he had to implement it in field activities.

Managers can materially help to enhance the quality and effectiveness of the evaluation process, but some agencies did not get the necessary management involvement. For example, NASA formed an internal control committee of top managers to (1) provide advice and guidance to the internal control activities, (2) review the results of the evaluations and internal reviews, and (3) monitor the corrective actions being taken. Despite the present crucial stage of implementation of the act, the committee is no longer active.

Not all agencies sufficiently involved their field managers in the internal control evaluation process. At Treasury, for example, five of the eight bureaus with field operations did not involve these managers in vulnerability 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. Generally, Treasury's bureaus now recognize this problem and plan to include field managers in the assessment process.

Several agencies had not instituted or implemented procedures to hold their managers accountable through the formal performance evaluations. For example, the Navy recently decided not to require comments in the fitness reports of military officers regarding performance in the area of internal controls. On the other hand, the Department of Education, which implemented such administrative procedures, made internal control functions a mandatory critical element in the performance plans of all Senior Executive Service and merit pay employees. The Department is also developing an awards program aimed specifically at internal control activities.

Effective implementation of the act will depend mostly on the commitment of the managers operating internal control systems. Accordingly, all agencies should hold responsible managers accountable for the quality and effectiveness of the internal control evaluation process.

PERFORMING MORE EFFECTIVE EVALUATIONS FOR DETECTING ACCOUNTING SYSTEM WEAKNESSES

Under section 4 of the Financial Integrity Act, each agency must report annually on whether its accounting systems conform to

the prescribed Comptroller General principles, standards, and related requirements. In contrast to section 2 covering internal control systems, the act did not require that guidance be developed for evaluating agency accounting systems.

For the second year, OMB has issued draft guidelines for conducting evaluations of accounting systems. Some agencies did not start reviews of their accounting systems until late in the first year, leaving insufficient time for comprehensive evaluations. Others were unsure of how to go about fulfilling their accounting system responsibilities under the act, and inconsistent approaches resulted.

On September 29, 1983, the Comptroller General suggested the following steps agencies could take in the first year to provide the "building blocks" for future evaluations of accounting systems: (1) organize the accounting system evaluation process, (2) develop an inventory or list of accounting systems, (3) identify previously reported deviations from the Comptroller General's requirements, (4) identify any projects underway to enhance accounting systems, (5) rank the systems based on how material the deviations might be, (6) begin reviewing the systems to find out if they comply with the requirements, and (7) plan for the first-year report.

While most agencies attempted to identify the systems which needed to be considered for reporting under the act, most omitted significant accounting operations or activities in their evaluations. At the Treasury Department, several important accounting operations were omitted, including the accounting system of its eight regional disbursing offices, accounting systems at field locations, the Bureau of Government Financial Operations' check processing and reconciliation subsystem and the Savings Bond Division's accounting system. The Department of the Air Force's inventory only included its primary systems and did not consider, in certain cases, the major support segments of its systems.

Although many agencies evaluated their accounting systems, these evaluations, for the most part, lacked depth. They were based primarily on experience, knowledge, and observations made by accounting officials, and answers to questionnaires, rather than on tests of the systems in operation.

For example, GSA instructions for compliance evaluations included preprinted worksheets outlining the Comptroller General's accounting principles and standards. The GSA comptroller's staff were to check "yes" or "no" to indicate whether the accounting system being evaluated met a particular principle or standard. The instructions stated that the evaluator could justify each "yes" response by referring to available documentation or by providing a brief narrative description of how the principle or standard was met, but a specific reference (such as page numbers or paragraphs) was not required. The comptroller's staff relied on their knowledge of the accounting systems to complete the checklist. According to a GSA official, the staff cited applicable policy or procedural manuals, when possible, to document their responses. They

did not, however, observe or test the systems in operation. As a result, while the method used for evaluation showed that aspects of the systems conformed on paper to the Comptroller General's principles, standards and related requirements, no assurance was given that the systems conformed in operation.

However, the questionnaire approach, if adequately performed, could have helped provide a reasonable starting point for the accounting system evaluation. For example, although DOT used a questionnaire like many of the agencies, it also required (1) documentation of the review process, (2) several quality control reviews, and (3) good geographic coverage. In addition, several DOT components put significant staff resources into the effort. Further, DOT has recognized the need for testing of systems in operation in its current instructions. Several agencies sought and received copies of DOT guidelines.

Also, accounting system evaluations were not always done consistently among various components or systems within a department. Agencies of the Department of Agriculture did not use a uniform approach in performing their evaluations, and two of them did not do a compliance evaluation of any type. At the Department of Energy, compliance assurances and supporting questionnaires prepared by components for its 18 accounting systems did not always adhere to the instructions provided.

Even though many agencies started their reviews of accounting systems late in the year, and confusion and inconsistency occurred among the agencies as to how to perform reviews under section 4, progress was made toward identifying areas where agency accounting systems must be improved. We reported to individual agencies the areas where their accounting system evaluations could be performed more effectively. A foundation has been established for more thorough reviews and for corrective actions in areas whose accounting systems do not conform to the Comptroller General's principles, standards, and related requirements.

Agencies should now work to build on the results of the first-year effort through such activities as (1) validating the inventory of accounting systems developed during the first year, (2) initiating system upgrade projects, (3) documenting their overall accounting system structures, (4) evaluating the operation of accounting systems--including appropriate testing--for compliance with the Comptroller General's principles, standards, and related requirements in all material respects, and (5) developing and implementing short- and long-range plans to bring their accounting systems into conformance with the Comptroller General's requirements.

NEED TO REEXAMINE REPORTING CRITERIA

Agencies disclosed many material weaknesses in the first-year reports under the act. Reporting criteria, however, need to be re-examined for the second year. A clear, consistent understanding of

what is meant by the terms "material weakness" and "reasonable assurance" is key to assuring that future reporting will be complete and meaningful.

Additional guidance is needed on what constitutes a material weakness

The act provides for the identification of any material weakness in the agency's systems of internal control, together with plans for corrective action, in the annual statement to the President and the Congress.

Some uncertainty existed within agencies in the first year as to what constitutes a material weakness and a more consistent definition is needed in the second year. The deputy director of OMB confirmed this in May 22, 1984, testimony before the House Government Operations Committee. He noted differences in interpretation in the first year over the definition of a material weakness and whether or not the material weakness was considered to be serious enough in the overall mission and budget of the agency for the systems to be in or out of compliance.

Current OMB guidance provides that material weaknesses included in the annual statement should consist of "matters of significance" to the President and the Congress. We have previously commented to OMB that its interpretation presupposes an ability on the part of agencies to ascertain what the President or the Congress may regard as significant, and, in one sense, simply superimposes the word "significant" over the word "material."

OMB officials believe a consensus on what constitutes a material weakness will evolve as agencies gain more experience under the act and learn from each other. While OMB's position has some merit, we see no reason not to provide additional guidance at this time since other objective criteria exist. Although by its nature the application of a materiality standard requires judgment, additional factors which should be considered by agencies in reporting a material weakness include

- a loss or potential loss of resources that would impair an agency's fulfillment of a mission (ratios or percentages of budgeted dollars, and relative dollar amounts based on agency criteria are commonly used measures),
- adverse publicity or embarrassment to the agency, which would diminish credibility or reputation,
- importance to the public or third parties (a good example would be a Social Security payment for which the recipient depends on the timely receipt of a check in the correct amount),
- problem which warrants the personal attention or awareness of the agency head or higher management (for instance, the

Air Force considers an event material if it requires attention at the next higher organizational level),

--violations of statutory or regulatory requirements, and

--potential conflicts of interest.

We plan to work with OMB to improve guidance in this area.

Need for improved reporting on what constitutes reasonable assurance

The act requires that agency year-end statements include whether or not systems of internal accounting and administrative control fully comply with the act's requirements. These requirements are that the systems be established in accordance with standards prescribed by the Comptroller General and shall provide reasonable assurances that the objectives of the act (see pp. 1 and 2) are attained. Sample report language issued by OMB to agencies provides for agency heads to certify (when appropriate) that "taken as a whole" the agency's system of internal control (section 2 of the act) provides "reasonable assurance" that the objectives of the act (such as safeguarding assets against waste, loss, or unauthorized use) were achieved.

The OMB reporting guidance stressed full disclosure of the steps taken to evaluate internal controls, together with information on all material internal control weaknesses identified. While we found that agencies generally disclosed their problems, which was the most important element of reporting in the first year, an analysis of the first-year reports indicates uncertainty as to what constitutes reasonable assurance.

One of the most difficult decisions agency heads faced in the first year was whether to report they had reasonable assurance that the systems of internal control met the requirements of the act. Three agencies (Agriculture, Commerce, and HUD) generally reported the evaluation process had not progressed to a point in the first year to enable them to provide an affirmative statement of reasonable assurance that their internal control systems "taken as a whole" met the act's requirements. The other 14 agencies reported they had reasonable assurance. Generally, however, these agencies were no further along in evaluating their internal control systems than the three agencies which acknowledged they had not completed enough of the process to provide reasonable assurance.

In addition, agencies reported reasonable assurance on their overall system of internal control even though reporting a number of serious material weaknesses. For example, the Secretary of Defense, while noting material weaknesses in the Department's \$86 billion procurement function (fiscal year 1984 procurement appropriations), its \$15 billion annual foreign military sales program, and in several other important functions, still reported reasonable assurance for the overall system of internal control.

HHS stated it had reasonable assurance its internal controls complied with the requirements of the act. The agency then proceeded to list 200 material weaknesses and identified in the first year another 1000 weaknesses considered to be immaterial. Further, the agency's first-year report excluded known material weaknesses in programs such as the Health Care Financing Administration's Medicare Program and the Social Security Administration's Supplemental Income Program. Operating and internal control weaknesses in the Supplemental Income Program alone had resulted in over \$125 million in erroneous benefit payments.

The problem as to what constitutes reasonable assurance was highlighted by the administrator of GSA in his first-year report. Although providing reasonable assurance that GSA's internal accounting and administrative controls were in compliance with the act's requirements, the administrator indicated a reservation in doing so. The following quotation from his statement to the President and the Congress, which is included in its entirety as appendix V, illustrates the problem.

"What I am confronted with, then, are two differing constructions of the term "reasonable assurance." The first, which is precise, accurate, and realistic reflects the commonly understood definition of providing the solid confidence in the soundness of Government that we ought to have. That assurance cannot be given. The second, which reflects the Government's inability to be precise is couched in terms designed to recognize that the actions of large numbers of people and the potential for unforeseen or uncontrollable events make it possible to provide the requested assurance."

"It is only with the above caveats that the extensive reviews . . ., the written assurances of GSA senior officials, and the corrective actions . . . enable me to provide reasonable assurance that our internal accounting and administrative controls are in compliance with the requirements of the Federal Managers' Financial Integrity Act of 1982. We will not relax our efforts to reduce the risk even further, and our level of assurance will grow."

In our reports on individual agencies' first-year efforts, we took the position that as agencies gain more experience in evaluating their systems of internal control and begin correcting the internal control weaknesses identified, the decisions made and opinions expressed on reasonable assurance will be more meaningful. Also, we believe a reexamination of reporting guidance is needed to provide for more meaningful reporting in the second year.

Agencies need to disclose more clearly the basis for their overall opinion, whether it be affirmative or negative. As an alternative approach to the present reporting language, agencies should:

- disclose functions and operations where controls are adequate to meet the Comptroller General's internal control standards,
- identify those functions and operations which do not provide adequate control followed by the details of the identified material weaknesses, and
- disclose functions and operations where they do not know whether adequate control exists (due to not having yet adequately evaluated the internal controls in question).

Agencies should then present their final opinion in accordance with the act's requirements, stating whether their internal control systems taken as a whole provide reasonable assurance that the systems meet the statutory objectives and the Comptroller General's standards. In stating their opinion, the agencies should include an appropriate explanation as to how they arrived at their overall conclusion.

Of course, where the magnitude and/or seriousness of the material weakness is so great in terms of the agency taken as a whole that overall reasonable assurance cannot be given, the agency should give a negative statement of reasonable assurance and should identify the Comptroller General's standards or statutory objectives which, because of the weaknesses, were not met. Also, where its evaluations have not yet covered internal controls over major functions and operations, the agency may not be able to state that it has reasonable assurance, as Agriculture, Commerce and HUD reported in the first year.

We believe this approach places the results of an agency's evaluation of its internal control systems in better perspective. It should lead to more informative reporting since an agency would have to distinguish more clearly between those operations which are adequately protected by internal controls and those areas which have weaknesses and lack needed protections. Under the alternative, an agency would still be required to provide an overall affirmative or negative statement for its systems taken as a whole, but would have to explain the basis for its opinion, especially where a number of material weaknesses exist, even if the agency has given an affirmative overall statement, as was generally the case in the first year.

RECOMMENDATIONS

Agencies were very receptive to the many recommendations and suggestions for improving evaluations of systems of internal accounting and administrative control and accounting systems included in the 22 agency reports. OMB can make further improvements by expanding the guidance covering ADP controls and by improving guidance on year-end reporting of material weaknesses and reasonable assurance.

Accordingly, we recommend that the Director, OMB,

- provide additional guidance to agencies to evaluate their ADP resources and systems by (1) defining general and application controls and suggesting factors to be considered in evaluating them, (2) establishing responsibility for making ADP control evaluations, and (3) identifying sources of more detailed guidance (In appendix IV to this report, we offer criteria that we think will help agencies better consider ADP controls.), and
- strengthen year-end reporting.

- Further define what constitutes a material weakness and provide more detail for agencies to use in arriving at judgments on the seriousness of their internal control problems. The factors included on pages 30 and 31 of this report should be considered in reporting on material weaknesses.
- Improve sample report language provided to agencies to disclose more clearly the basis for the overall opinion on reasonable assurance required by the act using the approach discussed in this report on pages 32 and 33 or a similar approach.

While not included in the draft report provided to OMB for comment, we discussed these recommendations with OMB officials and addressed the underlying problems in the draft. OMB officials said they would consider the need for further guidance. We will continue to work with OMB to enhance overall implementation of the Financial Integrity Act.

CHAPTER 4

STRONG EFFORTS TO IMPLEMENT THE FINANCIAL INTEGRITY ACT MUST CONTINUE

The framework has been established for evaluating and correcting internal control and accounting systems weaknesses. Agencies must assure that over time the Financial Integrity Act becomes an everyday tool for managers. This will not be easy, and the continued commitment of top management will be vital.

Most importantly, agencies will have to begin developing viable solutions to the internal control and accounting systems problems that have been and will be identified. Many of the problems reported by agencies in the first year are long-standing. Undoubtedly more problems will be identified in future years. The act's potential for saving billions of taxpayer dollars, and for helping restore the public's confidence in the federal government, will only be realized if agencies follow through with corrective actions.

MOMENTUM NEEDS TO BE MAINTAINED

Full implementation and incorporation of the act's requirements into federal agencies' overall management process is still ahead of us. It will take a sustained commitment by the Congress, agency heads, and the entire financial community to accomplish the task. It is vitally important that agency heads, senior management officials responsible for implementing the act at each agency, and heads of agency organizational units where assessments and reviews of systems of internal control and accounting are actually performed, continually reinforce the importance of effective implementation efforts.

Agencies can maintain the momentum of the first year into the second and later years in a number of ways.

- At the start of each year's Financial Integrity Act work, agency heads should emphasize its high priority and reiterate their support for the act throughout the year. Without continuous top management emphasis, progress made in the first year could be of no avail.
- Internal control officials must ensure that improvements and refinements, based on lessons learned in prior years, be incorporated into the current year process. This should include timely revisions to policy directives and guidance. Central direction of the effort is important, and the internal control officials must direct and oversee the processes including the monitoring of corrective actions.
- All agency staff must try to keep informed and to incorporate new and refined methods and techniques for evaluating

their internal control and accounting systems. Increased training is imperative. Program managers must be aware of the importance and nature of internal controls, and managers and staff responsible for performing vulnerability assessments and internal control reviews need to receive "how to" training.

--Many agencies can improve their review processes if they follow the suggestions of the OMB Task Force, GAO, and the inspectors general, and consider adopting some of the better techniques and methods of other agencies. Agencies' abilities to complete the evaluation process will also improve through on-the-job training as managers and staff gain experience with the act and become more comfortable in performing vulnerability assessments and internal control reviews.

--OMB and the inspectors general must continue their strong efforts to monitor the Financial Integrity Act process, provide technical assistance, and facilitate the exchange of effective methods and techniques. Given their expertise, active roles for the inspectors general, in particular, are most important. Agencies should look to their inspectors general for assistance as well as oversight of the evaluation process.

--Agencies must establish an effective quality assurance program as a key element in their overall Financial Integrity Act efforts. This should include agreement between the agency head and the agency inspector general concerning oversight of the process.

We are encouraged by the first-year effort. We see an increased awareness by federal managers of the need for good internal controls and accounting systems. Another encouraging factor is the establishment of a systematic process to evaluate, improve, and report on internal controls and accounting systems. Finally, the top management commitment and the efforts that all put forth have been the key to the success in implementing the program. This support must be sustained.

A NEED TO BEGIN CORRECTING THE PROBLEMS IDENTIFIED

Agencies must begin developing comprehensive plans to correct material weaknesses in their systems of internal control and accounting. Many of the weaknesses identified to date are long-standing and cannot be treated on a piecemeal and partial basis, as has often been the case in the past.

Completion of the internal control evaluation process is a means to pinpoint problems, with correction of the problems that have been and will be identified representing the "bottom-line" of

the act. The Congress, by requiring for the first time that management report annually on the state of internal controls and accounting systems and by providing that they include a description of plans to correct material weaknesses, provided needed accountability and discipline.

Assuring successful implementation of the act remains a high priority in GAO, and we are now planning a review of agencies' second-year efforts. In the first year, our review emphasized agency efforts to implement the evaluation process for their internal control and accounting systems. In the second year, we will be concentrating more on agency plans to address the problems identified and on the completeness of their reports to the Congress.

To assure that cost effective corrective actions are taken in a timely manner, federal agencies need to develop comprehensive plans of action and establish follow-up systems which track the status of actions taken to correct identified weaknesses. The OMB guidelines require that formal follow-up systems be established to record and to track recommendations and projected corrective action dates, and to monitor whether the changes are made as scheduled.

While progress occurred in the first year, the evaluation process has not yet been completed, and agencies had little time to formulate comprehensive corrective action plans. Therefore, first-year reports to the Congress primarily focused on the identified problems.

As agencies gain experience in implementing the act, and have a chance to examine carefully the range of their internal control and accounting systems problems, additional information on planned corrective actions should be included in their second-year act reports, and efforts to correct the problems identified should intensify.

In beginning the long and expensive task of correcting the many material weaknesses and accounting systems problems, agency efforts should be channeled toward a common goal of rebuilding their financial management structure.

Problems with the basic structure of financial management cannot be solved in piecemeal fashion, for they are too intertwined. In our judgment, successful reform will require a comprehensive, long-term, integrated approach. The effort should be government-wide in scope, serving the needs of both the Congress and the executive branch, by ensuring that consistent data are available across agency and department lines. The effort should stress (1) strengthened accounting, auditing, and reporting, (2) improved planning and programming, (3) streamlined budget process, and (4) systematic measurement of performance.

AGENCY COMMENTS

In commenting on a draft of this report (appendix VI), OMB agreed that a long-term commitment to improving internal controls is necessary and that weaknesses identified in the first year must now be corrected. OMB added that in some cases legislation may be required, and it will look to GAO for assistance in explaining this need to the Congress.

Federal Managers' Financial
Integrity Act of 1982

An Act To amend the Accounting and Auditing Act of 1950 to require ongoing evaluations and reports on the adequacy of the systems of internal accounting and administrative control of each executive agency, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. This Act may be cited as the "Federal Managers' Financial Integrity Act of 1982"

SEC. 2. Section 113 of the Accounting and Auditing Act of 1950 (31 U.S.C. 66a) is amended by adding at the end thereof the following new subsection:

"(d)(1)(A) To ensure compliance with the requirements of subsection (a)(3) of this section, internal accounting and administrative controls of each executive agency shall be established in accordance with standards prescribed by the Comptroller General, and shall provide reasonable assurances that—

"(i) obligations and costs are in compliance with applicable law;

"(ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

"(iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

"(B) The standards prescribed by the Comptroller General under this paragraph shall include standards to ensure the prompt resolution of all audit findings.

"(2) By December 31, 1982, the Director of the Office of Management and Budget, in consultation with the Comptroller General, shall establish guidelines for the evaluation by agencies of their systems of internal accounting and administrative control to determine such systems' compliance with the requirements of paragraph (1) of this subsection. The Director, in consultation with Comptroller General, may modify such guidelines from time to time as deemed necessary.

"(3) By December 31, 1983, and by December 31 of each succeeding year, the head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under paragraph (2) of this subsection, prepare a statement—

"(A) that the agency's systems of internal accounting and administrative control fully comply with the requirements of paragraph (1); or

"(B) that such systems do not fully comply with such requirements.

"(4) In the event that the head of an agency prepares a statement described in paragraph (3)(B), the head of such agency shall include with such statement a report in which any material weaknesses in the agency's systems of internal accounting and administrative control are identified and the plans and schedule for correcting any such weakness are described.

"(5) The statements and reports required by this subsection shall be signed by the head of each executive agency and transmitted to the President and the Congress. Such statements and reports shall also be made available to the public, except that, in the case of any such statement or report containing information which is—

"(A) specifically prohibited from disclosure by any provision of law; or

"(B) specifically required by Executive order to be kept secret in the interest of national defense or the conduct of foreign affairs.

such information shall be deleted prior to the report or statement being made available to the public."

SEC. 3. Section 201 of the Budget and Accounting Act, 1921 (31 U.S.C. 11), is amended by adding at the end thereof the following new subsection:

"(k)(1) The President shall include in the supporting detail accompanying each Budget submitted on or after January 1, 1983, a separate statement, with respect to each department and establishment, of the amounts of appropriations requested by the President for the Office of Inspector General, if any, of each such establishment or department.

"(2) At the request of a committee of the Congress, additional information concerning the amount of appropriations originally requested by any office of Inspector General, shall be submitted to such committee."

SEC. 4. Section 113(b) of the Accounting and Auditing Act of 1950 (31 U.S.C. 66a(b)), is amended by adding at the end thereof the following new sentence: "Each annual statement prepared pursuant to subsection (d) of this section shall include a separate report on whether the agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General under section 112 of this Act."

Approved September 8, 1982.

COMPTROLLER GENERAL'SINTERNAL CONTROL STANDARDS

In June 1983, the Comptroller General issued internal control standards to be followed by the executive agencies in establishing and maintaining systems of internal control.

The internal control standards define the minimum level of quality acceptable for internal control systems in operation and constitute the criteria against which systems are to be evaluated. These internal control standards apply to all operations and administrative functions but are not intended to limit or interfere with duly granted authority related to development of legislation, rule making, or other discretionary policy making in an agency.

General Standards

- Reasonable assurance. Internal control systems are to provide reasonable assurance that the objectives of the systems will be accomplished.
- Supportive attitude. Managers and employees are to maintain and demonstrate a positive and supportive attitude toward internal controls at all times.
- Competent personnel. Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal controls.
- Control objectives. Internal control objectives are to be identified or developed for each agency activity and are to be logical, applicable, and reasonably complete.
- Control techniques. Internal control techniques are to be effective and efficient in accomplishing their internal control objectives.

Specific Standards

- Documentation. Internal control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination.
- Recording of transactions and events. Transactions and other significant events are to be promptly recorded and properly classified.
- Execution of transactions and events. Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority.

- Separation of duties. Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.
- Supervision. Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved.
- Access to and accountability for resources. Access to resources and records is to be limited to authorized individuals, and accountability for the custody and use of resources is to be assigned and maintained. Periodic comparison shall be made of the resources with the recorded accountability to determine whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.

Audit Resolution Standard

- Prompt resolution of audit findings. Managers are to (1) promptly evaluate findings and recommendations reported by auditors, (2) determine proper actions in response to audit findings and recommendations, and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention.

DEPARTMENTS AND AGENCIESINCLUDED IN GAO'S FIRSTYEAR REVIEW

<u>Agency</u>	<u>Report Number</u>	<u>Report Date</u>
Department of Justice	GGD-84-63	05/08/84
Department of the Treasury	GGD-84-66	05/25/84
Department of Education	HRD-84-49	05/09/84
Department of Defense	NSIAD-84-98	05/01/84
Department of Health and Human Services	HRD-84-47	05/09/84
Department of Labor	HRD-84-45	05/03/84
Veterans Administration	HRD-84-46	04/27/84
Department of the Air Force	NSIAD-84-93	05/01/84
Department of the Army	NSIAD-84-92	05/01/84
Department of the Navy	NSIAD-84-94	05/01/84
Defense Logistics Agency	NSIAD-84-99	05/01/84
Defense Mapping Agency	NSIAD-84-101	05/01/84
National Aeronautics and Space Administration	NSIAD-84-100	05/01/84
Department of State	NSIAD-84-91	05/01/84
Department of Agriculture	RCED-84-138	06/21/84
Department of Commerce	RCED-84-133	06/22/84
Department of Energy	RCED-84-134	06/07/84
Housing and Urban Development	RCED-84-140	07/20/84
Department of the Interior	RCED-84-136	06/19/84
Small Business Administration	RCED-84-125	06/12/84
Department of Transportation	RCED-84-141	07/13/84
General Services Administration	GGD-84-57	05/22/84



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

JUN 21 1984

INFORMATION MANAGEMENT
& TECHNOLOGY DIVISION

The Honorable David A. Stockman
Director, Office of Management and
Budget

Dear Mr. Stockman:

Subject: Better Guidance Would Improve ADP Evaluations
in Support of the Federal Managers' Financial
Integrity Act of 1982

We recently reviewed the first-year implementation of the Federal Managers' Financial Integrity Act (FIA) of 1982 at 22 departments and major independent agencies. The results of our work have been reported individually to the agency heads and will be summarized in a report to the Congress.

We are writing to you because of our concern that the subject of internal controls in automated data processing (ADP) systems has not been given adequate attention or coverage in FIA evaluations. We attribute this in large part to the lack of guidance for agencies in this area. We believe OMB is in a position to offer the additional guidance that is needed, and we are offering to work with you to see that future evaluations are more responsive to the intent of the act.

With agencies using the existing guidance, we identified deficiencies in the following areas:

- Major ADP functions were sometimes ignored in the evaluation process, or large portions of the agency were excluded from ADP evaluations.
- Confusion existed in some cases about who was responsible for making ADP evaluations, with the result that no evaluations were done or they were not properly done.
- Where ADP controls were evaluated, the work did not fully address general and application controls.
- Many of the staff knowledgeable in ADP internal controls had only a limited role in the FIA process, and training provided to staff making the evaluations did not cover ADP internal controls.

These problems are discussed in more detail in enclosure I.

Taken together, we feel our observations demonstrate a need for more detailed guidance that defines appropriate ADP controls and establishes responsibility for making ADP evaluations. Without it, vulnerable ADP systems may not be identified and material weaknesses could remain undetected. We believe agencies want to properly implement the act but simply don't realize what is needed in this area. All would benefit from additional OMB guidance.


Along these lines, we found that some agencies were unaware or uncertain of the relationships between OMB Circulars A-71 Transmittal Memorandum No. 1, Security of Federal Automated Information Systems, and A-123, Internal Control Systems. As a result, several agencies did not coordinate the work under each circular while others tried to substitute A-71 work to meet A-123 requirements. Agencies should take advantage of work conducted under A-71, but such work generally is not a direct substitute for the A-123 requirements. Both circulars require an evaluation of internal controls, but the timing for evaluations and the party that should conduct the evaluations are different under each circular.

We believe that most if not all of the problems we noted can be mitigated by providing additional guidance or modifying existing guidance. We are aware that you are developing a new policy circular on federal information management. Including FIA requirements in this new circular, plus giving more breadth and specificity to the ADP section of the FIA Internal Control Guidelines, should provide the framework for improving ADP evaluations.

Enclosure II provides a conceptual overview of ADP internal controls along with criteria that can help managers assess the vulnerability of agency internal control systems. The information is offered for your use in preparing the additional guidance we feel is needed. Enclosure III lists the departments and agencies where GAO conducted its review.

We will be pleased to work with you on this guidance so that future FIA evaluations will be acceptable in the ADP controls area. Jim Watts has been designated to lead this effort for GAO, and can be reached on 275-3455.

Sincerely yours,


Warren G. Reed
Director

Enclosures

SUMMARY OF OBSERVATIONS ON
AGENCIES' EVALUATION OF ADP CONTROLS

The 22 departments and agencies we reviewed did not, for the most part, adequately evaluate their ADP controls in implementing the Federal Managers' Financial Integrity Act of 1982. We believe this stems primarily from the limited guidance provided by OMB and confusion over related guidance for evaluating ADP security as required by OMB's Circular A-71, Transmittal Memorandum No. 1.

BETTER GUIDANCE WOULD IMPROVE
AGENCY CONSIDERATION OF ADP CONTROLS

The present internal control guidelines provide only limited coverage to assessments of ADP controls. They require agencies to consider ADP when analyzing the general control environment, stating that consideration should be given to "... the strengths and exposures inherent in a system that uses ADP and the existence of appropriate controls." However, the guidelines do not define these controls. The accounting and auditing professions generally recognize internal ADP controls to include:

- General controls. These govern overall functions such as organization and management, application systems development, and computer operations, and affect the quality of services rendered to ADP users. The scope is quite broad, affecting most ADP hardware and application software systems.
- Application controls. These are part of individual software application systems. They control the quality of data input, processing, and output. Application controls are narrower in scope than general controls, because they are tailored to meet the specific control objectives of each software system.

Our review of 22 departments and agencies showed that most had difficulty considering ADP controls in their first-year FIA evaluations. Some agencies omitted major ADP or telecommunication functions from their controls evaluation, while others did not address general or application controls. The following summarizes the range of problems our review identified:

- Major ADP functions were sometimes not included in FIA evaluations. Two agencies, for example, omitted the vital area of telecommunications. Three other agencies omitted major data processing centers while two other agencies omitted both telecommunications and data processing centers. Several agencies made only very limited evaluations of ADP, excluding large portions of their operations.

- ADP general controls, for the most part, were not adequately assessed in areas such as software development and computer operations. For example, one component within an agency identified ADP as a broad assessable unit but excluded some ADP organizations responsible for general controls from the evaluation process. As a result, the controls in these organizations were not evaluated. In another component of the agency, the assessable unit was narrowly defined as ADP procurement. This component is a developer of software systems and a major user of a departmental computer center. As such, it is responsible for such functions as long range ADP planning, and systems design, testing, and maintenance. Its vulnerability assessment, however, did not include these functions. Agencies that did not assess ADP general controls may not have identified weaknesses that could affect several major agency programs.
- ADP application controls, for the most part, were not adequately assessed in program evaluations. For example, at one agency, which depends heavily on computers to administer more than \$17 billion in various loan programs, application controls were not addressed at all. At another agency, managers were asked to identify the ADP systems but were not required to assess the ADP application controls over the identified systems. Since application controls affect the accuracy and reliability of information processed in automated systems, agencies that did not fully assess such controls may have missed material weaknesses.
- Several of the agencies we reviewed did not assign responsibility for assessing ADP general and application controls. At the agency administering the loan programs, mentioned above, we noted confusion over responsibility. Confusion existed among program management, data processing management, and the accounting section about who should evaluate the ADP controls. At another agency, two major computer centers were not assessed because the data processing manager thought the responsibility for assessing controls within the center resided with the major users. The major users considered these controls the data processing manager's responsibility.
- Many of the ADP-knowledgeable personnel were not involved in the process, neither for developing policy nor for monitoring implementation of the act. For example, one agency did not involve the IG staff or bureau personnel with knowledge of ADP internal controls in (1) its identification of ADP-related activities or (2) its development of questionnaires addressing internal controls in ADP management, ADP security, and telecommunications. Another agency did not include representatives from ADP organizations (ADP managers, systems security officers, and office of inspector

general ADP audit personnel) throughout the process. Consequently, major ADP components were not addressed at this agency. Further, training was not provided to staff on how to evaluate ADP internal controls.

Without properly considering ADP, agencies have no assurance that vulnerable ADP systems will be identified and scheduled for internal control reviews. Thus, because the federal government depends so heavily on ADP to process and control hundreds of billions of dollars in revenues, assets, and entitlement and salary payments (to name only a few examples), material weaknesses may not be identified and the possibility of fraud, waste, and abuse in these systems will continue.

Guidance for evaluating ADP controls should define general and application controls and suggest factors to be considered in evaluating them. The guidance should also establish responsibility for making these evaluations and identify sources of more detailed guidance. With better guidance, agencies will be able to evaluate their ADP resources and systems more consistently and comprehensively. They will be in a better position to define their ADP training requirements and to ensure that the people involved in evaluations have the appropriate knowledge and skills. In enclosure II we offer criteria that we think will help agencies better consider ADP controls in implementing the act.

Agencies need clear definition of the relationship between A-71 and A-123

Several agencies did not recognize the relationship between OMB Circulars A-71 Transmittal Memorandum No. 1, Security of Federal Automated Information Systems, and A-123, Internal Control Systems. As a result, some agencies did not coordinate the ADP control reviews required by each of the circulars. Still others simply substituted A-71 reviews to fulfill the requirements of the FIA act, even though the scope and purpose of the reviews under each circular differ.

Until the relationship between the two circulars is clearly defined, agencies will have to deal with conflicting and redundant requirements. OMB Circular A-71, Transmittal Memorandum No. 1, states that agencies shall establish a computer security program and incorporate controls to safeguard sensitive data in automated systems. Further, these controls must include appropriate administrative, physical, and technical safeguards. These safeguards could be viewed as control techniques under A-123. Even though both circulars require evaluations of internal controls, the timing for conducting evaluations under each is different. A-123 requires evaluations of each assessable unit at least once every two years. A-71 requires evaluations to be conducted at least once every three years. Also, A-123 emphasizes that evaluations be performed by the heads of organizational units, while A-71 emphasizes that evaluations be conducted by an independent organization.

To illustrate the problems we found, one agency, which relied on the results of its ongoing A-71 review program, gave only limited attention to considering and evaluating ADP activities as part of the FIA process. At this agency, the evaluations performed under Circular A-71 were generally limited to the physical security of ADP, and did not include applications controls. Also, the security assessments used in place of vulnerability assessments did not address all of the relevant factors required by OMB's FIA guidelines. For example, the security assessments did not include a preliminary evaluation of safeguards, and covered relatively few of the elements of inherent-risk or the general control environment.

To the extent practical, however, agencies should take advantage of work under A-71 to fulfill some of the requirements of A-123. This is not always done. For example, at one agency the personnel responsible for A-123 were not aware of, and so did not take advantage of, the agency's program for A-71. A limited review of the agency's A-71 program showed that some general control areas had been adequately covered but that the program was not a direct substitute for the A-123 requirements. For example, the A-71 program did not cover some general control areas, such as systems development and maintenance; nor did it cover all application controls over input, processing, and output.

We note OMB's development of a new policy circular on federal information management, as announced in the September 12, 1983, Federal Register. We believe this project provides an opportunity for resolving the conflicts and redundancies in the A-71 and A-123 requirements.

We believe the difficulties surrounding the evaluation of ADP controls can be reduced if more detailed guidance is provided to agencies. In its leadership role, OMB could provide a framework for evaluating ADP internal controls.

Conceptual Overview
of ADP Internal Controls

OMB's internal control guidelines define an internal control system as, "the organizational structure and the sum of methods and measures used to achieve the objective of internal control." Managers are responsible for developing and maintaining an adequate system of internal controls within their programs and functions. They are also responsible for evaluating the system to determine whether it provides reasonable assurance that control objectives are being achieved. In order to evaluate the controls, the OMB guidelines require managers to conduct vulnerability assessments and, if necessary, internal control reviews of programs and functions.

According to the guidelines, managers should consider ADP controls when conducting vulnerability assessments and internal control reviews. The guidelines do not provide criteria for assessing ADP controls. Nor do they break out ADP controls into general and application controls. However, they implicitly address both types.

General controls are pervasive methods and measures covering all application systems. If inadequate, they may adversely affect systems. Application controls, on the other hand, are methods and measures that are unique to a specific application or task, such as payroll or inventory.

General controls consist of a series of objectives and techniques that, when adhered to, will provide reasonable assurance that the controls over the centralized ADP department are effectively in place. To determine whether the objectives are being achieved, a series of questions can be asked. The answers will help identify the techniques used to control the typical ADP functional areas, such as:

- Internal audit of ADP activities.
- Organization and management of the ADP department.
- Application systems design, development, and maintenance.
- Hardware.
- Systems software.
- Data center operations.
- Data center protection.

Application controls consist of control objectives and techniques designed to provide reasonable assurance that data origination, input, processing, and output controls unique to a specific application are in place. Here, too, a series of questions can be asked to help identify the techniques used for control. ,

As mentioned above, both types of controls must be considered during both the vulnerability assessment and the internal control review evaluations. The question is to what extent they should be assessed, not whether they should be assessed.

The following chart provides some criteria and a methodology that managers may use to adequately assess ADP general and application controls during vulnerability assessments and internal control reviews. ADP management should be primarily responsible for conducting evaluations in the general control areas. Program management should be primarily responsible for conducting evaluations in the application control areas. However, program management may need assistance from ADP personnel when evaluating application controls that are technical in nature, such as data validation and editing controls.

ADP control areas	Vulnerability assessments	Internal control reviews
<p style="text-align: center;"><u>General Control Areas</u></p> <ul style="list-style-type: none"> --Internal Audit of ADP activities --Organization and management of the ADP Department --Application systems design, development, & maintenance --Hardware --Systems software --Data center operations --Data center protection 	<p>ADP management should assess the general control environment by identifying the control objectives and techniques for each general control area, and by addressing the following factors:</p> <ul style="list-style-type: none"> --How well are the policies/procedures pertaining to each objective and technique documented and communicated to people? --How well and how recently have people been trained in the control objectives and techniques? --How reasonable are the control techniques in meeting the control objectives? --How recent and comprehensively have control objectives and techniques been evaluated independently by audit, a quality assurance review, or other study? How significant and recurring are any weaknesses? --What control problems are known to exist and how significant are they? 	<p>ADP management should evaluate the general control environment to determine whether control techniques accomplish objectives. ADP management should:</p> <ul style="list-style-type: none"> --Identify and document control objectives and techniques (refer to and update from V.A.) --Judge whether identified control techniques meet control objectives, --conduct compliance tests of key control techniques being utilized to meet control objectives, --consider the potential effect of strengths and weaknesses identified from compliance tests, and --summarize the results and identify corrective actions necessary.
<p style="text-align: center;"><u>Application Control Areas</u></p> <ul style="list-style-type: none"> --Data origination --Input --Processing --Output 	<p>Program management (users) should assess the application control environment by identifying the control objectives for each application control area and key application control techniques. They should address the following factors:</p> <ul style="list-style-type: none"> --How vulnerable is the ADP general control environment in which the application is maintained and processed? (Obtain from ADP management, and add views from own experience where applicable). --How well are the policies/procedures pertaining to each objective documented and communicated to people? --How reasonable are the key control techniques in meeting the control objectives? --How well and how recently have people been trained in the control objectives and techniques? --How recently and comprehensively have control objectives and techniques been evaluated independently by audit, a quality assurance review, or other study? How significant and recurring are any identified weaknesses? --What control problems are known to exist and how significant are they? 	<p>Program management (users) should evaluate application controls to determine whether control techniques accomplish objectives. They should</p> <ul style="list-style-type: none"> --Identify and document control objectives and techniques (refer to and update from V.A.), --Judge whether identified control techniques meet control objectives, --conduct compliance tests of key control techniques being utilized to meet control objectives, --consider the potential effect of strengths and weaknesses identified from compliance tests, and --summarize the results and identify corrective actions necessary.

FEDERAL DEPARTMENTS AND
AGENCIES GAO REVIEWED

<u>Defense Department¹</u>	<u>Civil Departments</u>
1. Office of the Secretary	11. Agriculture
2. Department of the Air Force	12. Commerce
3. Department of the Army	13. Education
4. Department of the Navy	14. Energy
5. Defense Logistics Agency	15. Health and Human Services
6. Defense Mapping Agency	16. Housing and Urban Development
<u>Other Agencies</u>	
7. General Services Administration	17. Interior
8. National Aeronautics & Space Administration	18. Justice
9. Small Business Administration	19. Labor
10. Veterans Administration	20. State
	21. Transportation
	22. Treasury

¹While the Department of Defense issued one overall report to Congress and the President, GAO reviewed and issued separate reports on six Defense components.

OFFICE OF THE COMPTROLLER OF THE GENERAL SERVICES Administration Washington, DC 20405

NOV 20 1984

The President
The White House
Washington, DC 20500

Dear Mr. President:

For nearly three years I have been working to bring the General Services Administration (GSA) under control and make it work better. It is a good Agency, with fine people who have responded with great effort to that challenge.

The Federal Managers' Financial Integrity Act of 1982 requires each agency head to provide "reasonable assurance" annually to the President and the Congress that all of his agency's internal control systems have been reviewed using methodology established by the Office of Management Budget (OMB) against requirements specified by the General Accounting Office (GAO) and that:

- a. Obligations and costs are in compliance with applicable laws;
- b. Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- c. Revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports, and to maintain accountability over assets.

I have examined the GAO requirements and the OMB methodology - both of which are extensive.

Three years ago we knew that the Government was not operating as it should. Enormous progress has been made with the infusion of dedicated people and through private sector executives such as our advisory board and the Grace Commission. Major areas which relate to this process remain to be corrected:

- a. The budget process is unworkable. This Agency has operated under continuing resolutions for my entire tenure.
- b. Managing people in an orderly businesslike way is prevented by the labyrinths and catacombs of the Federal personnel system.
- c. The management of the Government's assets lacks the required data base, central focus, and single oversight necessary for success.

Given that situation, the findings of outside observers, Webster's definition of "reasonable assurance," and careful reading of the requirements laid out in law, it gives me some concern that anyone in this position could give assurance, "reasonable" or otherwise, that the agency runs as well as it is expected to.

To want good controls; to try and close all potential weaknesses; to be insistent on honesty and integrity in all our activities; and to take swift and decisive action when anomalies occur are the factors which support reasonable assurance. To be diligent in pursuit of those objectives is one thing. To say that they have been fully achieved is quite another.

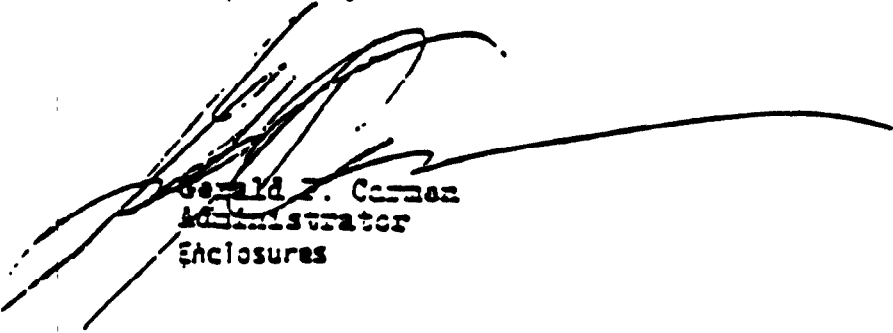
No analytical process, regardless of how well intentioned, can or should raise the confidence level of the American people in the quality of their Government without viable legislation and further executive action to eliminate the systemic problems.

I have been over these views with my staff. They have explained to me that, in spite of my views, "reasonable assurance" may still be given within the context of legislative intent and the guidelines issued by GAO/OMB which recognize that people are fallible, equipment is fallible, procedures are imperfect, and external events can destroy the most carefully designed controls.

What I am confronted with, then, are two differing constructions of the term "reasonable assurance." The first, which is precise, accurate, and realistic reflects the commonly understood definition of providing the solid confidence in the soundness of Government that we ought to have. That assurance cannot be given. The second, which reflects the Government's inability to be precise is couched in terms designed to recognize that the actions of large numbers of people and the potential for unforeseen or uncontrollable events make it possible to provide the requested assurance.

It is only with the above caveats that the extensive reviews as outlined in Attachment A, the written assurances of GSA senior officials, and the corrective actions outlined in Attachment B enable me to provide reasonable assurance that our internal accounting and administrative controls are in compliance with the requirements of the Federal Managers' Financial Integrity Act of 1982. We will not relax our efforts to reduce the risk even further, and our level of assurance will grow.

Respectfully,



Gerald F. Carman
Administrator
Enclosures



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 13 1984

Honorable Charles A. Bowsher
Comptroller General of the
United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. *Chuck* Bowsher:

This is in response to your draft report, "Implementation of the Federal Managers' Financial Integrity Act: The First Year."

We appreciate the support that the General Accounting Office has provided to the executive branch in implementing the Financial Integrity Act. We also appreciate the recognition in the draft report that the Administration, through the Office of Management and Budget, has provided strong direction and leadership to assure effective implementation. As you know, the level of effort expended by OMB and the interagency Financial Integrity Task Force has been unprecedented. With your assistance OMB developed guidelines, standards, and evaluation criteria for testing the adequacy of internal control systems; and worked individually with each department and major agency to assure that they were able to meet their responsibilities under the Act. The results described in your report show that these efforts have paid off.

We agree that a long term commitment to improving internal controls is necessary. Weaknesses identified in the first year must now be corrected. In some cases legislation may be required, and we look forward to your assistance in explaining this need to the Congress.

Once again, we appreciate your assistance and we appreciate the opportunity to comment on the draft report.

Sincerely,

Arlene Triplett

Arlene Triplett
Associate Director
for Management

(901373)



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