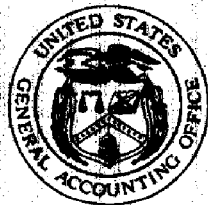


September 1994

**GOVERNMENT
CORPORATIONS**

**CFO Act Management
Reporting Could Be
Enhanced**



**Accounting and Information
Management Division**

B-257154

September 19, 1994

The Honorable John Glenn
Chairman
The Honorable William V. Roth, Jr.
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable John Conyers, Jr.
Chairman
The Honorable William F. Clinger, Jr.
Ranking Minority Member
Committee on Government Operations
House of Representatives

The Congress passed the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576, November 15, 1990) to address critically needed improvements in the federal government's financial management practices, systems, and reporting. While most of its provisions are directed at executive agencies, the CFO Act also broadened audit and management reporting for government corporations and related entities which represent a major element of the federal government. The CFO Act amended the Government Corporation Control Act to strengthen existing audit requirements for government corporations¹ and requires each to issue an annual management report to the Congress that includes financial statements, management's statement on internal controls, and the auditor's report resulting from the audit of the financial statements. In addition, the act provides for the inclusion of a reconciliation to the corporation's budget report and other information necessary to inform the Congress about the corporation's operations and financial condition.

As part of our efforts to help ensure the successful implementation of the CFO Act, we set out to determine, for 1992, whether the required financial audits were performed and management reports issued by corporations. Also, to understand management's basis for its statement on internal controls, we identified the approaches used by management to assess

¹As used in this report, the term "government corporations" refers to those entities identified in the Government Corporation Control Act as mixed-ownership or wholly-owned corporations. These entities generally conduct revenue-producing, commercial-type activities on a self-sustaining basis and have many of the attributes of private corporations. The term also includes other entities that are specifically subject to the audit and management reporting requirements of the Government Corporation Control Act. See appendix I for a list of the government corporations and other entities which are subject to these requirements and included in this review.

internal controls. We also determined whether government corporations had sufficient guidance to effectively implement the act's audit and management reporting requirements.

We are sending you this report to assist in your Committees' oversight of CFO Act implementation.

Results in Brief

Thirty-three of the 34 government corporations obtained audits of their 1992 financial statements, and the auditors for 31 of these 33 reported that the financial statements were fairly presented in accordance with generally accepted accounting principles. Accounting problems caused the auditors for the other two corporations to not issue opinions on selected financial statements; also, one of these auditors qualified its opinion on the statement of financial condition. The one corporation that did not obtain an audit stated that it was unaware of the CFO Act requirement but planned to comply in the future. A second corporation was also unaware of the CFO Act requirement but subsequently took steps to have its 1992 financial statements audited.

All but three of the 34 government corporations issued the required management reports for 1992. As previously stated, two were not aware of the requirements and one did not issue a 1992 management report because it said resources were needed for higher priority work. For the remaining 31, the management reports generally contained the information required by the CFO Act including the financial statements and management's statement on internal controls. Management for 27 of the 31 corporations that issued a management report reported that its internal controls provided reasonable assurance that the objectives of internal controls were being achieved. The other four corporations did not specifically state whether internal control objectives were being achieved.

We believe the management reports would be more useful if they were prepared using consistent criteria and implementing guidance for assessing internal controls and preparing other financial and performance information. Due in part to an absence of authoritative guidance, the government corporations used different approaches to prepare the management reports resulting in significant differences in assessing and reporting on the condition of internal controls and other required information which reduced the usefulness of the reports. OMB has developed criteria and guidance for executive departments and agencies to follow in implementing various reporting requirements under the

Federal Managers' Financial Integrity Act and the CFO Act. As a result, OMB is in the best position to assist government corporations in establishing similar implementation guidance.

We also believe that the value and usefulness of annual financial statement audits both to management and the Congress can be enhanced by obtaining positive assurance from the corporations' auditors on the effectiveness of internal accounting controls.

Background

In 1990, the Congress passed the Chief Financial Officers Act (Public Law 101-576, November 15, 1990) to (1) bring more effective general and financial management practices to the federal government, (2) provide for improvement in agency systems of accounting, financial management, and internal controls to help ensure the issuance of reliable financial information and to deter fraud, waste, and abuse of government resources, and (3) provide for the production of complete, reliable, timely, and consistent financial information to the executive branch and the Congress to assist them in financing, managing, and evaluating federal programs.

While most of the CFO Act's provisions are directed at executive agencies, it also contains provisions regarding financial accountability and reporting for government corporations. The CFO Act amended the audit and reporting requirements contained in the Government Corporation Control Act (GCCA) (31 U.S.C. 9101 *et seq.*) which are applicable to the entities listed in the GCCA and to certain other governmental entities—such as the African Development and Inter-American Foundations whose enabling legislation requires that they follow them. Thus, when the CFO Act amended the GCCA to strengthen audit and management reporting requirements for the corporations listed in the act, it also strengthened audit and reporting requirements for those other government entities. See appendix I for a list of the 34 government entities we identified as subject to the GCCA's audit and management reporting requirements.

The CFO Act strengthened the GCCA's financial statement audit requirements by requiring annual audits in place of less frequent audits previously required for most government corporations. Audits required under the act are to be conducted by either the corporation's Inspector General or an external auditor and in accordance with generally accepted

government auditing standards (GAGAS).² Further, GAO may conduct a required audit at its discretion or at the request of a Committee of the Congress in lieu of an audit by the Inspector General or an external auditor. Annual financial statement audits serve to improve the quality and accuracy of financial information by providing an independent assessment of the reliability of management's financial statements and helps establish discipline in the financial systems and controls.

To strengthen management's accountability and make the financial results more visible, the CFO Act also requires the management of each government corporation to report to the Congress not later than 180 days after the end of each fiscal year. Each report is required to contain the following information:

- the corporation's annual financial statements;
- a reconciliation to the budget report of the government corporation, if applicable;
- the report resulting from the audit of the corporation's financial statements;
- management's statement on internal controls consistent with the requirements for agency statements on internal accounting and administrative control systems³ under the Federal Managers' Financial Integrity Act of 1982 (FMFIA) (Public Law 97-255); and
- any other comments or information necessary to inform the Congress about the operations and financial condition of the corporation.

Although FMFIA does not apply directly to any government corporation, the CFO Act established internal control reporting requirements for corporations that are similar to those imposed on executive agencies by FMFIA.

Under FMFIA, executive agencies are required to (1) establish a system of internal accounting and administrative controls which provide reasonable

²GAGAS are issued by the Comptroller General of the United States and apply to financial and performance audits. For financial statement audits, GAGAS incorporated the fieldwork and reporting requirements of generally accepted auditing standards (GAAS) issued by the American Institute of Certified Public Accountants. However, unlike GAAS, GAGAS require the auditor to issue a written report on the results of its work on internal controls and compliance with laws and regulations conducted as part of the financial audit.

³Internal accounting and administrative controls consist of the plan of organization and the methods and procedures adopted by management to ensure that resources are used consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

assurance that three specific internal control objectives⁴ are achieved, (2) evaluate annually their system of internal accounting and administrative controls using guidelines established by OMB, and (3) issue a statement annually on whether the agency's internal accounting and administrative controls fully comply with established internal control standards and provide reasonable assurance that internal control objectives are being achieved. If the system of internal accounting and administrative controls does not comply with the standards and/or does not provide reasonable assurance, FMFIA requires that the annual statement include a report identifying any material internal control weakness found and the agency's plans for correcting the weakness.

Objectives, Scope, and Methodology

Our objectives in this review were to

- determine whether government corporations were meeting the CFO Act's annual auditing and reporting requirements,
- identify the approaches used by corporations to assess internal controls and support management's statement on internal controls, and
- determine if corporations have sufficient guidance to effectively implement the act.

To accomplish these objectives, we discussed with OMB officials the universe of entities subject to the audit and reporting requirements contained in the GCCA, as amended by the CFO Act. We also obtained and reviewed any guidance that OMB provided to government corporations to assist them in implementing the CFO Act. We obtained and reviewed the 1992 management reports and related documents issued by government corporations to determine whether the corporations met the CFO Act's auditing and reporting requirements.

To identify the basic approaches used to assess and report on internal controls and determine whether they had sufficient guidance to implement the act, we interviewed financial management officials from each corporation and obtained documentation on the approach each corporation used to assess and report on internal controls. However, we did not evaluate the effectiveness of the approaches used or the results that were produced.

⁴Under FMFIA, the objectives of the system of internal controls are to provide reasonable assurance 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 assets.

The Office of Management and Budget provided written comments on a draft of this report. These comments are presented and evaluated in the "Agency Comments and Our Evaluation" section and are reprinted in appendix VII. Our work was performed in accordance with generally accepted government auditing standards.

Most 1992 Financial Statements Were Reliable

Thirty-three of the 34 government corporations had their 1992 financial statements audited in accordance with GAGAS as required by the CFO Act. The one exception was the African Development Foundation (ADF). Independent public accounting firms audited the financial statements of 29 of the 33 corporations that obtained audits. We audited the financial statements of three corporations—the Federal Deposit Insurance Corporation (FDIC), Pension Benefit Guaranty Corporation (PBGC), and Resolution Trust Corporation (RTC).⁵ The Department of Agriculture's Inspector General audited the 1992 financial statements of the Commodity Credit Corporation (CCC).

In explaining why ADF did not meet the CFO Act's statutory audit requirement, officials of the Foundation advised us that they were initially unaware of the requirement. Once it was determined that the CFO Act's audit requirement was applicable, the ADF initiated steps to plan for the preparation and audit of its 1994 financial statements. A second entity, the Inter-American Foundation (IAF), was also initially unaware of the audit requirement. Subsequently, it took steps to have its 1992 financial statements audited. In this regard, on June 24, 1994, the IAF's auditor issued its report on 1992 financial statements.

For all but two—the Federal Housing Administration (FHA) and PBGC—of the audited government corporations, the auditors reported that the financial statements were fairly presented in accordance with generally accepted accounting principles. A scope limitation on the FHA independent auditor's work prevented the auditor from expressing an opinion on FHA's September 30, 1992, statements of operations and cash flows. The scope limitation occurred because FHA was unable to identify for the auditor the fiscal years in which the events giving rise to an additional loss reserve

⁵Under separate statutory requirements, GAO is responsible for auditing the financial statements of FDIC and RTC. GAO has conducted audits of PBGC's financial statements because of its high risk and continuing congressional interest. The results of these audits are contained in *Financial Audit: Federal Deposit Insurance Corporation's 1992 and 1991 Financial Statements* (GAO/AIMD-93-5, June 30, 1993); *Financial Audit: Pension Benefit Guaranty Corporation's 1992 and 1991 Financial Statements* (GAO/AIMD-93-21, September 29, 1993); and *Financial Audit: Resolution Trust Corporation's 1992 and 1991 Financial Statements* (GAO/AIMD-93-6, June 30, 1993).

occurred due to the lack of accurate loan information and a loan assessment process in prior years.

We qualified our opinion on the statement of financial condition for one of PBGC's two funds because a scope limitation prevented us from assessing whether the Multiemployer Fund's liability for future financial assistance was fairly presented and because material uncertainties affected the liability assessment process. Specifically, PBGC had not obtained sufficient data on liabilities of certain financially troubled multiemployer plans for us to determine the reliability of the reported liability amount.⁶ In addition, we did not express an opinion on PBGC's fiscal year 1992 statements of operations and cash flows for its two funds because PBGC's fiscal year 1991 financial statements were unauditible and those statements materially affected PBGC's fiscal year 1992 operations and cash flows. For fiscal year 1993, Price Waterhouse and GAO conducted full scope audits of FHA and PBGC, respectively. Appendix II lists the auditors for the government corporations and provides information on their audit reports.

Most Management Reports Were Issued

Management for 31 of the 34 government corporations issued their 1992 reports as required by the CFO Act. ADF, IAF, and the Federal Financing Bank (FFB) were the exceptions. As previously discussed, ADF and IAF initially were not aware of the CFO Act's management reporting requirement but have taken steps to meet the reporting requirement in the future. An FFB official advised us that FFB did not issue a 1992 management report because its resources were needed for higher priority work. Twenty-eight of the 31 corporations which issued 1992 management reports did so on a timely basis. The other three corporations issued their management reports late—by an average of 4 months—because of administrative delays and because their auditors were not in a position to complete their audits and issue their reports before the corporations' management reports were due.

The 31 management reports generally contained the information—financial statements, auditor's report, and management's statement on internal controls—explicitly required by the CFO Act. With respect to internal controls, management for 27 of the 31 corporations reported that

⁶After issuing our qualified opinion on PBGC's fiscal year 1992 statement of financial condition for the Multiemployer Fund, PBGC obtained sufficient information on the multiemployer plans in question to assess its potential loss exposure. After evaluating the information, PBGC restated its fiscal year 1992 liability for future financial assistance to record additional liabilities. As a result, we subsequently removed the qualification on our fiscal year 1992 opinion on the Multiemployer Funds statement of financial position. (See GAO/AIMD-94-109, May 4, 1994.)

they had reasonable assurance that internal control objectives were being achieved. However, management's internal control reporting for four other corporations—Export-Import Bank, Pennsylvania Avenue Development Corporation (PADC), FHA, and RTC—did not specifically state whether or not management had reasonable assurance that control objectives were being achieved. As part of their management report, management for 6 of the 31 corporations—CCC, FDIC, FHA, GNMA,⁷ PBGC, and RTC—included descriptions of material weaknesses in internal accounting and administrative controls identified as part of their assessment. The management reports for the other 25 government corporations did not disclose any material weaknesses. Appendix III provides a brief summary of the weaknesses reported by management of the six government corporations.

In addition to management's statement on internal controls, all but one of the management reports contained the results of the financial statement audit, the auditor's tests of compliance with laws and regulations, and the auditor's work on internal controls. The exception was PBGC which issued its management report without the auditor's report because the audit was ongoing in March 1993 when PBGC's management report was due. With respect to compliance with laws and regulations, the auditors for 29 corporations reported that they found no material instance of noncompliance with laws and regulations tested. For the other three corporations that were audited, the auditors' report on compliance with laws and regulations reported individual instances of material noncompliance with laws and regulations.⁸

The auditors for the six corporations discussed above also reported material internal control weaknesses identified during their audit. GAO, as auditor for three of the corporations—FDIC, PBGC, and RTC—identified and reported material internal control weaknesses that were not identified by management, while the weaknesses reported by the auditors for the other three corporations were generally consistent with the weaknesses reported by management.

In addition to the items explicitly required, the CFO Act also provides for management to include in its annual report a reconciliation to the budget, if applicable, and other information necessary to inform the Congress about the corporation's operations and financial condition. The

⁷Government National Mortgage Association.

⁸The auditors' report on compliance with laws and regulations for three separate Federal Home Loan Banks described separate instances of material noncompliance with Federal Home Loan Bank Board policies, but did not always refer to specific provisions of laws and regulations.

management reports for 7 of the 31 corporations included some form of reconciliation to the budget. With respect to other information, 29 of the 31 management reports included other information; however, the nature and extent of this information varied. Most of the reports contained a description of the corporation, highlights of financial condition and results of operations, and other information about the operation of the corporation. Two corporations—the Financing Corporation and Resolution Funding Corporation—only included their financial statements, auditor's report, and management's statement on internal controls.

Appendix IV provides further details on the contents of each corporation's management report for fiscal year 1992.

CFO Act Reporting Can Be Enhanced

We found that due, in part, to a lack of authoritative criteria and guidance, government corporations followed a variety of approaches in assessing and reporting on internal controls and in reporting other information in their annual management report to the Congress. The absence of authoritative criteria and guidance has contributed to assessment and reporting differences which effectively reduce the usefulness of the annual management reports.

Establishing a common framework for government corporations to follow in assessing and reporting on internal controls and in developing and reporting other information should improve the informative value and consistency of the reports and enhance their usefulness to the Congress. In addition, we believe that expanding the independent auditor's responsibilities for examining and reporting on the effectiveness of internal controls as part of the CFO Act financial audit can complement and enhance management's assessment and reporting on internal controls and provide the Congress with an independent evaluation of management's assessment.

Various Approaches Used to Assess and Report on Internal Controls

We found that government corporations used a variety of approaches to assess and report on internal controls in support of management's statement on internal controls required by the CFO Act. The CFO Act requires government corporations to annually report on the adequacy of their internal controls in a manner consistent with internal control assessment and reporting requirements imposed on executive agencies by the FMFIA. However, government corporations are generally not required to

follow assessment criteria and guidelines—established by OMB for executive agencies—in assessing and reporting on internal controls.

FMFIA required OMB to issue guidelines for executive agencies to follow in evaluating internal controls in support of FMFIA's annual internal control reporting requirement. OMB's guidance (Circular A-123) provides a common baseline or framework for executive agencies to follow in establishing a system of internal accounting and administrative controls and evaluating the effectiveness of their system of internal controls. Additionally, FMFIA requires that executive agencies prepare an annual statement on the adequacy of internal controls based on their assessment conducted in accordance with OMB's guidance. OMB's guidance also requires that the agency's annual statement on internal controls include a description of any material weaknesses (and related plans for corrective actions) identified as part of the internal control assessment process.

In August 1992, OMB sent a memorandum to the heads of the government corporations reminding them of the CFO Act requirement to report on their assessment of internal accounting and administrative controls. To further assist the corporations, OMB provided them with a copy of OMB's reporting instructions which executive agencies are required to follow in preparing their annual FMFIA internal control report. However, its memorandum was only advisory in nature because OMB does not issue similar guidelines for government corporations.

Our review of the approaches used by government corporations to assess and report on internal controls found that three corporations—ADF, FFB, and IAF—did not perform an internal control assessment. Of the 31 government corporations for which an internal control assessment was performed, 14 reported that they followed OMB's assessment and reporting guidelines to support management's statement on internal controls. The other 17 corporations used a variety of alternative approaches—ranging from utilizing the work performed by external auditors to reviewing the internal and external auditors' work and discussions with the auditors and management officials—to support management's statement on internal controls.

While the scope of our review did not include an evaluation of the effectiveness of each corporation's approach, we found that most of the alternative approaches used by the 17 corporations did not address important elements of OMB's guidelines. In our view, the absence of these elements effectively limits the scope and comprehensiveness of

management's assessment of and conclusions on the effectiveness of internal controls.

Most of the 17 corporations using alternative approaches did not require a specific management evaluation of the effectiveness of internal controls and/or did not require that material internal control weaknesses be identified and reported, along with appropriate corrective actions, as part of management's statement on internal controls required by the CFO Act. Specific internal control evaluations which are designed to identify and raise, for management's consideration, material weaknesses (and related corrective actions) are important features of OMB's guidelines. They provide management with an informed basis from which to draw a conclusion on the overall adequacy of internal controls, as well as provide the information on material weaknesses (and related corrective actions) needed for effective reporting to the Congress under the CFO Act.

We noted other significant differences in the alternative approaches followed by some corporations. For three government corporations,⁹ the assessment of internal controls was not performed internally. Instead, management stated that it relied on the internal control work performed by external auditors as support for management's statement on the adequacy of internal controls. However, auditing standards do not require that financial auditors conduct the kind of evaluation or assessment of the effectiveness of internal controls which management is expected to perform under FMFIA and the CFO Act. In addition, under normal circumstances, the scope of internal control work performed by financial auditors would not necessarily include internal administrative controls which are included within the scope of management's statement on internal controls required by the CFO Act. Appendix V provides information on the approaches followed by management of the government corporations to support their statements on internal controls.

The limitations of some of the assessment and reporting approaches can be seen by examining the nature and extent of management's internal control disclosures included as part of management's statement on internal controls. In addition to including management's statement on internal controls as required by the CFO Act, six corporations disclosed the nature and extent of material internal control weaknesses (and related

⁹Two of the three corporations—the Financing Corporation and the Resolution Funding Corporation—relied on assessments made by a team of outside auditors from the audit departments of the 12 Federal Home Loan Banks. The management of the Pennsylvania Avenue Development Corporation relied on the internal control work performed by its independent financial auditor to support management's assurance statement on internal controls.

corrective actions). Each of the six corporations reported that they followed OMB's guidelines, which require that material weaknesses and corrective actions be reported. The fact that OMB guidelines require management to identify and report publicly any material weaknesses and corrective actions identified during its internal control assessment, likely explains why the CFO Act management reports for the six corporations also contained these important disclosures. However, because the alternative approaches followed by most of the 17 corporations did not require the identification and reporting of material internal control weaknesses, no conclusions on whether material internal control weaknesses existed at these corporations can be reached from reviewing their management reports. In addition, while management for four government corporations—Export-Import Bank, FHA, PADC, and RTC—included in their management report a discussion of internal controls, they did not explicitly state whether or not management had reasonable assurance that internal control objectives were being achieved.

To provide the Congress with consistent and meaningful information on the adequacy of internal controls and the existence of material weaknesses, we believe that government corporations should adopt a common framework or approach to assessing and reporting on internal controls. While this can be achieved by following OMB's internal control guidelines applicable to executive agencies, another alternative exists. Government corporations could elect to follow the framework for evaluating and reporting on internal controls issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)¹⁰ entitled Internal Control-Integrated Framework. This framework, issued in September 1992, with its May 1994 addendum concerning safeguarding of assets, represents an effective approach for evaluating and reporting on internal controls.

Varied Reporting of Other Information

While the 31 management reports issued for 1992 generally contained the financial statements, auditor's report, and management's statement on internal controls, most reports did not include a reconciliation to the corporation's budget report or provide a consistent level of other information on the operations and financial condition of the corporations. The act requires that management's annual CFO Act report contain a reconciliation to the budget report of the corporation, if applicable, as well as other information necessary to inform the Congress about the

¹⁰COSO consists of the Financial Executives Institute, American Institute of Certified Public Accountants, American Accounting Association, The Institute of Internal Auditors, and the Institute of Management Accountants.

operations and financial condition of the corporation. However, while OMB established guidance for executive departments and agencies to follow in preparing similar information for inclusion in agencies' CFO Act reports, government corporations are not subject to the guidance and no other mechanism presently exists for establishing such guidance for corporations.

By preparing a reconciliation to its budget report, an entity shows how its expenses reported on its statement of operations relate to amounts reported in the President's budget. It provides a meaningful comparison or crosswalk between an entity's accrual-based operating results and its obligations and outlays information reported in the President's budget. Also, this type of reconciliation provides increased credibility to unaudited budgetary information reported as "actual" by linking such information back to audited financial information for the same period.

While many government corporations receive no direct government funds, 17 of the 31 corporations that issued management reports for 1992 had some aspect of their 1992 financial operations reported in the President's FY 1994 budget which, in our view, suggests that a reconciliation to the budget would have been appropriate. However, only 7 of the 17 corporations included a reconciliation to the budget in their management reports. In addition, officials for most of those corporations that prepared reconciliations indicated their uncertainty about what the reconciliation should contain and that guidance applicable to government corporations would have been useful. We believe that the relatively few government corporations that prepared a reconciliation to budget and the uncertainties experienced by those corporations that prepared one is due largely to the absence of authoritative guidance on when a reconciliation should be prepared and its contents.

Management reports for government corporations are also required by the CFO Act to contain "... any other comments and information necessary to inform the Congress about the operations and financial condition of the corporation." Again, OMB has issued guidance specifying the form and content of the other financial information that is to accompany agency financial statements. The guidance is intended to provide executive agencies with a framework for meeting a major CFO Act objective to develop financial statements that supply information useful to the Congress, government managers, and the public. OMB's guidance applicable to executive agencies requires an overview of the reporting entity which explains and expands upon the financial statements by

providing a clear and concise discussion of the reporting entity; its mission, goals, and objectives; performance measures; financial results and condition; and relevant financial and performance data on programs and activities. However, as with internal controls and reconciliation to budget, government corporations are not required to follow this guidance in developing the other information to include in their management reports.

All but 2 of the 31 Corporations—the Financing Corporation and Resolution Funding Corporation—issued management reports that contained other information. However, the nature and extent of the information varied widely. Some corporations provided only limited information on their operations and financial condition, while others supplied more extensive information on financial condition, program operations, and, in some cases, performance information.

We believe that the usefulness of government corporations' management reports would be improved by including, at a minimum, the type of overview information currently called for in OMB's guidance to executive agencies on the form and content of other financial information. Providing this type of information as part of each corporation's management report would enable government corporations to begin meeting new strategic planning and performance measurement requirements established by the Government Performance and Results Act of 1993 (GPRA).¹¹ When GPRA is fully implemented, government corporations will be required to develop and report on strategic and annual performance plans, performance goals and indicators, and resource requirements. Beginning now to develop and report overview-type information will improve the usefulness of annual CFO Act management reports while facilitating corporations' implementation of GPRA.

Positive Assurance on Internal Controls Should Enhance Management Reporting

We believe that increasing the auditors' responsibilities to test and report on the effectiveness of internal accounting controls would enhance the usefulness of the auditors' internal control work to management and the Congress. Requiring the auditor to conduct an examination of internal accounting controls of sufficient scope to support positive assurance on their effectiveness would complement and enhance management's internal assessment of internal controls while providing the Congress with an

¹¹Strategic plans are required no later than September 30, 1997, followed by annual performance plans beginning with fiscal year 1999, and annual program performance reports no later than March 31, 2000.

independent assessment of management's statement on the adequacy of internal accounting controls.

Government auditing standards require auditors to obtain a sufficient understanding of the internal control structure to determine the nature, timing, and extent of audit procedures. After assessing the audit risk associated with relying on internal controls, the auditor may plan to rely on internal controls which, in turn, requires that the operating effectiveness of specific internal controls be evaluated. If the controls are effective, the auditor may reduce the nature and extent of other audit procedures. The auditor is not required to test the effectiveness of specific controls, if the auditor believes that it would be inefficient to do so. The likelihood that the auditor will find it efficient and effective to test specific controls increases with the size and complexity of the entity being audited. Because the extent of the auditors' internal control work can vary, government auditing standards do not require auditors to express any assurance about the effectiveness of internal controls when reporting on internal controls or on the results of their financial statement audits. However, the standards do require auditors to report any significant internal control deficiencies identified in the course of their internal control work.

Recognizing the importance and value of an independent assessment of the effectiveness of internal controls, OMB and GAO have placed greater emphasis on testing internal controls as part of federal financial audits. OMB, in establishing guidance for CFO Act audits of executive agencies' financial statements (OMB Bulletin No. 93-06, January 8, 1993), required auditors to go beyond government auditing standards and test significant internal controls when the auditor believed that the controls were properly designed and likely to be operating. While the level of internal control work required on the fiscal year 1992 audits was not sufficient for the auditors to provide positive assurance on the effectiveness of internal accounting controls, OMB, in its bulletin, stated its intention to expand future guidance to require the level of testing needed to support an auditor's conclusion of positive assurance.

In 1992, GAO revised its financial audit methodology to go beyond existing government auditing standards by requiring that our auditors perform sufficient internal control work to enable us to provide management and the Congress with an opinion on the effectiveness of internal accounting

controls.¹² We implemented our revised audit methodology on seven fiscal year 1992 CFO Act audits of both executive agencies and government corporations. In these audits, we performed sufficient work on internal accounting controls to determine whether they provided reasonable assurance that assets were safeguarded against loss from unauthorized use or disposition; transactions were executed in accordance with management authority, and laws and regulations; and transactions were properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with the applicable accounting principles and to maintain accountability for assets. Appendix VI lists our reports on our 1992 CFO Act financial audits of four executive departments and agencies and three government corporations.

The value and benefit of performing the additional internal control work needed to support positive assurance is evident in the results of our additional work. In each of our seven CFO Act audits for 1992, we found that internal controls were not effective in achieving all of their objectives. We believe the results of our additional work complemented and enhanced management's internal assessment by identifying serious internal control weaknesses that had not been recognized in management's assessment and provided the Congress with an independent evaluation of management's statement on internal controls. Identifying additional weaknesses should also help to strengthen future management control assessments and speed the corrective actions needed to strengthen asset safeguards and facilitate more timely and reliable financial reporting.

Government corporations can increase the value and usefulness of their external auditor's work on internal controls and provide the Congress with an independent assessment of the effectiveness of internal controls by expanding their external auditors' responsibilities to examine and report on management's representations on the effectiveness of internal controls over financial reporting, safeguarding of assets, and compliance with laws and regulations. However, while current government auditing standards do not require financial auditors to perform the work needed to provide positive assurance on internal controls, they do permit the auditor to examine and report, with positive assurance, on management's written

¹²The broader-scope internal control work required by our financial audit methodology and the assurances that result typically apply only to internal accounting controls and not to internal administrative or operational controls.

representations concerning the effectiveness of an entity's internal control structure.¹³

Conclusions

Although most government corporations had their 1992 financial statements audited and issued their required CFO Act management reports, the value and usefulness of the audits and management reports required by the act can be enhanced by ensuring that government corporations follow a common framework or approach in assessing and reporting on internal controls and in preparing a reconciliation to the budget and other information to be included in the annual management report. Building on its experience with executive agencies and departments in implementing FMFLA and the CFO Act, OMB could work closely with the government corporations to address each of the assessment and reporting issues raised in this report.

Expanding the auditor's responsibilities on federal financial audits to perform the internal control work needed to provide positive assurance on internal accounting controls would provide management and the Congress with an independent, comprehensive report on these controls. Accordingly, we strongly encourage the management of government corporations to build on recent OMB and GAO efforts by requesting that their auditors examine and report on management's representations concerning the effectiveness of the internal controls structure. The COSO Internal Control-Integrated Framework establishes criteria for assessing and reporting on internal controls that are recognized by business management and auditors that OMB and government corporations should consider adopting. We believe that management reporting on controls coupled with an auditor's review of management's representation is an effective model for examining and reporting on internal controls.

¹³Comptroller General's Government Auditing Standards, 1994 Revision, and Statement on Standards for Attestation Engagements No. 2: Reporting on an Entity's Internal Control Structure Over Financial Reporting issued by the Auditing Standards Board, American Institute of Certified Public Accountants, May 1993.

Recommendations

To improve the usefulness of the CFO Act's audit and reporting requirements for government corporations and to enhance the consistency of management reporting to the Congress, we recommend that the Director of the Office of Management and Budget work closely with the heads of government corporations to establish an appropriate framework for corporations to follow in

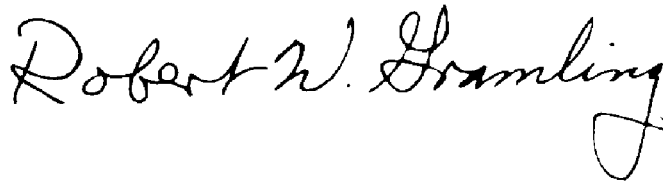
- assessing and reporting on internal controls;
- determining when a reconciliation to budget is appropriate and, if so, what it should contain; and
- establishing the nature and extent of other information to be included in corporations' annual management reports.

Agency Comments and Our Evaluation

In commenting on a draft of this report, OMB concurred with our recommendations and said it plans to work with the corporations to improve their CFO Act management reports. Specifically, OMB said it would (1) continue to provide corporations with access to criteria and guidance it has developed for executive departments and agencies to follow in implementing the requirements of the CFO Act and (2) provide the technical assistance necessary to assist government corporations in implementing the CFO Act. OMB's written comments are included in appendix VII.

We are sending copies of this report to the Director, Office of Management and Budget; heads of all government corporations; and interested congressional committees. Copies will also be made available to others upon request.

Please call me at (202) 512-9406 if you or your staffs have any questions concerning the report. Major contributors to this report are listed in appendix VIII.



Robert W. Gramling
Director, Corporate Financial
Audits

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Abbreviations

ADF	African Development Foundation
CFO	chief financial officer
CCC	Commodity Credit Corporation
COSO	Committee on Sponsoring Organizations of the Treadway Commission
FDIC	Federal Deposit Insurance Corporation
FFB	Federal Financing Bank
FHA	Federal Housing Administration
FMFLA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
GAAS	generally accepted auditing standards
GAGAS	generally accepted government auditing standards
GCCA	Government Corporation Control Act
GNMA	Government National Mortgage Association
GPRA	Government Performance and Results Act
IAF	Inter-American Foundation
OMB	Office of Management and Budget
PADC	Pennsylvania Avenue Development Corporation
PBGC	Pension Benefit Guaranty Corporation
RTC	Resolution Trust Corporation

Government Corporations Subject to the CFO Act

African Development Foundation
Amtrak (National Railroad Passenger Corporation)
Bonneville Power Administration
Commodity Credit Corporation
Export-Import Bank
Federal Crop Insurance Corporation
Federal Deposit Insurance Corporation
Federal Financing Bank
Federal Home Loan Bank of Atlanta
Federal Home Loan Bank of Boston
Federal Home Loan Bank of Chicago
Federal Home Loan Bank of Cincinnati
Federal Home Loan Bank of Dallas
Federal Home Loan Bank of Des Moines
Federal Home Loan Bank of Indianapolis
Federal Home Loan Bank of New York
Federal Home Loan Bank of Pittsburgh
Federal Home Loan Bank of Seattle
Federal Home Loan Bank of San Francisco
Federal Home Loan Bank of Topeka
Federal Housing Administration
Federal Prison Industries
The Financing Corporation
Government National Mortgage Association
Inter-American Foundation
National Credit Union Administration Central Liquidity Facility
Overseas Private Investment Corporation
Pennsylvania Avenue Development Corporation
Pension Benefit Guaranty Corporation
Resolution Funding Corporation
Resolution Trust Corporation
Rural Telephone Bank
Saint Lawrence Seaway Development Corporation
Tennessee Valley Authority

Government Corporations' 1992 Financial Audit Reports

Corporation	Auditor	Type of opinion	Internal control report prepared	Compliance report prepared
African Development Foundation	Financial statements not prepared	N/A	N/A	N/A
Amtrak	Arthur Andersen	Unqualified	Yes	Yes
Bonneville Power Administration	Price Waterhouse	Unqualified	Yes	Yes
Commodity Credit Corporation	Agriculture Inspector General	Unqualified	Yes	Yes
Export-Import Bank	Price Waterhouse	Unqualified	Yes	Yes
Federal Crop Insurance Corporation	KPMG Peat Marwick	Unqualified	Yes	Yes
Federal Deposit Insurance Corporation	GAO	Unqualified	Yes	Yes
Federal Financing Bank	Gregory K. Washington	Unqualified	Yes	Yes
Federal Home Loan Banks (all 12)	Price Waterhouse	Unqualified	Yes	Yes
Federal Housing Administration	Price Waterhouse	Disclaimer (with respect to statements of operations and cash flows)	Yes	Yes
Federal Prison Industries	Urbach Kahn & Werlin	Unqualified	Yes	Yes
The Financing Corporation	Price Waterhouse	Unqualified	Yes	Yes
Government National Mortgage Association	Price Waterhouse	Unqualified	Yes	Yes
Inter-American Foundation	Brown & Company	Unqualified	Yes	Yes
National Credit Union Administration Central Liquidity Facility	Price Waterhouse	Unqualified	Yes	Yes
Overseas Private Investment Corporation	Price Waterhouse	Unqualified	Yes	Yes
Pennsylvania Avenue Development Corporation	Urbach Kahn & Werlin	Unqualified	Yes	Yes
Pension Benefit Guaranty Corporation	GAO	Disclaimer (with respect to statements of operations and cash flows) and qualified (with respect to one fund)	Yes	Yes
Resolution Funding Corporation	Price Waterhouse	Unqualified	Yes	Yes
Resolution Trust Corporation	GAO	Unqualified	Yes	Yes
Rural Telephone Bank	Urbach Kahn & Werlin	Unqualified	Yes	Yes
Saint Lawrence Seaway Development Corporation	Arthur Andersen	Unqualified	Yes	Yes
Tennessee Valley Authority	Coopers & Lybrand	Unqualified	Yes	Yes

Management Reporting on Internal Controls

Thirty-one of the 34 government corporations issued management reports for 1992. Twenty-seven of the 31 management reports reported management's conclusions that it had reasonable assurance that its internal control objectives were being achieved. The management report for the four other corporations—Export-Import Bank, FHA, PADC and RTC—did not specifically state whether management had reasonable assurance or not.

In reporting on internal controls, management for 6 of the 31 corporations included a description of material weaknesses in internal controls.

- CCC reported three material weaknesses pertaining to interest waived due to statutory marketing price-support loan provisions, the inventory management system, and issuance of grain warehouse receipts.
- FDIC reported 12 material internal control weaknesses. These weaknesses included the reliability, data integrity, user training, and reconciliations of several management information systems. FDIC also noted the need for stronger controls in its procurement activities and security over certain official records and information systems.
- FHA reported four material internal control weaknesses. The weaknesses related to FHA's automated systems and the lack of staff and financial resources to effectively service notes and maintain property values.
- GNMA reported three material weaknesses in internal controls. These weaknesses addressed the need for improvements in subserver and contractor monitoring, and systems development, operation, and maintenance. In addition, GNMA cited the need to formally define and approve criteria for withholding commitment authority and granting waivers.
- PBGC reported nine material internal control weaknesses. The areas identified included general accounting systems, premium collections, procurement operations, loss prevention, and claim recoveries related to terminated pension plans. PBGC also noted weaknesses with document backup and storage, accounting controls, and unsupported accounting policies and actuarial assumptions.
- RTC reported 13 material internal control weaknesses for 1992. The areas identified included acquisition of legal services, controls over receiverships, deposits insurance payouts, and claims assessment. The RTC also noted weaknesses in its contracting policies and procedures, property appraisal practices, asset management, monitoring of contractors, and oversight of conservatorships.

Government Corporations' 1992 Management Reports

Corporation	Submitted by due date	Report contents				
		Financial statements	Reconciliation to budget report	Internal control statement	Audit report	Other information
African Development Foundation	(1992 management report not issued)	N/A	N/A	N/A	N/A	N/A
Amtrak	Yes	Yes	No	Yes	Yes	Yes
Bonneville Power Administration	Yes	Yes	No	Yes	Yes	Yes
Commodity Credit Corporation	No	Yes	Yes	Yes	Yes	Yes
Export-Import Bank	Yes	Yes	No	Yes	Yes	Yes
Federal Crop Insurance Corporation	Yes	Yes	Yes	Yes	Yes	Yes
Federal Deposit Insurance Corporation	Yes	Yes	No	Yes	Yes	Yes
Federal Financing Bank	(1992 management report not issued)	N/A	N/A	N/A	N/A	N/A
Federal Home Loan Banks (12)	Yes	Yes	No	Yes	Yes	Yes
Federal Housing Administration	No	Yes	Yes	Yes	Yes	Yes
Federal Prison Industries	Yes	Yes	No	Yes	Yes	Yes
The Financing Corporation	Yes	Yes	No	No	Yes	Yes
Government National Mortgage Association	No	Yes	Yes	Yes	Yes	Yes
Inter-American Foundation	(1992 management report not issued)	N/A	N/A	N/A	N/A	N/A
National Credit Union Administration Central Liquidity Facility	No	Yes	No	Yes	Yes	Yes
Overseas Private Investment Corporation	Yes	Yes	No	Yes	Yes	Yes
Pennsylvania Avenue Development Corporation	Yes	Yes	Yes	Yes	Yes	Yes

(continued)

**Appendix IV
Government Corporations' 1992
Management Reports**

Corporation	Submitted by due date	Report contents				
		Financial statements	Reconciliation to budget report	Internal control statement	Audit report	Other information
Pension Benefit Guaranty Corporation	Yes	Yes	Yes	Yes	No	Yes
Resolution Funding Corporation	Yes	Yes	No	Yes	Yes	No
Resolution Trust Corporation	Yes	Yes	No	Yes	Yes	Yes
Rural Telephone Bank	Yes	Yes	No	Yes	Yes	Yes
Saint Lawrence Seaway Development Corporation	Yes	Yes	Yes	Yes	Yes	Yes
Tennessee Valley Authority	Yes	Yes	No	Yes	Yes	Yes

Internal Control Assessment Procedures Used by Government Corporations

Corporation	Procedures
African Development Foundation	Did not assess controls.
Amtrak	Internally developed internal control assessment procedures.
Bonneville Power Administration	OMB internal control assessment guidance.
Commodity Credit Corporation	OMB internal control assessment guidance.
Export-Import Bank	OMB internal control assessment guidance.
Federal Crop Insurance Corporation	OMB internal control assessment guidance.
Federal Deposit Insurance Corporation	OMB internal control assessment guidance.
Federal Financing Bank	Did not assess controls.
Federal Home Loan Banks (12)	Internally developed internal control assessment procedures.
Federal Housing Administration	OMB internal control assessment guidance.
Federal Prison Industries	OMB internal control assessment guidance.
The Financing Corporation	Has not developed internal procedures to assess internal controls but utilized the work of external auditors.
Government National Mortgage Association	OMB internal control assessment guidance.
Inter-American Foundation	Did not assess controls.
National Credit Union Administration Central Liquidity Facility	OMB internal control assessment guidance.
Overseas Private Investment Corporation	OMB internal control assessment guidance.
Pennsylvania Avenue Development Corporation	Has not developed internal procedures to assess internal controls but utilized the work of external auditors.
Pension Benefit Guaranty Corporation	OMB internal control assessment guidance.
Resolution Funding Corporation	Has not developed internal procedures to assess internal controls but utilized the work of external auditors.
Resolution Trust Corporation	OMB internal control assessment guidance.
Rural Telephone Bank	OMB internal control assessment guidance.
Saint Lawrence Seaway Development Corporation	OMB internal control assessment guidance.
Tennessee Valley Authority	Internally developed internal control assessment procedures.

GAO 1992 CFO Act Financial Audit Reports

Financial Audit: Examination of the Army's Financial Statements for Fiscal Years 1992 and 1991 (GAO/AIMD-93-1, June 20, 1993).

Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

Financial Audit: Examination of Customs' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-3, June 30, 1993).

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992 (GAO/AIMD-93-4, June 30, 1993).

Financial Audit: Federal Deposit Insurance Corporation's 1992 and 1991 Financial Statements (GAO/AIMD-93-5, June 30, 1993).

Financial Audit: Resolution Trust Corporation's 1992 and 1991 Financial Statements (GAO/AIMD-93-6, June 30, 1993).

Financial Audit: Pension Benefit Guaranty Corporation's 1992 and 1991 Financial Statements (GAO/AIMD-93-21, September 29, 1993).

Comments From the Office of Management and Budget



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D. C. 20503

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information Management Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

Thank you for the opportunity to comment on the draft General Accounting Report (GAO) "Government Corporations CFO Act Management Reporting Could be Enhanced." In accordance with Section 236 of the Legislative Reorganization Act of 1970, this letter provides our comments on the draft report.

The report recommends that the Director of the Office of Management and Budget work closely with the heads of Government corporations to establish an appropriate framework for corporations to follow in:

- o assessing and reporting on internal controls,
- o determining when a reconciliation to budget is appropriate, and if so what it should contain, and
- o establishing the nature and extent of other information to be included in corporations' annual management reports.

The Office of Management and Budget (OMB) concurs with GAO's recommendations and, within the framework of its statutory authority, plans to continue to work with Government corporations to improve their management reports.

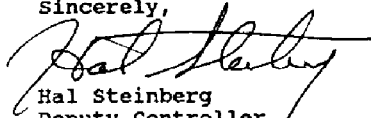
As GAO noted, OMB developed criteria and guidance for executive departments and agencies to follow in implementing the requirements of the Chief Financial Officers Act (CFOs Act). OMB also provided Government corporations advisory guidance for use in complying with the internal control reporting requirement of the CFOs Act. The guidance that OMB provided executive agencies addresses the issues which concern GAO. This guidance has been made available to the Government corporations. However, OMB lacks the statutory authority to prescribe for Government corporations guidance similar to that prescribed for executive agencies.

Appendix VII
Comments From the Office of Management
and Budget

OMB will continue to provide Government corporations access to the guidance provided executive departments and agencies and will provide the technical assistance necessary to assist in implementation.

Thank you again for the opportunity to provide these comments.

Sincerely,



Hal Steinberg
Deputy Controller

Major Contributors to This Report

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