JFMIP

The Proceedings of a conference sponsored by the Chief Financial Officers (CFO) Council and the Joint Financial Management Improvement Program

Implementing the Administration's Plan for Audited Financial Statements in the Federal Government

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Contents

Foreword

On Tuesday, September 18, 1990, at the Crystal Gateway Marriott Hotel in Arlington, Virginia, a conference entitled "Implementing the Administration's Plan for Audited Financial Statements in the Federal Government" was held under the joint sponsorship of the Chief Financial Officers (CFO) Council and the Joint Financial Management Improvement Program (JFMIP). As part of JFMIP's mission to disseminate information addressing current issues in financial management policies and practices within the government and to enhance the spirit of cooperation among financial managers, we are publishing the Conference proceedings.

The Chief Financial Officers (CFO) Council meets monthly to discuss salient financial management issues.The Council activities are done through various committees: Executive, Human Resources, Financial Systems and Information (the subcommittee on Audited Financial Statements falls under this committee), Central Agency Requirements, Legislative, and Organization and Structure.

The JFMIP is a joint undertaking of the General Accounting Office, the Office of Management and Budget, Department of the Treasury, and the Office of Personnel Management, working in cooperation with each other and operating agencies to improve financial management in the Government. As part of its overall mission, the JFMIP periodically sponsors conferences, seminars and forums on issues in financial management.

The keynote addresses at the "Audited Financial Statements" conference were presented by Frank Hodsoll, Chief Financial Officer of the United States and Executive Associate Director for Management at the Office of Management and Budget, and by Donald Chapin, Assistant Comptroller General of the United States for Accounting and Financial Management. Mr. Hodsoll addressed "The Administration's Five Point Program" for accounting standards, information and systems standards, agency financial systems, central agency financial systems, and audited financial statements. Mr. Chapin addressed the "General Accounting Office's Perspective on Audited Financial Statements."

The agenda of the CFO Subcommittee on Audited Financial Statements was presented. In morning presentations and in afternoon workshop sessions, government agency financial management representatives and, as appropriate, representatives from the General Accounting Office, offices of inspectors general, and independent auditing firms discussed the implementation of audited financial statements by the General Services Administration, the Department of Labor, the Social Security Administration (Department of Health and Human Services), and the Department of Veterans Affairs.

Acknowledgements

We would like to acknowledge and thank all those who participated in this conference. We especially like to thank those individuals who worked behind the scene to ensure that the conference was run smoothly and successfully.

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Chapter 1
Opening Remarks

Virginia Robinson
Executive Director, JFMIP

Good morning. I'm Virginia Robinson, Executive Director of the Joint Financial Management Improvement Program and a member of the Chief Financial Officers Council. I am very pleased to welcome you to our forum on "Audited Financial Statements." It's really good to see such a good turn-out today. As of last evening, we had about 410 people registered, and we did have a number of walk-ins this morning. We are very pleased to see so much interest in this kind of technical program.

We have not only people from our traditional federal community and the major agencies. We have a number of people with us from the D.C. government and quite a few people from out of town. We even have a person with us from Pakistan. We like to know that we are appealing to a broad audience. And we have an excellent mix of audit, accounting, budget, and information resources people with us here today.

We are also glad that we were able to relocate the program so that we could accommodate participants from the private sector as well as the public sector to work together on this information exchange. We have excellent representation from the audit community, and we are very pleased about that especially since we are talking about the audit of financial statements today. There is one other area that I also hope will be emphasized today that is just as important as the audit, and that is the area that's covered by our operating people, and, as usual, we don't have quite as many of them in attendance as we do from the audit and the staff communities.

I would like to take this opportunity to emphasize that we will work very hard in the future to see that we have good participation and representation in these forums from operating people in accounting and budget who really are on the front lines—the people who have to develop these statements that we're planning to audit. Frequently, they're putting out fires, making funds transfers, preparing the reports, developing testimony, and all of those things that really make our government work. They're just as important. They really need the training, and we will need to provide more opportunities to make sure that they, too, are fully participating in these programs, especially in the area of resource management.

We tend to find the resources that we need to do the audits. We tend to find the resources that we need to do the staff work. But, again, we will have to make the resources available for the expanded functions that are being required of our operating people who are developing these statements and really making our government work. One of the things that we talk about when we discuss auditing financial statements is to emphasize how well the statements have served the business sector, and that we know that they will also serve the federal sector very well.

We know, though, that there are some things that have been done in the business world, some other things, that we would also like to emulate, and one is this all-important area of training. And, again, I say training for the people in operations as well as for the people who will be auditing the statements.

You'll be hearing more about training, especially from the JFMIP perspective, as we issue our training report which will be forthcoming very shortly.

One of the other projects that we're working on in JFMIP that I'd like to mention at this time that is very much related to audited financial statements is our JFMIP standardization of financial information project. In that project, we expect to deliver two principal products. One is a glossary of terms so that we can have standardized terminology used across government. A second product we expect from that project is a compilation of data elements that will be in the external reports for Treasury and the Office of Management and Budget. Just reflect on how much more meaningful these financial statements will be when we have consistent terminology and streamlined data elements—the ones that are really needed—for external reports. We hope to finish that project well in advance of additional major efforts that move forward on audited financial statements. In fact, we're estimating that we should have the product out in 3 to 4 months for your reactions. So that information will be very much a part of reporting mechanisms that are in place as the financial statements are continually audited.

I noticed a little ad—not a little ad, a big ad—in the subway station on my way to work a few days ago, and I think it's apropos though it is in another field that is somewhat unrelated to financial management. It described, sort of in a nutshell, what's important in the medical field, and I think there is an analogy for us that we can use in financial management. I think it sort of summarizes the message that I think we're trying to convey today. This excerpt is from an ad from a respectable hospital in this area, and the ad reads "it's not the number of patients who come to our hospital that's important; it's the number of patients who go home."

An analogy for us, I think, in the financial management community, is that it's not so important the number of footnotes, the number of pages, that we have in our financial statements and our other reports. What's important is the number of reports that are used and at least read and preferably the number that will be taken home.

I'd like to move now to another pleasure that I have this morning, and that is to introduce the second Chief Financial Officer of the U.S. Government. It seems a very short while ago at one of our JFMIP conferences that Mr. Frank Hodsoll was first introduced as the Chief Financial Officer and Executive Associate Director of the Office of Management and Budget. Given all the challenges we have before us in the federal financial management community, I do wonder if he feels as though it has been just a short while since he took that position.

Mr. Hodsoll was appointed Executive Associate Director of OMB in February 1989 by President Bush. He has responsibility for OMB management functions. He advises the Director of OMB on procurement policy and privatization as well as selected aspects of international affairs and national security. All of this is in addition to his very important financial management role. There will be a presidential emphasis on strengthening the management of federal agencies, building on the initiatives of the Reagan Administration in this area.

Mr. Hodsoll was Chairman of the National Endowment for the Arts where he served since November 1981 until he was appointed to this position in 1989. He was previously Deputy Assistant to President Reagan and deputy to White House Chief of Staff James A. Baker. He has held senior positions in a variety of federal agencies, including the Department of State, the Department of Commerce, and the Environmental Protection Agency. An attorney and former managing director of a British trading company in the Philippines, he has degrees from Yale, Cambridge, and Stanford law school. Please join me in welcoming Mr. Frank Hodsoll.

Keynote Address

Frank Hodsoll
Office of Management and Budget

Good morning. It's good to see such a large turnout at this seminar on audited financial statements. I commend the CFO Council and JFMIP for identifying the need for the seminar and for their excellent work in making all the necessary arrangements.

This seminar is important. As you may know, audited financial statements are the cornerstone of the Administration's financial management improvement strategy. In my talk this morning, I will be reviewing the overall strategy with you and explaining the key role of audited financial statements.

The problem, as you well know, is that we don't really have adequate guidance or standards within the federal government for the preparation of financial statements. We'll have that guidance and those standards, hopefully, before too long. The CFO Council has a project underway to propose revisions in the Treasury Form 220 report series and, as I will discuss later, OMB, Treasury, and GAO are working hard to establish a joint mechanism for setting accounting standards.

In the meantime, how do you proceed to comply with the Administration's requirement for audited financial statements? I hope this seminar will help you to answer that question. The agencies on today's program have marched out on their own. They have already been through the trials and tribulations of preparing financial statements and having them audited. They have learned lessons, and they are prepared to pass them on to us today. I very much appreciate these agencies' willingness to share their wisdom.

Now, before getting to my topic, which is the Administration's overall strategy for financial management improvement, I'd like to spend a minute talking about you. I know that this audience is highly representative of the government financial management community. I want to take this opportunity to thank you for the fine work and progress that have been made over the past few years in improving financial management. We always hear in the press about the things we're not doing well, but we don't always get recognition for the improvements that are being made.

In recent years there has been an emphasis on upgrading individual agency financial systems. Nearly every department and agency has a major upgrade underway. Taken as a whole, this is no doubt the largest upgrade program ever undertaken. You have all contributed significantly to this program. Agencies have cooperated by sharing systems, providing system services to others, and consolidating systems internally. This is resulting in more efficient and effective financial systems across government. We're doing well, but we still have a long way to go.

Summary of the "Five Point Program"

While we must continue to upgrade our individual systems, the time has clearly come to focus on making those systems compatible and on making sure that they are producing accurate and useful information for program managers as well as financial managers. In other words, we need a governmentwide strategy for a broad range of financial management improvements. I am here today to tell you that we have such a strategy. We call it the "Five Point Program." The five points are:

1. Accounting Standards. Standards that govern the way we measure and record assets, liabilities, costs, and so on are, of course, the essential foundation of a credible financial reporting and disclosure process.

2. Information and Systems Standards. These standards are essential to allow for electronic exchange of information among systems, and to assure that minimum functional capabilities are provided in all of our systems.

3. Agency Financial Systems. We need to continue to upgrade these financial systems. We need those systems to produce timely and auditable data on both operations and the key indicators of success, failure and impending problems. We need, in particular, to begin work now on integrating financial and program data.

4. Central Agency Financial Systems. Improved central systems are necessary for governmentwide management. These systems must be compatible with and, ultimately, electronically linked to agency systems.

5. Audited Financial Statements. Audited statements will provide needed information on the financial condition of agencies and programs. Equally important, they will force improved systems and operations. No agency head will want to sign financial statements that are expressly stated to be unauditable.

In the best of worlds, these activities would be accomplished sequentially. The accounting standards first, followed by information and functional standards, full systems development, and then, finally, audited financial statements. Of course, this is not realistic, since each agency is at a different point in its systems development cycle, and activities such as standards-setting are processes that evolve over time. Thus, we are going to have to move out on all five fronts simultaneously. Let me tell you what this means.

Accounting Standards

As you know, the General Accounting Office has set accounting standards since the Budget and Accounting Procedures Act of 1950. There is general agreement among GAO, OMB, and Treasury that improved standards are needed and that we must have a better system for enforcing them. Also, there are constitutional problems with GAO's attempting to set standards for the executive branch.

A solution we are pursuing—in collaboration with GAO and Treasury—is a joint accounting standards advisory board that would make recommendations to GAO, Treasury, and OMB. Accepted recommendations would be published by both OMB and GAO.

The board would have representatives from OMB, Treasury, GAO, the Congressional Budget Office, civilian and defense agencies, and the private sector. The Board would be supported by an Executive Director and technical staff to perform the required research and related activities. Our intention is that the Board would function with a high degree of independence and public disclosure.

This is obviously important to the subject of today's session. Financial statements are dependent on sound accounting standards. On the other hand, moving ahead with audited statements in parallel will flush out weaknesses in current standards that the Board will need to address.

Information and Systems Standards

This part of the program builds upon work ongoing in the Joint Financial Management Improvement Program (JFMIP). An effort is underway to identify and define, at a very detailed level, the financial and budget execution information that flows from agencies to Treasury and OMB. The objective is to provide consistent data definitions, eliminate redundant data, and establish a standard data base encompassing central agency requirements. This will be the foundation for ultimately linking agency and central systems electronically. We expect to complete the initial data base definition early next year.

This effort also involves developing additional functional standards for systems. We have a good base in place, with the *Core Financial Systems Requirements* and the recently issued Personnel-Payroll functional requirements. JFMIP now has a project underway to establish Travel System requirements. These should be completed by the end of this calendar year. We expect to identify and establish a schedule for other subsystems by November.

Financial Systems

Currently, agencies are required to produce and maintain 5-year financial systems plans. The plans are submitted to OMB annually along with the budget. Given the large number of plans submitted and the limited resources available to review them in OMB, we have not been in a position to make informed judgments on the merits of the plans, the adequacy of the planning processes, or the levels of funding that should be provided. We want to be advocates for deserving agency systems plans and related resource requirements, but we need to have a good understanding of the plans in order to do this.

We are determined to gain that understanding. This year, interagency review teams are going into five volunteer agencies for an intense 2-week assessment of the agencies' plan development processes, as well as an evaluation of their Five-Year plans. These reviews will give OMB the information we need to be effective advocates for funding financial systems improvements within the 1992 budget. Eventually all departments will be reviewed. Lessons learned will be included in a revision of OMB Circular A-127, as well.

Some of you may be sitting here with a slight amount of consternation, wondering if your agency may be one of the "volunteered" agencies in the Administration's plans. Well, fear not, the five agencies have been selected and progress is well under way. Interagency teams have begun their reviews at the Departments of Agriculture, Commerce, Transportation, Treasury, and Veterans Affairs. In fact, the preliminary reports will be completed within a few weeks.

I want to make one point about the content of agency plans. The plans must include steps to integrate financial and program information. I don't mean to say that this must be done in the first year, but the plan must head in this direction and include milestones each year that show measurable progress. The integration of program and financial information is absolutely essential to effective program management at all levels. We can't expect program managers to be supportive of systems that cannot meet their management information needs. Plans that do not move us in this direction are simply not acceptable.

Central Agency Financial and Budget Systems

The current process for central agency collection of budget and accounting data is, I am sorry to say, neither efficient nor consistent. It requires duplicate reporting; major segments are highly reliant on paper reporting; information on budget execution, including unobligated balances, is not centrally accessible; and the process causes reconciliation problems between Treasury and OMB.

In order to solve these problems, we are undertaking a major effort to automate budget execution data, expand budget execution reporting, and, eventually, establish an integrated budget and accounting data base.

1. The automation of budget execution data. A joint team of OMB and Treasury staff is currently designing a system that will allow agencies to electronically enter budget execution data on the SF-133 into a Treasury data base, which will be accessible to OMB. Beginning in January 1991, these data will be reported monthly.

2. Expanded budget execution reporting. OMB will define additional budget execution data elements to provide disclosure of contingent liabilities and commitments.

3. Establishment of single budget and accounting data base. This part of the initiative will merge the budget execution data base with other Treasury financial data bases to create a single uniform source of financial and budget information. Such a data base would eliminate the need for most individual agency reports to Treasury and OMB.

Establishment of this single budget and accounting data base is a long-term objective. Progress is underway, however, and the first components of the system will be tested in late 1990. Over the next 3 years, the major tasks will be carried out by the Treasury Department. The project is scheduled to be completed by 1994.

Audited Financial Statements

Our objective is to have agencywide audited financial statements produced in each cabinet department, EPA, and NASA by 1994. Today's session is an outgrowth of this effort. We have asked agencies to provide specific plans on how they will achieve this objective. As we review these plans, one of the things we are looking for is specific milestones that reflect measurable progress each year. For example, financial statements by program or agency components that lead incrementally to agencywide statements. We are generally pleased with the level of agency commitment reflected in the plans that we have received to date.

Incidentally, 10 of our 16 target agencies are planning to produce audited financial statements—either for the entire agency or agency components—in fiscal year 1991.

Summary and Closing

Now that I've provided some detail on the component parts of our Five Point Program, I'd like to talk a little about the Program as a whole. First, as you have certainly gathered, it is ambitious and broad in scope. Second, its parts are closely interrelated—progress in each part will be dependent on progress in the other parts. Third, it is long-term. We are not looking for quick fixes or immediate success.

Take the example of audited financial statements. We would all like to see the federal government produce audited financial statements that are accurate, consistent, and meaningful—statements that could and would be used to improve the management of the government. That is clearly going to take some time, because first we have to have adequate standards in place and our systems in shape. But, in the interim, requiring audited financial statements is going to help assure that those standards and systems improvements are made.

What is attractive to me about this strategy is that it has big goals, but a very practical, common sense approach toward meeting them.

Clearly, this Program is worthy of our collective commitment. No one should underestimate the importance of what we are trying to accomplish. Federal government spending is over 1 trillion dollars a year—one-fifth of our Gross National Product. Without sound financial control and reporting systems, billions of taxpayer dollars are at risk.

OMB, Treasury, JFMIP,and the CFO Council are all playing major roles in moving the Five-Point Program forward. Ultimately, however, the Program's success will depend on you. The Administration can chart courses and lay out plans, but, in the end, we're more on the sidelines than in the game. You are the players, and your agencies are where the work gets done.

I appreciate you attending this seminar—it indicates to me that we have your support in tackling this critical issue of improving financial management in the federal government. I trust that the seminar will provide you with valuable insights on how your agency should go about preparing financial statements. Hopefully, it will also introduce you to people to consult with after the seminar. If, at the end of the day, you think there's a need for additional structured discussion and/or training in this area, please make your voice heard. We are ready to listen and respond.

Thank you very much.

Questions and Answers:

Q - A number of people are here from smaller agencies today, and they are very much interested. What will be expected of them from the Administration's Five Point Program?

A - We started with the larger agencies, but it's our hope that the smaller agencies will be able to proceed with all of the parts of the Five Point Program as quickly as possible. We will try to help some of the smaller agencies along. Clearly, all agencies of government eventually have to be in the same area of progress in financial management. In our movement from 1991 through 1994, we expect that we will see progress starting for parts of the agencies and building towards agencywide financial statements.

Q - Are means being considered to submit financial statements electronically between agencies?

A - I think it may be doable in the future, but we will need to do that at the central level.

Q - Will this process eliminate the need for the SF-220 series reports—that's the balance sheet or portions of a balance sheet currently prepared by the agencies—and the SF-225, which is a report on obligations? Will these be eliminated in the future?

A - Even though in particular agencies financial statements may take somewhat different forms, eventually there will be standard reporting requirements and some system for aggregating that information. For the moment, the 220 series and the 225 will very much remain; Treasury is looking at revisions in the 220 series and maybe over time that will change. But the need for central aggregation will continue and so some central series to bring together reports or the information on the reports as the basis for the financial statements will still be needed.

Q - How will adequate personnel and funding be provided for implementing the Five Point Program?

A - For the five volunteer agencies, we will be working with the budget side of OMB right up to the director level to see if the plans produce a completely credible way of achieving the objectives that I mentioned. If the agencies require resources, I think I can assure that those resources will be in the President's budget. Equally important, we at OMB will be working with the appropriations subcommittees on the Hill to assure that those resources are put into agency budgets next year as a very high priority. Over the next 2 or 3 years, we hope to complete this team approach in each of the agencies that I've mentioned so that we will be able to move these financial management plans along.

Q - What are Congress's plans to establish a chief financial officer for the entire federal government, and how is this timed with the Administration's Five Point Program?

A - As some of you know, there are two bills introduced on the Hill, one by Senator Glenn and a number of others, and one by Congressman Horton and a number of others. There is a draft that is being considered by Congressman Conyers and there may be other bills as well. Within the executive branch, there is a fair amount of agreement as to the kind of things that ought to happen at the agency level and that ought to happen in terms of audited financial statements, and reporting and the like. In terms of the central agencies and the central CFO, there is no agreement within the administration either as to the structure or the location of a central CFO at this time. That's something that will have to evolve over the coming days but maybe not until next year. While there are some forces that would like to get CFO legislation passed this year, my guess is that the hearings that are underway in the House and will be underway in the Senate will probably set the stage for a more concerted legislative look next year.

Q - Would you comment on the prospects of funding of the Five Point Program? Do you know what the aggregate U.S. Government request is for this?

A - I think that the prospects for funding, particularly as we move through next year, will be very good because through the early parts of the budget process and the appropriations process, we will have the whole Administration working with the Congress to try and get these things done. So I have very high hopes for next year. In terms of this year, we got caught between going up with a budget amendment that would have added money for these purposes to agency budgets and the news at mid-session review that we were going to have a much worse budget deficit problem than we had anticipated. Therefore, we had to revert to offsets as a matter of political reality. As far as OMB is concerned, we will be putting the money in the budget and fighting for it, and our experience where we have gone up and actually talked with committees has been positive.

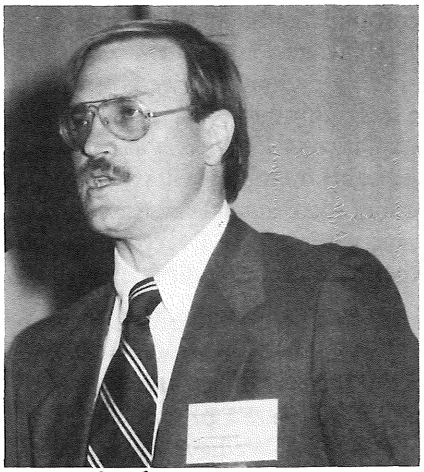
Q - It seems to me that the success of the program will be heavily influenced by Congress and their emphasis on the appropriations process. Step three proposes to integrate finance and program information. Can you provide further details?

A - The success of the program will be heavily influenced by the Congress and by the appropriations subcommittees, but we think we have a fairly good wicket there. Basically, the HUD scandals and the publicity given to some of the GAO reporting on particular agencies has energized a number of folks on the Hill not to want to get caught in their oversight capacities with something nasty coming along that they couldn't predict. Since improved financial reporting is an essential part of the remedy, we are getting very good informal reactions to the process by most Congressmen and Senators. There are still concerns on the part of some that financial reporting in accordance with what we hope will become generally accepted federal accounting principles might prejudice certain kinds of programs in that it will emphasize assets and liabilities in terms of financial condition, whereas the budget, which is essentially a cash financial document, doesn't do that.

Generally speaking, we feel that the appropriations process will be supportive. The integration of financial and program information—do I have further details? Not in a technical sense, but as we go through these financial management plans, I expect that the teams will come back with some technical points on how to make progress in particular agencies and programs.

Chapter 2

Subcommittee on Audited Financial Statements



Larry Eisenhart
Department of Health and Human Services

As representative of the CFO Subcommittee on Audited Financial Statements, I would like to tell about the representation of the subcommittee and some of its objectives since it has direct relation to the agenda of audited financial statements. The subcommittee is comprised of eight agency representatives from the General Services Administration and the Departments of Agriculture, Defense, Energy, Health and Human Services, Labor, Transportation, and Veterans Affairs. We also have representatives from the central agencies--Office of Management and Budget, the General Accounting Office, and the Department of the Treasury--and from the President's Council on Integrity and Efficiency.

What is this subcommittee all about? This seminar is the first agenda of the subcommittee. However, the prime responsibility of the subcommittee is to review the SF-220 agency reports (financial statements) and the processes it takes to produce those as well as the current initiatives for audited financial statements. We will also look at trying to ensure that we have an integrated reporting process between the reports which go to Treasury and the final audited financial statements that are being called for by the President and OMB.

We plan two different products. The first will recommend to whatever body is appropriate at the time—given that we might have a CFO or we might have a financial accounting standards board—changes to the federal agency financial reports (SF-220) that are submitted to Treasury and any changes on issues that we feel need to be addressed with accounting policy in producing a set of revised SF-220 reports. We hope to complete that deliverable by March 1991 and, in the process, ensure that it is integrated with the new standard general ledger. The second task will be to look at additional issues that one would have to deal with once revised SF-220 reports are submitted to Treasury and audited financial statements are prepared. One of the big differences is timing—when do you submit reports to the Department of Treasury and when do you have your final product that has been fully audited?

Our CFO Subcommittee has sent out a survey form to most of the agencies with the objective of learning the current problems that agencies are facing in preparing the SF-220 reports and issues that they have to deal with concerning audited financial statements. A number of agencies are either in the process of producing some form of audited financial statement, or—as have these four agencies up here—have already produced them. We hope to have our review of the timing problems and related issues completed by September 1991. We may consider holding a second seminar, maybe in April, to let everyone know the trials and tribulations that everyone went through to produce the fiscal year 1990 reports, as well as the Subcommittee's findings on SF-220 reports and issues with accounting and policies. The Subcommittee may also serve as a clearinghouse, and we will soon write to agencies and provide telephone numbers for information exchange.

Panel Session on Agencies' Perspectives: General Services Administration

LeRoy Boucher
General Services Administration

Good morning. GSA prepares annual consolidated financial statements and our statements are audited by the public accounting firm of Arthur Andersen & Company. Jay Meriwether and I are going to give you two different perspectives of what it was like to go through those audits and this afternoon Bob Suda, also of the GSA Office of Finance, will be moderator for our workshop session. The panel members will try to answer questions you might have concerning the financial statement audit, one that is conducted by a public accounting firm. Everyone on the workshop panel has multiple years of experience in this audit process.

GSA's administrator is Mr. Richard G. Austin and he presides over the very diverse functions of the General Services Administration—all of those supplies, buildings, telephones, and ADP services, actually a rather substantial financial organization. In fact, if GSA were a private company, we would rank number 72 on the Fortune 500 list. We have annual sales that exceed $6 billion, and we make almost 2 million payments to over 100,000 vendors each year.

We started preparing consolidated financial statements in 1980. At that time, we prepared a statement of changes in financial position and an abbreviated consolidated income and cost statement and, as you might expect, it was not quite complete and not quite right. We couldn't figure out how to handle the national stockpile activities at that time, so we did the easy thing, we just left it out.

By 1982 we had added a consolidated balance sheet, comparative data, a brief summary of the results of operations, and format changes to the statement of changes in financial position. Up to this point we were still preparing the annual consolidated statements for our own use within the Office of Finance. We took our first big step in 1983 by publishing our consolidated statements as part of the GSA's annual operating summary. The report included the three primary financial statements, descriptions of significant accounting policies, supporting notes, and schedules. The 1984 statements were fundamentally the same as 1983, although we did try to implement the requirements of the new *(Policy and Procedures Manual for Guidance of Federal Agencies) Title 2* and we finally included the national stockpile activities.

In 1985, the General Accounting Office decided to audit our financial statements. That first year was truly a learning experience for both GAO and us. Every time we got together there would be new news on what the process would be and what the products would be. We pretty much dog-eared the 1985 AICPA publication called *Accounting Trends and Techniques*, an annual survey of how 600 different firms present their financial statements. With so many options and the process so new to us, it is no wonder that things kept changing every time we got together.

When we started, we didn't even know that there would be four products resulting from the audit, those products being the

- auditor's report
- report on compliance with applicable laws and regulations
- report on internal controls
- management letter recommendations.

We were audited solely by the GAO for 3 years and we received a qualified opinion in each of those years. In 1988, we began the transition to having the audit performed by an independent CPA firm. Our IG conducted a competitive procurement and Arthur Andersen & Company was selected to audit our 1988 statements. For 1988, they were responsible for all aspects of the audit except for one revolving fund, as the GAO was still responsible for the Federal Supply Service General Supply Fund. GAO fed the results of their audit to Arthur Andersen & Company, which was responsible for the overall audit results. For the first time, in 1988 the GSA earned an unqualified opinion.

Our 1989 statements followed the same format as the previous 4 years. Arthur Andersen and Company conducted the entire audit and performed the FMFIA A-127 review. We saved a tremendous amount of time and energy in 1989 by using a personal computer software package—an automated mapping program—to consolidate various trial balances. This step is absolutely essential for us to complete our work timely. We also earned an unqualified opinion in 1989.

At GSA we have to consolidate various types of funds including revolving, general, specific, and deposit. But with that, there really are, without question, just three funds that comprise all the work; these are the revolving funds for

- the Public Building Service,
- the Information, Resource and Management Service, and
- the Federal Supply Service.

The audit process for us begins in July with discussions on the audit plan and with status meetings with our services. This is followed by the preliminary field work being accomplished before the end of the fiscal year. From that point through the end of January, all critical activities take place, some over and over again. Following resolutions, we expect an auditor's opinion some time around mid-February, and we have received all four products by the end of April. Just like you will have, we have had our start-up problems; each of the services is directly involved with the process and there was some initial resistance and fear both within our services and within the Office of Finance.

The process initially took a lot of time and effort to accomplish until we finally learned what to do and, of course, how to do it most effectively. Initially we couldn't always find the back-up that we needed to support some of the accounting entries that we had made; these were the significant deficiencies we encountered for the first 3 years of being audited. You would think that all of our receivables would be collectible since all of our customers are our sister agencies. Unfortunately, this is not true, but also unfortunately we never acknowledged that fact and we would keep receivables on the books just about forever. Due to the audit process, though, we established appropriate allowance for bad debt procedures in each of the revolving funds. Another early problem was that in our Public Building Service, we frequently had either not recorded or had misclassified work in process and completed construction.

Now, you know there is a year end and I know there is a year end. We know there is a pipeline and you would think because of that we would get all the year-end accruals in. We didn't. We still don't. It is always going to be something; you'll miss something every year. Some of our reconciliations within the funds were either ignored or they were not done on a timely basis. This occurred in part because of the overwhelming work that initially had to be organized for us when we consolidated our accounting operations into two regions. The reconciliations not getting done also resulted from our orientation at that time—we had always had a payables and receivables frame of mind. We did only a so-so job in the area of accounting control and we didn't have to do otherwise because no one was looking over our shoulders.

Doing the financial statement audit certainly changed that. We have redirected appropriate attention to accounting control and I must admit that we are much, much better accountants because of it. We initially lacked clear-cut year-end cut-off procedures for our clients and our components to follow; now we have them in place.

Of the four products that result from the audit of financial statements, we are all familiar with the auditor's report and, of course, our aim is always to earn an unqualified opinion. You will receive a report of compliance with applicable laws and regulations; the auditors look to see if, in fact, we follow all of the rules and regulations that have been established for the conduct of our business. If they find that we are, in fact, following all the rules, then they can feel reasonably comfortable that our financial statements are materially correct. You will also receive a report of internal controls. Here the auditors check to see whether or not they concur that controls are in place to safeguard the assets of the agency. They review policies and procedures established for income, expenditures, control of assets, and financial reporting. Lastly, and in my opinion most useful, you will receive the management letter recommendations.

The management letter is your road map for the immediate future. It contains all the deficiencies that were found that did not materially affect the financial statements but were, nonetheless, errors that need to be corrected. We had 54 such deficiencies in 1988 and 51 deficiencies in 1989. If you don't correct something between the fiscal years, the error will come back to haunt you on the next year's management letter.

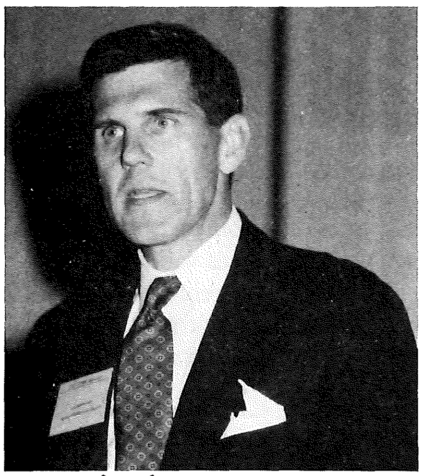
Clearly, one of the benefits of being audited is that you get to work with some very objective accountants who are also very competent. Sometimes we don't see the forest for the trees, and sometimes we do, and when we do, it is sort of nice to have your processes validated. And the management letter, again, not only identifies management deficiencies, but it provides the clout within your agency to get those issues resolved. Remember, they're there forever unless something is done about them.

When you say that you've been audited, you are saying that an outside force has commented on the quality of your stewardship role. I believe this adds tremendously to your credibility, and it supports all your related financial responsibilities. Lastly, and in no way least, the public's confidence in us is raised by having our financial statements audited by a public accounting firm.

Here's a picture of where we were and where we are. Two accountants dedicated for 4 months complete the consolidation process to see the audit through completion; that's pretty much what we now expect this commitment to be. Of course, there are still regularly scheduled status meetings attended by the program managers, accountants, and auditors for the entire time period from July through February.

I think that we're doing a pretty good job at GSA. I think that the annual audits certainly have played a large part in our success. I do truly believe it is one of the reasons why we have been so successful. It has truly made better accountants of us. Of other things that have helped, one is that we have one centralized accounting system for the agency. We also went through a major consolidation in 1986 so that all of our accounting operations would be performed in only two regions. The work ethic of the people of Kansas City and Fort Worth, in my opinion, is unmatched; they do a tremendous job for us. And, lastly, we conduct our own internal reviews each year in each region in payables, receivables, accounting control, and accounting operations to make sure that they do a good job for us; we have check lists for each of these areas and each check list exceeds 100 items.

Now I'd like to turn the program over to Mr. Jay Meriwether of Arthur Andersen and Company.



Jay Meriwether
Arthur Andersen & Co.

Thank you, Roy. You did a great job in terms of giving that overview. It's really gratifying for me as an auditor to sit here in front of such a large group and see the interest that is being demonstrated in the program that Frank Hodsoll outlined for you this morning and also to see the interest in specifically the auditing of financial statements. We do believe that there is a value to that process and a value that we can contribute as part of that process. It's nice to get up here and be able to tell or take part in telling a success story, and the GSA development of their consolidated financial statements and the auditing of those financial statements is a real success story where a great deal of that success goes to the auditee.

In our review, the key success factors have been planning and preparation by the agency, a good process, as Roy has outlined for you, in the year closing and reporting procedures, the consolidation—the streamlining of that, the coordination of gathering information from the various services, bureaus, and other points throughout the agency. A positive attitude—one of "this will be a beneficial exercise"—not one of "here comes the auditor again." It requires a buy-in from management and GSA did have that from their senior management and that includes Dick Austin. Also, that sort of buy-in and that support, I think, trickles down to financial managers and it makes them want to do a good job because they believe that it will be well recognized and well rewarded.

Team work between the auditee and the auditor is critical; that's something that we set up early on in our process and have adhered to faithfully. It means biweekly status meetings throughout the key points of the audit process with the financial management, with key people from the different services, and also with the Inspector General's Office responsible for overseeing our contract. Sometimes those meetings are only 10 or 15 minutes long with each one of the groups, but we found that just getting together regularly to make sure that we're communicating where we are and to hear any comments that the individuals have to offer to us has been helpful in the process. It has helped in terms of the timely resolution of issues that were identified in the preliminary process or early in the beginning of the final work so that those don't become things that hold up the conclusion of the audit work.

As Roy mentioned, this past year we were really ready to sign off by January 31 on the financial statements, and I think that's a real tribute to GSA and what they were able to do. That's not far behind what the private sector is expected to do in terms of their 10K reporting requirements.

The key issues that have to be addressed by the agency are support for balance sheet accounts, something that, as Roy mentioned to you, GSA struggled with over a period of several years before they got it right, but I think they've got it in good shape now; recognition of all liabilities that aren't necessarily required in the budget reporting but are needed for the financial reporting; support for key footnote information regarding interagency activities, leases, commitment and contingencies; legal contingencies; working with the general counsels within an agency; and getting them to opine and share information with you is a real challenge. But we worked through that one and got what we needed.

Key areas to address are making sure that we focus early on the state of the data processing system, the controls, the effectiveness and efficiency with which it puts forth the information. Always in question to me as an auditor is how long is this going to take and what is the level of effort and the answers are that it depends. It depends on the size of the organization, the complexity of the transactions they're involved in, the number of physical locations, the strength of the internal control structure, the condition of the books and records—what is required of the first-time-through effort to get the road map developed to be able to do that audit.

In GSA's case, we were able to come in and follow the GAO audit efforts, and I think that they really laid the groundwork for our successful audit. We had some basis of evaluating what the effort would be, based on what GAO and the GSA IG staff had spent in the 1987 audit; that was roughly 22,000 man-hours. We took a little bit of a gamble that first year and we guessed that we, over a couple of years, would be able to cut that time in half. And we relied upon certain productivity methodologies and techniques that we have in place. We sensed that there was an improving internal control environment within the agency and that we had a group of people who were willing to work with us to make this a successful effort. We were able to do the 1989 audit in 11,000 man-hours; I think that we did a good job, we have a client that is happy, and we did have a few things to offer to them in ways of suggestions and improvement in terms of the 51 management letter recommendations.

Thank you for your interest and your attention.

Panel Session on Agencies' Perspectives: Department of Labor

Michael Griffin
Department of Labor

The Department of Labor offers perhaps an interesting contrast to the General Services Administration. Of course, we deal primarily in social programs, highly decentralized, and we don't have perhaps the same degree of systems consolidation that GSA has. Being a social program-oriented agency, our programs offer some unique problems that I'll be getting into in terms of producing financial statements. Let me just give you a little history. Our effort really took off back about 1985; we don't have nearly the experience GSA has had, but in 1985 our Office of the Inspector General undertook a study to determine the feasibility of producing financial statements. Upon concluding the study, which came out very positively, we got commitment from then Secretary Brock and our Assistant Secretary for Administration and Management, Tom Komerek.

The IG has really taken the predominant role in our agency and has designed, compiled, and audited those statements. There have been comments about the propriety of both compiling and auditing, but—remember, 5 years ago, management was very heavily into building financial systems—management participation was somewhat limited. In light of that, I did not feel uncomfortable with the IG's role, and we have a very positive working relationship with our Inspector General. The Office of IG took the primary lead in researching financial statements that had been produced in the federal, state, and local governments; at that time, GAO's *(Policy and Procedures Manual for Guidance of Federal Agencies) Title 2* was being modified, and that was very topical. At the same time, Treasury was modifying the SF-220 reports, and that had a profound effect upon our overall effort.

An initial stage of the IG's work was an in-depth review under a control and risk evaluation (CARE) methodology. We saw hundreds of pages of flow charts that we were asked to validate; there was a very extensive CARE review throughout our department. In retrospect, that was a very important stage for us, a very important step for us to have gone through because it provided the audit community with a basis for getting in and doing the audits, for doing sampling on the systems, for validating information from our systems, and the process produced the foundation for proceeding with further financial statement compilation and audit work.

We have prepared financial statements for each of the past 4 years. Our 1989 statements are fully compatible with Treasury reporting requirements, and, we feel, with GAO *Title 2* financial disclosure requirements. We have used the statements in a broader annual report issued by the Secretary of Labor, and we hope to continue to issue official consolidated statements with consistent supporting information, program information, and supporting detailed financial data related to those programs. And we want to issue the statements along business lines, recognizing that in the federal government there are perhaps some unique presentation problems.

By far the greatest financial activity within the Department of Labor is in the Employment and Training Administration, primarily two lines of business, one the Unemployment Trust Fund and the other the Job Training Partnership Act. The Unemployment Trust Fund is a very highly decentralized delivery system of income security benefits to the unemployed; it is run by the states with oversight provided by the Department. Perhaps two-thirds of our total assets come from it. The Employment and Training Administration also administers the Job Training Partnership Act, a grant program of some $4 to $5 billion annually. Further, it administers the Job Corps Program with approximately 100 Job Corps Centers throughout the United States.

Our next agency, the Employment Standards Administration, administers two benefit programs of great importance and substantial assets and liabilities. One is the Federal Employees Compensation Act; the other is a trust fund, the Black Lung Disability Trust Fund, that pays medical disability and survivor benefits for disabled coal miners. The Black Lung Disability program is unusual in that it is set up as a trust fund; there are earmarked receipts for the trust fund and yet there are congressional appropriations limitations that are placed on it, a fact that has presented some unique display problems. The Employment Standards Administration also administers regulatory programs in the workplace in terms of wage-hour and child labor laws.

Several other agencies administer enforcement programs including Safety and Health, Mine Safety and Health Administration, and the Pension Welfare Benefits Administration (administers Employment Retirement Income Security Act laws). These are very labor-intensive programs, totally separate entities within DOL, and very different in character from the Employment and Training Administration.

DOL is not a large agency by employment standards (about 18,000 FTEs) but we have a very diversified set of programs. Our agencies or administrations have varied combinations of Treasury SF-220 reporting requirements; in auditing, four discrete audits were done (of Employment and Training Administration, Employment Standards, Occupational Safety and Health, and Mine Safety and Health) and another represented consolidating those discrete audit entities and including smaller entities.

DOL is using an integrated accounting system, the Department of Labor Accounting and Related Systems (DOLARS), which is undergoing redevelopment. The Department is seeking greater integration of systems.

For compilation of financial statements, a number of external data sources outside DOL systems must provide data. The Treasury Department, for example, is a major source of information for the Unemployment Trust Fund as IRS collects employer taxes that feed into the trust fund. Certain information related to the Unemployment Trust Fund and major grant programs is collected from the states.

Initially, our SF-220s were not used as a basis for the Inspector General's work. The CARE review that I mentioned earlier identified a lot of information that simply wasn't getting consolidated and coordinated in our departmental system; our Employment and Training Administration had several systems that weren't fully tied in with our departmental system and its production of SF-220 reports. We had multiple reporting responsibilities, or dual reporting responsibilities, with the Treasury Department and we were not reporting the full scope of Unemployment Trust Fund activity in our 220s. The full scope of activity, however, was picked up in the financial statements—this area shows a governmentwide coordination problem that I suspect many of you may get into with major funds, perhaps, if you use Treasury as your banking agent.

The audit compilation work performed by the Inspector General identified a variety of problems related to actuarial liabilities not being fully identified in our SF-220s, accrual estimates that simply weren't booked, summary data pulled in from subsidiary systems which failed to reconcile with department system data, and inaccuracies that had to be addressed.

Let me talk a little bit about the resource requirements. I mentioned earlier the CARE review that was undertaken; that cost approximately $1.5 million and was conducted over approximately an 18-month period. The design and feasibility work cost approximately $1.4 million. Compilation and audit work in the first year ran roughly $2 million. So we were running between $5 and $6 million overall in front-end costs in the first couple of years to do the CARE review work and to do the design work on the financial statements. With that investment, there has been quite a decline in costs. In 1987 our costs for contract audit and compilation was $3 million; $2 million in 1988, and $1.9 million in 1989, so you can see that the costs do go down dramatically but that it is the front-end that is a little scary.

What benefits have we effected from this major effort? I think primarily the internal control and audit findings have really gotten the most attention of management, and I provided you with a listing of some of the major problems that were identified. Our general ledger and our central accounting system did not reflect all financial activity of the department with respect to capitalized property accounts receivable and the information in the Unemployment Trust Fund that had to be coordinated with Treasury. Our subsidiary records were not accurate; they were incomplete and did not tie in with the general ledger. This was important with respect to the grant contract management subsystem and a departmental property management system. We had the misclassified obligations that I referred to earlier, and we had problems in developing a methodology for computing the liability for future benefit payments that were not based on sound actuarial principles.

Being responsible for Section 4 certifications at year end, you can imagine that to have such an extensive review of our systems and audit, I view that as a tremendous benefit. I sleep a little better submitting that report, sending it forward. More importantly, it has really guided our management in revising our systems, modernizing them, and replacing systems. It has brought our agency closer together; in the past, our SF-220 reporting had been done primarily at the departmental level with very little attention given to it in our agencies.

In many cases, as I have shown you, much of our detail that needs to be verified and audited is in those agencies. So we feel that our agencies and agency heads should have a stake in the SF-220 reporting, which leads to the audited financial statements. We have found that our data integrity has improved, particularly in areas that are not budget related, i.e., in certain proprietary accounting lines as our enforcement agencies all maintain a fairly healthy debt portfolio related to assessments of employers in the workplace. With these audit findings, for the first time some of that information started making sense. Beyond that, we found that people are actually starting to manage those debt portfolios much better and that is an important consideration.

Considering the next steps, the good news is that the financial statements we have produced have been largely a product of the Inspector General; we have prepared the same plan as many of you have to transfer the compilation expertise to management. It is going to be a major effort, and a systems changeover is one of the complications that we will experience, one that will require a whole new set of detailed operating procedures for compiling those statements.

We need to revisit special issues as they come up. The Subcommittee's work certainly will have an impact on us. We need to examine the number of audit reports, I think, that are issued and I think we are starting to reduce their number. We issued five separate audit reports in prior years; I believe we are working toward still compiling on the same basis but limiting the number of audit reports that come out of the effort.

We want to try to get away from some of the layering of the audits, continue the same scope, but cut down on the volume of audits circulating in the department. We need to build and are working on a better reporting capability for our SF-220 report generation. Our audits have come out with reasonable timeliness, but with room for improvement. We manage to get the audit statements out by March, but some of the internal control reports and the management representation material does not get processed as quickly as it should and that is important if we are going to meet our objectives in that area.

We feel very strongly that the SF-220s should serve as a basis—a final step—before the compilation of audited statements. We're very supportive of the effort to use the SF-220s as a bridge to the final production of audited financial statements. We are, of course, looking for a common set of principles and guidelines so that the substance of our reports settles down; we're hoping that the outline that Frank Hodsoll provided us this morning will help settle and stabilize financial reporting so that we can get on with the job.

Panel Session on Agencies' Perspectives: Social Security Administration

Norman Goldstein
Social Security Administration
Department of Health and Human Services

It is a pleasure to be here with you to share some of our experiences, some of our problems, that we have had over the course of the last 3 or 4 years in doing financial statements. It goes without saying, I think, if there was one common theme that ran across all the presentations that have occurred up until this point in time, that one of the most critical elements in being able to do an audited financial statement is your relationship with the auditor.

In our case, we were particularly fortunate to have Dick Kusserow and Tim Trockenbrot who asserted a commitment, a leadership, to this effort and made sure that it occurred. Without that effort, without that collaboration and cooperation, it couldn't have happened. By far, I think the greater burden in doing the financial statements, assuming that your systems are such that you can pull the information together, falls heavily on the audit side.

Certainly that was the case at SSA. We chose to do financial statements about 3 1/2 years ago. We did that as one of our initiatives to try to instill and improve the public confidence in the administration of the Social Security Trust Fund. As you know, over the course of a number of years, there has always been a question mark as to how well Social Security is doing, whether the trust funds will be there. One of our interests has been trying to promote public confidence in the trust funds that they will be there and our ability to exercise a fiduciary responsibility over those trust funds; that we do, in fact, take it seriously and that we want to do a good job in doing so.

Another reason why we wanted to embark on doing audited financial statements is the desire to operate in a more business-like fashion. We felt that this was an important element in any activity that we did, we wanted to make major decisions in a business-like fashion, and we thought using audited financial statements was one vehicle by which we could further our objectives of operating in that fashion in the sense that it instilled greater professionalism, discipline and accountability into our accounting staffs, into the organization as a whole, and we thought that would serve a useful purpose.

By way of background in terms of what Social Security is, we administer a program that approximates $250 billion a year. By far the largest bulk of that money obviously is in the trust fund payments to beneficiaries. Our administrative budget is something on the magnitude of $4 billion a year. We administer funds that are funded out of general revenues as well as trust funds. One of the first decisions that we had to make was whether or not we wanted to do the final statements with particular emphasis strictly on the trust fund side of it, or did we want to incorporate the general fund side of it as well.

Because of the closely-intertwined nature of our activities, we chose to have all our operations subjected to financial audit. We are a decentralized organization in that we have 1300 field offices and 10 regional offices and other facilities throughout the country. Nonetheless, we operate a centralized accounting operation. I think that, too, contributed to our ability to pull together the effort to do the financial statements. If, in fact, you had a decentralized accounting operation, I am sure the efforts of coordinating the pulling together of that information would add a degree of complexity that we didn't have to deal with specifically within SSA.

Another issue that one needs to decide when going forward with the effort of doing financial statements is the mechanism by which you want to publish your financial statements. In SSA's case, we considered three objectives. Each year we published what we call a trustee's report which is basically a cash-based report projecting the health of the Social Security Trust Funds; the report strictly deals with the trust funds and it is predicated on actuarial estimates and forecasts where we'll be 75 years out.

Another alternative was stand-alone financial statements. A third alternative was publishing them in the SSA annual report which we're required to issue by May 1 of each year. We chose to put it in the SSA's annual report because it did have widespread publication; and it was a document that was known. We wanted it to be a first-class effort. The addition of the financial statements, we felt, would enhance the annual report and the utility of the annual report. Making that decision led to certain other constraints about which I think you have heard from some of the previous speakers—that is, it sets up a series of time frames which when you're first embarking on the process seem almost insurmountable.

Nonetheless, where there's a commitment and, thanks to the efforts of GAO and I guess some of the baseline experience that they had attained over the course of the years, we were able to construct a scenario where, in fact, it was possible to do. But to give you a flavor of how this drives the process, we basically for fiscal year 1990 are providing 24 days to close the books and another 18 workdays to prepare the financial statements.

We have essentially allotted 39 days to the Inspector General's Office to perform their audit of these financial statements. As you have heard from some of the previous speakers, it's possible to do. It does take advance planning and coordination. It also takes teamwork both from the operating agency level as well as from your auditor. After you've gone through the review of the financial statements, by the time you go through the publication process, the proofing, the editorializing, and allow the printer 30 days to print the document, and if you want to get it out, and in our case our goal is to get it out by March 15, that really tightens up the time frames by which the process runs. So you really need to make a commitment to do it and to pull your thoughts together on how to approach it.

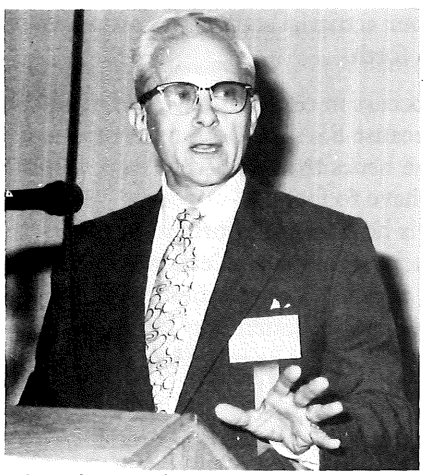
From a staff point of view, we estimate that it takes something like 3 or 4 work-years of effort to do this effort. I'm sure Tim will let you know that from his point of view; he has invested a lot more time than we have. Obviously, prior to the closing out of the reports and prior to the close of the fiscal year, we go through a lot of activity to gather information for the auditors to go to our actuarial staff to get estimates of liabilities, contingent liabilities, and so forth.

There is a lot of discussion that occurs in order that we can meet these time frames that we spoke of. Because SSA has both trust fund and general fund responsibilities, one of the issues that we had to face, and in some if not all cases I'm sure you will have to face too in your relationships with Treasury and GSA, is how to get information that is necessary to incorporate into the financial statements. Certainly in our initial year we went through a process with GSA as to whether buildings should be reported or reflected on our financial statements or on their financial statements. This was specifically the case as related to buildings that were paid for by the trust funds.

We had to get general counsel opinions. So there is a certain amount of thinking of what happens when you have interagency relationships. We have a similar situation with Treasury where they do all the tax collections, the FICA tax collections, and so forth, and how that information gets incorporated into our financial statements, the kinds of alternative audit techniques that the IG has to go through to satisfy themselves as to the reasonableness of the numbers being reported to us, all pose additional problems and issues that need to be discussed and addressed in the initial efforts to pull together financial statements.

Another issue which I would share as a governmentwide issue is the issue of materiality. I think that there needs to be feedback from OMB in terms of the efforts that have occurred up to this point in time. I think that we don't really have a good baseline of experience as to what constitutes materiality and what is the paradigm for a qualified or unqualified opinion. In our case we have $163 billion of assets and we run into situations where we might not have a particular aspect of an inventory that ties in with the general ledger, for example. That raises questions so that we get into theoretical discussions as to how it should be reported. There probably isn't as good a base of information and experience as to the kinds of issues that should be dealt with in terms of the presentation of materiality and how those qualified versus unqualified opinions would be provided. I think we want to make sure that governmentwide we can have some consistency of application of those principles and there's a need to oversee that overall process to ensure that the consistency is occurring.

With that, I'd like to turn it over to Tim who can share with you from his perspective the task that he had to undertake in auditing our statements.



Timothy Trockenbrot
Department of Health and Human

Thanks, Norm. I thank you for your introductory comments concerning our relationship; I'm sure some of our staff might have had some other comments at the conclusion of the exit conference. It sometimes occurs. But nevertheless I think it was a very good working relationship with SSA, and that we're very happy for. Norm has given you some insight into the preparation of a financial statement for Social Security. And what I'd like to do now is to cover some of the issues that are involved in the audit of these statements. Now many of us in this audience had not embarked on this, as I understand, but you may in the future. What I'd like to do is to give you background information regarding the Office of the Inspector General at HHS. I think this will put the enormity of the task in perspective, especially when one considers the budgeted outlays of the Social Security Administration represent over 64 percent of the total in the Department of Health and Human Services. The Office of the IG is responsible for the audit and investigations of over 300 programs administered by the Department. Major programs and agencies besides SSA include the Health Care Financing Administration which is responsible for Medicare and Medicaid programs; the Public Health Service which is responsible for the Food and Drug Administration, National Institutes of Health, the Centers for Disease Control, and a few other programs; the Family Support Administration which handles the Aid to Families with Dependent Children; and the Human Development and Services group which handles many of the aging programs in the Department. I mention this because with a total staff of only a little over 650 auditors, resources to perform a full range of audits of these programs are already scarce.

The decision to participate in the preparation of the audit of Social Security's financial statements, I believe, was a joint decision which included the former Commissioner of Social Security Dorcas Hardy, Comptroller General of the United States Charles Bowsher, and Inspector General Dick Kusserow. Obviously, with this level of support, all systems were "go" because a decision had been made that "we're going to do it" and we did. I'd like to mention, though, that is was very fortunate to have

Dick Kusserow at the helm because Dick is a very strong proponent of the CFO concept and the improvement of financial management in the government. In fact, he is testifying this afternoon before the House Committee on Government Operations in support of the Federal Financial Management Reform Act of 1990.

Some issues and concerns that I would like to mention include, first, staffing. Fortunately, on my staff at the time I had several CPAs and I could assign a number of them to the audit. A problem was that they had limited experience in auditing financial statements for the purpose of expressing an audit opinion. For assistance,we turned to GAO which had detailed to us an auditor well experienced in the audit of federal agencies, financial accounting, and preparing financial audit statements. This individual, Jim Nycum, now with DHHS, worked side-by-side with Dennis Snyder, our present audit manager who has been the manager on this assignment for 3 years. Both will be at this afternoon's SSA workshop. I must say, too, that both Dennis Duquette of GAO and his financial management division have been tremendous supporters of our efforts throughout the entire engagement because when we first began on the audit, it was "where do we begin?" Dennis had provided us considerable counsel and advice. We also called upon GAO for assistance by their actuarial staff with the actuarial projections that we had to face at Social Security in the unfunded liabilities.

Further, GAO provided training for all staff assigned to the audit by giving the Controls and Risk Evaluation (CARE) course. CARE was developed by GAO, first, to identify and evaluate the adequacy of controls and accounting systems of an agency and, second, to determine the degree of conformance of these systems with accounting principles, standards, and other requirements.

I think it's important to note, and we did early in the second year, that it is management who is responsible for the statements. The Statement on Auditing Standards, SAS No. 58, titled "Reports on Audited Financial Statements," April 1988, added the wording to the introductory paragraph of the opinion letter differentiating management's responsibility from the auditor's responsibility, a very important distinction. We incorporated revised wording in our opinion on Social Security's financial statements for fiscal year 1988, and that continued for 1989 as well. Management is to acknowledge awareness of its responsibilities for the fair presentation in the financial statements of financial position, results of operation, and changes in financial position in conformity with generally accepted accounting principles for federal agencies—*(Policy and Procedures Manual for Guidance of Federal Agencies) Title 2*—as we refer to it, in the management representation letter it provides to its auditors. This is required by the Statement on Auditing

Standards No. 19. The management representation letter also covers items such as availability of records for audit, the absence of errors or irregularities, information regarding subsequent events, violations or possible violations of laws or regulations, and other matters.

The audit standards also provide for obtaining a legal representation letter from the agency's legal counsel as required by the Statement on Auditing Standard No. 12. The purpose of this letter is to determine if there are any pending or threatening litigation claims or assessments and to provide an estimate of the potential loss. Now the auditor's responsibility is to express an opinion on the financial statements based on the results of the audit. The results of the audit are expressed in

- an opinion letter on the financial statements which is to be included in publication with the financial statements
- a report of internal accounting controls covering the auditor's understanding of the agency's internal control structure and the assessment of control and risk, and
- a report on the auditor's test of the agency's compliance with applicable laws and regulations.

GAO's Office of Policy in concert with GAO's Accounting and Financial Management Division issued a guide which has been very useful; it's titled "Assessing Compliance with Applicable Laws and Regulations" and dated December 1989. I think that for those who are getting underway early on audits, it is a very good idea to refer to these and other publications I'll mention in a moment. The audit reports can be issued individually or combined in one report covering the financial audit. Additional items of significance can be brought to management's attention in the management letter. This was mentioned to be a very useful document in the GSA presentation earlier; they indicated they had 54 items in the first year and 51 in the second. While I didn't count ours, I know that we did have issues that we brought to their attention and I think it has been very beneficial to management.

I have made several references to accounting principles and auditing standards; let me briefly tell you which ones govern financial statement preparation and audit. The accounting principles for federal agencies are promulgated by the General Accounting Office and commonly referred to as *Title 2* of GAO's *Policy and Procedures Manual for Guidance for Federal Agencies*. The *Government Auditing Standards*—referred to as the "Yellow Book"—was published by GAO in revised form in 1988 and it describes the standards of field work and reporting standards for audit of government financial statements. It incorporates the standards of field work and reporting of the AICPA; without restating those standards, it prescribes supplemental standards of field work needed to satisfy the unique needs of government financial audits. Future statements of the AICPA will also be adopted and incorporated unless specifically excluded by GAO through formal announcement.

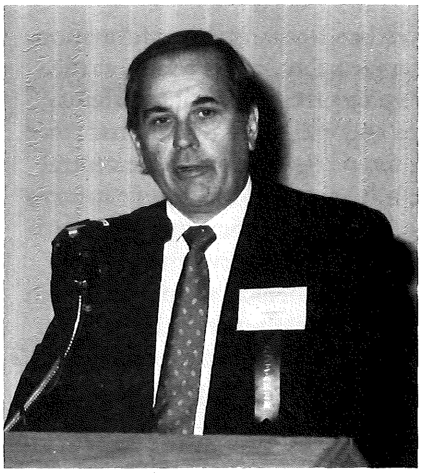
It is necessary for the government accountant and the auditor to keep abreast of additional pronouncements by the AICPA and GAO. We do this in our office by obtaining the AICPA's annual publications of professional standards and through continuing professional education of our staff. My view is that it is just as important for agency accounting staff responsible for the preparation of financial statements to keep abreast of accounting and auditing developments, including not only GAO's *Title 2* but also JFMIP's *Core Financial Systems Requirements* which is very beneficial, *Government Auditing Standards* (GAO "Yellow Book"), AICPA's *Statements on Auditing Standards* ("SAS"), and the audit accounting standards issued by the Financial Accounting Standards Board.

Norm (Goldstein) mentioned earlier that the auditors have approximately 39 days to examine the financial statements and footnotes prior to issuing an opinion. While this is true, much of the work is done during the interim period and at Social Security a lot of work was done during those early few months. I would like to give you a brief overview of how we approach the audit of SSA. The first two audits of financial statements were performed under extremely tight time frames; in the first year, we had fewer than 7 months from initiation of the audit to issuance of the audit opinion. The 7 months included the CARE training from GAO; the actual field work was limited to about 4 months time during which we had to perform sufficient review to be able to express an opinion on the statement. Our due date for the audit opinion was determined by the date established for issuance in the annual report. With that in mind, we had to rely very heavily on the work done in other areas in reviewing internal controls and evaluations of accounting systems. This included work done by SSA's quality assurance staff, audits by the GAO, and our own audits and assessments in the Office of IG. Social Security's quality assurance staff, for example, has a regular program to evaluate the accuracy of payments to beneficiaries; that program had been audited and reported on by GAO and we were able to use the results of SSA's work and GAO's audit to limit our review of internal controls in this area relating to benefit payments. We developed what we call a sort of synergistic effect in being able to do this because there were many audits done by GAO, by the Department's internal staff, and by the IG's staff. Being able to limit your substantive testing is very important in accomplishing the job in the time frame.

Let me mention a few of the cost benefits that we experienced in performing this review. The audit that we embarked on, of course, was extremely demanding both in terms of resources and talent and requiring many judgmental decisions. To fulfill our commitment in the audit of the financial statements at Social Security, we expended 3,000 staff days in the first year. This involved as many as 60 auditors in the first year's audit, over two-thirds of whom were CPAs. I don't say that to scare you, because we have been able to drastically reduce that in the second and third years—but, nevertheless, that first-year investment, if you've never been audited before, is a very sizeable investment. In return for those resources, we would expect that there be some benefits to both the department and the auditors and our experience has shown that preparation of the audited financial statements results in benefits to both.

At Social Security, the Commissioner was able to report both to Congress and the public that the financial statements which were audited by the Office of Inspector General fully disclosed financial information on all SSA-administered programs and demonstrated the financial soundness of those programs. In fiscal year 1989, income to the trust funds exceed outgo by over $52 billion; current estimates show that under any plausible economic and demographic conditions the programs will be able to pay benefits well into the next century. This information was included in the annual report to the Congress and in notices sent to over 38 million beneficiaries across the country. While the benefit from reporting this information is somewhat intangible, there are some more definite and measurable improvements resulting from the audit of financial statements. First, the process instills discipline in the agency's financial system that in many cases was sorely lacking. Second, the process of preparing statements ensures that a proper link exists between accounting transactions and reporting. The statements are understandable to the majority of readers whether they be officials of the Department of the Treasury, OMB, the Congress, or our taxpayers. Third, the agency obtains an independent assessment of whether accounting systems contain adequate safeguards to protect resources entrusted to the agency.

Panel Session on Agencies' Perspectives: Department of Veterans Affairs



Frank Derville
Department of Veterans Affairs

We have prepared consolidated financial statements and had them audited for the last 4 years. For us to put together consolidated statements and to have them audited is no easy task; I'll give you some facts about what the Department of Veterans Affairs really is.

We currently are the largest hospital system operated in world; we have 172 medical centers and 5 independent outpatient clinics. The Department has 58 regional offices responsible for servicing the needs of our beneficiaries in the areas of compensation, pensions, and educational benefits. We operate 111 national cemeteries. We have 2 insurance centers, are the fifth largest U.S. insurance company, and currently have $278 billion worth of insurance. In support functions,we have 3 supply depots in the country; we have 3 major data processing centers; we have 3 finance centers; and we have 4 canteen service field offices. Last, but not least, we have our central office at 810 Vermont Avenue. The Department employs over 250,000 people, which means we do a payroll for them. To be able to put all this together and get our statements, we have what we call field finance activities at each hospital, at each supply center, at two of the finance centers, and at our 58 offices—that adds up to about 225 different field finance activities.

Our administrative payments and accounting for them is done in our Austin finance center in Texas; our compensation, pension, education, and other payments and accounting are done at our finance center in Hines, Illinois, just outside Chicago. Our life insurance program is operated in Philadelphia and in St. Paul. Because we have a large receivables balance like most other people that we are trying very hard to collect, we have a centralized accounts receivables activity in St. Paul for our benefit-related debts. We're starting now into what we call third-party payments. Our many cemeteries have only a small staff at each, and their accounting and payments are done generally through one of our hospitals.

Our appropriations structure mirrors what I have told you here. We have 15 general fund appropriations and 11 revolving funds; we maintain 5 trust funds, 5 deposit funds, and 5 clearing accounts. Our appropriations include annual, multi-year, and no-year accounts. At any one time, we are generally working about 80 active appropriations or funds.

Putting that together, believe me, is no easy task. We do it on 41 aged, antiquated, out-of-date, 1960- and 1970-era financial systems. We actually have about 80 trial balances that we put together to do consolidation. The general ledgers, if you want to call it that, and the trial balances do not have the same accounts; we are moving toward a standard general ledger and chart of accounts, but we're not there yet.

So we are in the process not only of hand-pulling this information together this year, but—like most of you probably in this room- at the same time we are trying to change and update the accounting systems. We are restructuring our payroll systems and will bring up the first piece of it in February 1991. We hope to get the reengineering of the central system done by the end of 1992. We're modernizing our benefit systems in the Chicago office. We're in the process of redesigning our insurance systems. We're replacing our procurement and inventory system—we maintain and process a considerable amount of medical supplies through our supply depots. Last, but not least, we are building an integrated financial management system. We contracted for an off-the-shelf system 2 years ago, and we're in our second of about 5, maybe 6, years of actually moving from these 41 antiquated systems into a truly integrated system that will allow us to bring all of this data together.

You can see that our staff spends a lot of time putting data together, making sure the controls are there, working with auditors, and what have you. Our Inspector General has provided tremendous assistance, as have the General Accounting Office people who actually have done our audits. I'll tell you a bit about the costs of them. For the 1986 financial statement auidit, GAO put in about 14,500 staff days and required us to have about 5 FTEs to support that. For the 1989 audit, GAO put in 3,500 staff days, augmented by some contractual help. Our Inspector General contributed 10 FTEs to the audit work. We have been able to reduce our piece of this from 5 FTEs to 2 1/2 FTEs a year. As we got better, the work load has come down and everybody has benefitted. The year just finished was the last year for GAO's auditing; our Inspector General has agreed to take up the task.

As you may know, it is no easy task. In terms of actions during consolidation, I think we do the same things we heard today. Obviously there are corrections to the accounts that are initially reported. There are preliminary adjustments and final adjustments as a result of the auditor's work. We end up with a consolidated statement. We get a qualified opinion—it used to have two qualifications, but last year we got it down to one. The qualification remaining is on our land and buildings account. As the VA was blessed with inheriting hospitals and cemeteries from the military, the facilities were in pretty good shape, but the records weren't. On many facilities, we really have no traceable valuation on what is there; for this, budget constraints preclude our doing appraisals work as the payments for them would take funds from programmatic work. It leaves us with a qualification that we take seriously and are going to try to figure out a different way to get ourselves out of that bind. But with that exception, we do have a clean opinion.

The problems we have encountered are many of those you have heard about today. We had trouble in the beginning, and even today at some points, getting management to buy into this. They look at the work as something that has to be done, but not necessarily the most important work to be done at the VA. Initially, and in some cases even today in our field facilities, there is a fear of being audited and what people might find.

In our case, I think the time frames of when we start to when we finish are too slow; I think we finally got our results in late May or early June of this past year for the 1989 year and, to be most useful, we're going to try to move that up this year. We're going to try to put into our statements some programmatic information in future years, to see if we can get the programmatic people to buy a little more into what's going on here.

We get a report on control weaknesses which we use considerably, a report on compliance with laws and regulations, a management letter that goes to our Secretary with items that are not material enough for them to have to qualify the report, but are material enough in their opinion that they need to be reported to management.

I think we have gotten three important things out of this. One of the items that we have definitely pulled out of here is the ability to get some financing and budget authority to start rebuilding our systems. By actually being able to show people the value of good systems and the data that can come from them, we've been able to convince our budget people as well as the people in OMB and the Congress to provide money to change our systems.

We think the data that has come out of this has been very useful in terms of testimony that we have given on the Hill on financial statements on our liabilities and our ability actually to be able to ascertain what our risk is out there in terms of loan guarantees or compensation and future compensation payments. We use the information from the statements all the time in testimony, and we can do that because it is reliable information now.

Drawing off that, what it has given us on the accounting side is that we've been able to put a discipline both into our people and our systems—into the way we do things. We've tightened up internal controls. We've gone after our material weaknesses, and it really has helped us considerably.

Chapter 4

Perspective on Audited Financial Statements

Alvin Tucker
Department of Defense

We're very fortunate today to have as our guest speaker a gentleman from GAO who I think we can properly characterize as a sparkplug certainly in the recent events and in moving the government forward towards audited financial statements.

Donald Chapin is the Assistant Comptroller General of the United States for Accounting and Financial Management. He is responsible for the operations of the Accounting and Financial Management Division of the U.S. General Accounting Office. His duties include conducting financial audits of federal agencies and government-owned corporations, directing the accounting and auditing standard setting process for the federal government, reviewing and auditing of federal agency financial management systems and internal controls, coordinating the GAO program on mismanagement, fraud, and abuse, the oversight of federal inspectors general and other federal audit activities, reviewing the federal budget structure and budget-related issues, and advising Congress on auditing, accounting, and financial management issues.

In addition, Mr. Chapin currently is the GAO representative for the following organizations:

- the Joint Financial Management Improvement Program,
- the National Intergovernmental Audit Forum,
- the Government Accounting Standards Advisory Council, and
- the Financial Accounting Standards Advisory Council.

Mr. Chapin joined GAO in October 1989. From 1984 to 1989 he was an independent financial consultant specializing in management controls and business evaluations. Before that, from 1954 to 1984, Mr. Chapin was a partner of Arthur Young & Company and served in various capacities as senior client handling partner, managing partner for Continental Europe, national director for management consulting, national director for practice development, and national director of auditing. Mr. Chapin is a certified public accountant and practices in New York and Florida; he is a member of the SEC practice section of the AICPA. He also is a member of the Accountants Club of New York and a former member of the AICPA Auditing Standards Executive Committee. He has held a number of corporate directorships and is responsible for a number of publications including *Internal Audits and Top Management* and *Management Controls for Multinationals*. Mr. Chapin is a Phi Beta Kappa graduate of Williams College, where he majored in economics, and he has an MBA in accounting from the Wharton School of Finance at the University of Pennsylvania.

I ask you to welcome Donald Chapin. Thank you.

Keynote Address

Donald Chapin
General Accounting Office

It is a pleasure to be your luncheon speaker today. We at GAO commend OMB for its commitment to sound financial reporting and financial audits. We commend the CFO Council and the JFMIP for their leadership in sponsoring this seminar. It is also a very enjoyable experience for me because I feel that we have crossed a very important bridge. Today we're talking seriously about **how** to do a financial audit. It wasn't too long ago that we were talking about **why** we should do a financial audit. That is a big change.

Today, I'd like to give you GAO's perspective on the challenges faced in conducting a financial statement audit. I will address these challenges within four broad categories:

1. Preparing for an audit,
2. Arranging for an auditor,
3. Dealing with challenges during the audit, and
4. Reporting on audit results.

The preparation for an audit, like any effective management process, requires the right organization with sufficient authorities. It is important that an agency have a CFO structure that is able to pull together departmentwide financial reports. Assembling departmentwide consolidated financial statements involves extraordinary coordination among the reporting entities, and it is less painful when there is strong financial management leadership at the top of the agency.

It is also desirable, I think, that an agency have an advisory audit committee. I would like to open your minds up to that possibility. Audit committees are commonplace in the private sector, but they do not, as of now, have much prominence in the public sector—but they should. An advisory audit committee can perform more than just an oversight rule like that exercised by OMB or the Congress. It can help the agency and its auditors to achieve their objectives. It can help top management avoid many financial management pitfalls.

As I see it, an advisory committee can review the breadth and depth and scope of the audit plan, can monitor the audit work performed, and review the audit report prepared. It can provide advice regarding interpretation of accounting principles and the preparation of management reports. It can act as a sounding board for new systems plans and other financial management initiatives and it can assess the effectiveness of the audit resolution process. Believe it. An advisory audit committee can help the CFO and the IG get their jobs done.

Another important aspect of planning for an audit is arranging to have the right people. It goes without saying that fully-qualified people are needed at the top. CFOs and their deputies need to have the necessary training and experience. It's also equally essential that an agency have staff with the accounting skills needed to prepare its financial statements.

One of the more difficult challenges that we've had to face in initial audits is the agency's lack of sufficient numbers of skilled accountants. Such people are needed to assemble financial statements from the typically large variety of input sources, to prepare the consolidating adjustments, and to deal with the numerous accounting issues. They are essential to timely reporting. Too often financial reports are uselessly late because there aren't enough experienced agency staff to properly prepare them and provide the needed documentation to the auditors. So I want you to try to get a handle on the number of qualified people you'll need and start recruiting to fill your needs.

A third important area in preparing for a financial audit involves the underlying financial management systems. This is perhaps the most difficult problem facing most agencies. For the most part, financial management systems that we've been encountering in our financial audits to date have been marginally adequate. Most of you will not have a transaction-driven general ledger. Typically you'll be facing the need to collect financial information from manual and automated programs and accounting systems that loosely band together to form the agency's financial reporting system.

In fact, some financial statement accounts may have to be developed from program or budget data and even the wizardry of statistical analysis. The result of this systems structure is sometimes poor-quality information being reported up to Treasury. And this situation could even result in your auditor declaring you to be unauditable. It depends on how bad it is. For most agencies, developing comprehensive and fully-integrated financial management systems that are reliable and in compliance with all the requisite accounting standards will take some time.

It's important to begin the process now. In so doing, try to establish accounting systems or usable data systems where they don't exist and work on the integration of existing systems. This will both advance toward the goal of fully-integrated systems and improve your chances of getting an audited set of financial statements. Don't use the situation I've described as an excuse to wait before having a financial audit.

Together, the agency and its auditors can usually develop a complete set of financial statements using the variety of financial information available. Derived account balances, however, may not be auditable. And this has been the problem where property and equipment accounts are uncounted frequently. The auditors will qualify their report when this is the case, but it's not all bad. There is much to be gained from isolating accounting and reporting problems and the underlying financial management systems that need to be addressed.

The second broad challenge that I'd like to talk about is arranging for the audit. I'd like to exclude those situations where the GAO and the Inspector General has announced an intention to conduct a financial audit. In these cases, however, I would like to make one comment, that it is very important that a financial audit be viewed as a joint effort. Now I know that agencies are always helpful when we come in to do an audit. But in the case of the financial statements, there needs to be a real team approach. These audits should be viewed as an important part of an agency's financial management activities. In addition to the information they provide, they impart discipline to the financial operations and help deal with the process of improving systems. Also, if you treat the process as a team effort and you get the auditor involved in planning for the audit and in other decisions that you'll need to make like resolving accounting and reporting issues, the process will be a lot less painful.

With regard to procurement of CPA services, I have a few points I'd like to make. First, it's necessary that the selection and contracting with an outside auditor be given high-level attention within the agency, defining the scope of work, the deliverables, agency support to be given, and other contract details that are very important the first time around.

The CFO, the IG, and the advisory audit committee should be involved. But the agency head also should be involved to some extent. If you make a mistake here, it will run up the cost and produce disappointing results. Second, the ultimate real cost of an outside audit is very much dependent on the oversight and cooperation given by the agency. You should try to minimize your cost, your chances of paying too much for the results achieved. There is some value from an audit that results in a disclaimer of opinion—but not full value.

First-time audits can be problematic. Often the auditor in this situation can only opine on the balance sheet and then with great qualification. You ought to be prepared for that outcome in the first year, but you can reduce the cost of such audits if the auditor doesn't do detailed auditing work for unauditable or unreportable situations. Expectations have to be carefully set and judiciously monitored. The agency contact person for the auditor needs to be someone knowledgeable of financial auditing, able to speak for the agency and not encumbered with excessive duties.

There's a cost to an agency beyond the price of an audit contract. And that's the cost of the commitment of resources to support the auditor. Auditors require space and support services, access to people and records and some help. The time commitment of agency personnel will be a major cost and how much that turns out to be will depend on the planning and control of the audit. Not to acknowledge this will result in a frustrating and unnecessarily expensive experience. We've been contracting with CPA firms to support our audit efforts for several years now. I think you can say that we've learned a lot through that experience and gotten pretty good at it.

We've evolved a selection and contracting process that has resulted in an engagement of firms with well-qualified staff and at competitive prices. We're planning to share our approach with you. We've been consulting with the GSA on the development of a governmentwide contract for audit services, and we will be publishing guidelines for the procurement of CPA services.

The next major challenge I'd like to discuss is the audit itself, or, I should say, the weaknesses that will surface from the audit. The first-time and even a second-time audit will bring forth both anticipated and unanticipated weaknesses. It may be advisable to contract for an audit review or a preaudit before the final decision is taken to go forward with a full scope audit. This will typically result in an "audit requirements" report which will set out what may be fatal flaws that will need to be corrected before an agency can be successfully audited.

It's been our experience that most problems will be sufficiently correctable with the application of resources to permit an audit to go forward and achieve worthwhile results. But, as I said before, don't be disappointed if in the first year all you can achieve is an audited balance sheet with one or more qualifications for certain accounts. In our experience, that's about par for the course.

Let me share with you some of the typical challenges to successful first-time audits of large federal agencies. First, widespread operations—dispersion of accounting operations and records around the country, or the world. If systems and procedures are not uniform and there are numerous operations of financial significance, this will be a major audit problem. Just finding out what the various systems are that will be needed to prepare financial statements is a major undertaking. Organization of audit resources and audit planning will be a major challenge.

Second, risky ADP operations—if data processing operations are not well controlled, particularly with regard to access to programs and data files, or if the application systems have not been thoroughly tested, or are known to be unreliable, the audit is going to be a tough challenge. And the auditor you select to do the work will need specialized skills and imagination to deal with this kind of a challenge.

Third, weak financial systems and controls—as I discussed earlier, if there are inadequate financial management systems or accounting practices that are not being followed, or no experience in preparing accrual-based financial statements, it will add considerable time to the audit, and it could even make an audit impractical. Then there is a problem of material weaknesses and internal controls. Many control weaknesses can be overcome by a different audit strategy, albeit more costly, but some weaknesses may make the kind of audit opinion you want unattainable.

Now I'd like to highlight a few of the conditions or weaknesses we find on initial audits. At the top of my list is the lack of monitoring of operations by agency management. This problem is particularly difficult where an agency has "turned over" part of its operations to the private sector without maintaining good controls. Next on my list is the failure to use fundamental accounting procedures and controls. Considering that reconciliations are an important control mechanism to prevent or detect fraud, embezzlement or illegal acts, we are frequently surprised that they are not being performed, or are being performed so poorly. We find accounts out of balance by millions and hundreds of millions of dollars. For example, detailed records of accounts and loans receivable are often not reconciled with control accounts. Property records, when they exist, are also not reconciled with control accounts and so on. We see too many instances of weak internal controls and ineffective FMFIA processes when these are relatively easy to identify and correct. We are amazed that control weaknesses persist and don't get fixed.

And last on my list is the lack of commitment to sound financial reporting, as evidenced by sometimes erroneous financial statements sent to Treasury and OMB. The root of the problem is apathy toward financial reporting. Agency CFOs have to turn this situation around and they have to make good reporting important to everyone.

This then brings me to the last challenge, that of reporting on results. The form and content of your financial statements needs attention. We believe that the statements that you're used to seeing should be augmented by an analysis of appropriations which ties them into the financial statements. We've just developed such a statement format and are exposing it for comment in our audit report to the Veterans Administration. But there are other form and content issues that need to be addressed by each of the agencies and there should be some guidance provided by the CFO Council on this issue.

Financial statements are an important vehicle for top management to present the results of its actions for public scrutiny. They should be part of a larger annual report on how management has discharged its fiduciary responsibilities. One of the things I wanted to do today, once again, is to encourage you to prepare such an accountability report each year. I would suggest that it might contain the following: first, a statement of agency objectives by program. This would be management's interpretations of the congressional mandate; second, a discussion and analysis of operations that ties the financial statement results to agency objectives. We've experimented on this in the recent VA audit and are satisfied that it can be done and it can be very illuminating. Third, the financial statements and auditor's report itself. And last, a summary of the agency's FMFIA report and the auditor's reports on internal control and compliance. Looking forward, we would anticipate that the auditor can cover, to some degree, the FMFIA report in its report on internal controls and compliance. But that's the future.

In conclusion its probably not an understatement to say that we've got a very tough job ahead of us. But it's certainly a job that's doable and one that definitely needs doing. We've developed, at GAO, a great deal of experience in doing this work and, while I admit we don't have the answers to all the questions, we're certainly willing to work with agencies to help them as much as we can as they develop plans for financial statement audits. Thank you very much for your attention, and I'd be delighted to take some questions.

Q - "With the cost of these audits in the civilian side of the house, has any analysis been done on the cost of doing an in-house or out-of-house with the idea of possibly a federal auditing agency that does this throughout the government?"

A - I don't know of any such plans or considerations. The cost differentials are fairly easy to compute since one of the things you do in your contract with an outside auditor is to establish the rate for the work. So you can do this, but no study to my knowledge is underway to justify some kind of overall federal audit agency that would supersede any IG prerogatives or preclude having independent public accountants do some of the work..

Q - "Can a CFO contract directly to do the financial statement audit, or what is the GAO position?"

A - That's a tough question. As you well know, the IG community claims that they are 100 percent responsible for all auditing activities within their agency, and the legislation suggests that that's the case. However, the CFO has a very important role to play in this whole matter because the audit results are his. They're his to use and the results are very important to his progress in improving financial systems and getting controls in place. So the CFO cannot be left out. What we have now is sort of a settling down of who's going to do what, and I would hope that when it's all over that the contract for outside audit services is with the agency CFO with the IG playing a very important role in the selection process.

Q - "In your opinion should the CFO—I assume it means CFO of the United States—be located in OMB, Treasury Department, or independent?"

A - As you know, we support the Glenn bill which calls for the CFO function provided for in the bill to be in OMB.

Q - "Please comment upon the adequacy of existing accounting standards as they relate to the preparation of financial statements."

A - Well, we have them. There is a set of codified accounting standards in existence for the guidance of the federal government. But I would be the first to admit that they need to be updated and they need to be extended to deal with some of the important issues that we're all going to face for the first time. As Frank (Hodsoll) may have said this morning, there's a process that we hope to bring to conclusion soon that will involve a broad group of competent people within government and outside government to help us set the necessary accounting standards that will fill in some of the voids and amend some things we already have to bring them closer into alliance with the needs of the federal government.

Q - "Audited financial statements are useful in the private sector because the investing public knows how to read them and act on them. However, what is being done to inform the public that audited government financial statements exists? Who's going to explain what the accounts and statements mean to largely unsophisticated taxpayers?"

A - You know, it's not so easy to read financial statements in the private sector. Most people don't. The people that do are financial analysts who explain it all in a few simple words and extract, from the documents that the accountants so laboriously prepare, the essence of them, what they mean, what they show, what they indicate about the results of the company and where it's going. I foresee a similar process happening in the federal government.

There should be a discussion and analysis that goes along with the set of financial statements so that the unsophisticated reader can grasp what's happening at the agency, can understand the trends, can see what the impacts on funding are going to be, and make certain basic determinations about the efficiency and effectiveness of the agency insofar as that can be shown from financial information. That's the function of financial analysis, balance sheets, income statements and footnotes. The information for that analysis comes from the financial statements and without the statements you can't make the analysis. The same problem exists for government that exists for the private sector.

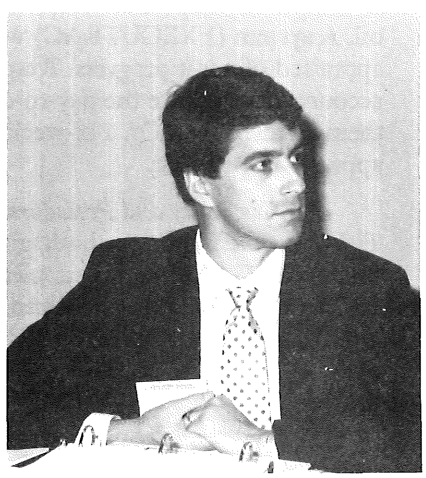
In government, like the private sector, we have to get good at interpreting the financial statements and telling the unsophisticated people outside the agency—namely the taxpayers and the Congress—what they really mean. And we can do that. We've tried it out on the VA. We are proud of our initial efforts in terms of taking a set of financial statements and producing an informative discussion and analysis. We've done the work at VA for 4 years so we've got a good history to look at. I think we've come up with some very interesting observations that distill what is happening in that agency from a financial point of view. I think you all should see that document when it comes out. It is with the VA now for comment. I would urge those that are considering how to make good use of financial statements to take a look at the VA discussion and analysis and see whether you can use the same kind of approach in explaining your agency's financial statements to the users who are not sophisticated and need some help in reading them.

Chapter 5

Workshop on Financial Statements: General Services Administration





Panel members included

(top left): Robert Suda
(top right): Donzell Jackson
(middle left): Gerard Edwards
(middle right): Edward Gramp
General Services Administration
(bottom left): Larry Albert
(bottom right): John Catalfamo
Arthur Anderson & Co.

Robert Suda, Director of the Information Resource Management Services and Public Building Service Accounting Division, GSA's Office of Finance, and moderator of the workshop, introduced panelists Donzell Jackson, Gerard Edwards, and Edward Gramp from GSA and Larry Albert and John Catalfamo from Arthur Andersen & Company.

Mr. Suda began with a slide presentation and discussion. He first described the scheduling of the major events in the preparation process, which encompassed the preliminary meetings held in early September to the receipt of the audit opinion in the first week of February. He noted that last year, for the first time, the trial balance was downloaded to a personal computer (PC) and off-the-shelf software was used to consolidate balances; this process reduced preparation time by nearly 2 months. The auditors now have the preliminary numbers by December 15, which gives them a good start toward meeting the scheduled completion date.

Mr. Suda pointed out the major segments of the annual report, its four primary financial statements and the supplemental schedules. Supplemental schedules are presented by fund type; i.e., general, special, revolving and deposit. Ninety-three percent of GSA's spending is by the revolving funds.

The most important sources of data for the financial statements are the GSA general ledger trial balance, system-generated cost reports, and the GSA Form 816, from which changes in capital asset accounts can be analyzed. External reports supply some data and reconciliation is performed to selected report balances. Other reports also supply data, such as the financial statements for each of the revolving funds, which are prepared and distributed internally. These statements, along with the cost reports, are among the tools used to effectively manage the revolving fund programs.

Information is provided from within the accounting system for analyses of intra-GSA activity, property and equipment, and other areas. A benefit of this analysis work (and the audits) has been the identification of significant amounts of equipment that had not been properly capitalized. Operating staff prepare schedules for receivables, future lease costs, and long term debt. Most support work is done by Washington-based staff, some by the Kansas City and the Fort Worth Accounting Centers which are relied on for tracking such matters as subsequent events. External information is needed; examples include the GSA General Counsel providing contingent liability amounts and the payroll system providing amounts of unfunded liabilities and other detailed breakdowns.

Communications is vital to a successful audit. Since GSA is very business oriented, their drawing upon the private sector expertise of Arthur Andersen & Company has been quite beneficial. An applied technique has improved the process for taking an inventory for coal and oil. A system (EXECUTRAC) was implemented to keep top management appraised of audit progress. Responsibility is given to the senior staff accountants to make the day-to-day audit decisions rather than bring them to managers. On a bi-weekly basis, all parties to the audit meet to appraise its progress.

GAO's *Policy and Procedures Manual for Guidance of Federal Agencies, Title 2* is relied upon for basic guidance to generally accepted accounting principles (GAAP) and is supplemented by other sources. Again, the auditor may have the specialized experience needed to advise in establishing standards, or resolving issues.

The GSA Annual report is distributed to Congress, OMB, GAO, GSA management and is used for agency recruiting. In addition, requests for copies are received from citizens and universities.

Larry Albert, Arthur Andersen & Company's manager for the GSA audit, provided two slides which detailed the chronology of a financial audit. He stressed the importance during an audit of frequent communication. A perpetual listing is kept of issues that warrant discussion and account balances or other items for which further information or adjustments are needed. Weekly meetings with GSA and daily communication usually resolves matters readily that could otherwise become problems. GSA has been very responsive; some recommendations that were included in the 1988 or 1989 management letters had often being acted upon by the GSA staff even prior to the issuance of the letter.

Mr. Albert indicated his company has a top-down approach in performing audits. They look first at the goal, which is to issue three opinions, the primary one being the auditor's opinion on the fairness of the financial statements and the others being on internal controls and on laws and regulations. The work for the three opinions is performed concurrently, as the auditor has to have a clear understanding of the internal controls and the laws and regulations before the financial audit can be completed. Testing is chosen that is thorough, yet cost-effective. In evaluating internal controls, the overall agency control environment is assessed as general risks, areas of review include the EDP systems complexity, the materiality of the various programs, and other factors. Specific risk analysis is then performed at the account level; from these analyses, the substantive tests may be developed. These tests may be confirmations, review of reconciliations, detailed vouchering, and others. From these risk assessments the detailed work programs are developed.

Mr. Albert indicated that the auditors found it fortunate to audit following several years of GAO audits, because there had been opportunity to identify and resolve material problems; hence, they were able to provide an unqualified opinion for each of these 2 years.

Contract for auditing services

GSA is in the process of arranging a governmentwide contract for auditing services. The solicitation proposal is expected to be "on the street" mid-October to early November and the procurement schedule issued in 1991.

Selected questions and answers

Q - "Could the software package used for mapping and consolidation of trial balances at GSA be used at other agencies? Please describe it. Will it permit account adjustments and provide a proper audit trail? Can it be purchased?"

A - GSA uses two software packages, the first is the Data Transfer System (DATRAN) which downloads data from the mainframe computer to a microcomputer environment. The second, the Microcomputer Trial Balance System (MTBS) maps whatever general ledger accounts are specified into financial statement formats (or any other scheme). The MTBS produces over 30 separate financial statements for GSA, then combines them. Work is underway to use the MTBS for SF-220 series reports. The MTBS, as used by GSA, is "tailored" for making account adjustments and provides a proper audit trail. The MTBS is a licensed software package (Arthur Anderson & Company can advise about its acquisition); other products with similar capabilities are available on the market.

Q - "What role did the (GSA) IG play in the audit?"

A - They contracted for it; the financial statements have been entirely prepared by the Office of Finance. Through the first several audits, the IG worked with GAO to evaluate internal controls and verify that the work produced was complete and thorough.

Q - "How is Arthur Andersen & Co. involved in GSA's (OMB Circular) A-127 review process?"

A - GSA has the responsibility for A-127 reviews; AA&Co. is doing the detailed reviews of the systems on a rotating basis. The GSA Office of Financial Management Systems is doing the limited reviews.

Q - "Discuss where the SGL is used at GSA."

A - Currently, the trial balances are cross-walked to the SGL accounts. GSA is in the process of converting to the Standard General Ledger.

Q - "Do balances on the SF-220 series reports agree with those on the Financial Statements?"

A - They reconcile, but may not agree. Subsequent to year-end closing there may be material adjustments recommended by the operating components or by the auditors. One recent point of difference, however, is that beginning in FY 1989, the Funds with Treasury account has adopted the GAAP standard, i.e., it will reflect the agency's true "cash" position rather than Treasury's balance which is also posted to by other agencies' transactions.

Q - "Does GSA have a single integrated accounting system?"

A - Yes, GSA operates the National Electronic Accounting and Reporting System (NEARS), which is a single integrated system.

Q - "Are the reviews required by (OMB Circulars) A-123 and A-127 performed as part of the audit?"

A - Yes for A-127; no for A-123. A lot of the review work done within the audit helps to fulfill the agency's responsibilities under A-127 and A-123. In the report AA&Co. issues for A-127 requirements, they include everything done in the form of internal control reviews. The Administrator can then take this input, along with what the IG and others have done, and be better able to appraise if the agency has complied with the Circulars.

Q - "Compare GSA's contract with AA&Co. versus the services received from the GAO."

A - They have both been very positive experiences for us. Obviously, the great results from the AA&Co. audits were built upon the work GAO performed the prior 3 years. We are better as an agency from working with GAO, and progressed further through our dealings with AA&Co.

Q - "What was the cost of the AA&Co. audit?"

A - Since the scope of the work performed year to year varies, it is not easy to quantify, however a "ballpark figure" for last year would be $500 thousand. Some people have questioned how we could do the audit for less cost to GSA than was incurred by the GAO. One reason may be that AA&Co.'s documentation process is more streamlined, i.e., the GAO's responsibility to report to the Congress requires a higher level of documentation than that required by private sector standards. Having major program areas well-documented by GAO helped AA&Co. in its work; and GSA had corrected the more serious deficiencies before engaging AA&Co. for audit services.

Q - "Why are there so many management letter concerns?"

A - The management letter addresses both financial and program management issues. Some issues suggest improvements in the flow of data and reports. They are all very important to us. GSA's Staff Offices and Services (program areas) have strict deadlines to respond to management issues.

Q - "Are the financial statements prepared in accordance with GAAP?"

A - Yes, they are presented in accordance with GAO's *Policy and Procedures Manual for Guidance of Federal Agencies, Title 2* and follow the pronouncements of the Financial Accounting Standards Board.

Q - "What observations do you have on the federal government's unfunded liabilities?"

A - This would be a personal observation. It is imperative that an entity prepare its financial statements on an accrual basis; there is no way that a business can be properly managed strictly by using a cash basis presentation. An example of this would be the financial mess New York City experienced some years ago while trying to manage on a cash basis.

Q - "When GSA began the process for the first audit by a CPA firm, was there an auditability assessment done? And if so, what were some of the major deficiencies found by AA&Co.?"

A - No formal auditability assessment was done. Again, it was due to AA&Co. following GAO in auditing GSA. Through their previous audit experience, GSA had developed the good internal control environment to preclude this need.

Workshop on Financial Statements: Department of Labor

As the Department of Labor (DOL) had just completed its 4th year of having the departmentwide financial statements audited, this workshop included discussion of DOL's 4 years of experience in compiling financial statements and having them audited. Three individuals spoke during this session. First, Robert McGregor of the Office of Inspector General (IG) of the DOL spoke about an overview of DOL and the approach to audit the financial statements. Next, Hunter Rice of Metcalf, Rice, Fricke, and Davis (CPA firm participating under contract in the DOL financial statement audit) spoke about statement preparation, presentation, and audit of the Employment and Training Administration, the largest DOL agency. Lastly, Steven Censky of Williams, Young, and Associates (a firm participating under contract in the DOL financial statement audit) spoke about the overall consolidation and compilation of DOL statements.

Robert McGregor
Department of Labor

Overview of DOL and the Audit of Financial Statements

Mr. McGregor's talk was divided into several sections. His introductory remarks centered on the objectives of the audit and the reasons for undertaking such a project without regulatory or administrative requirements. DOL's Office of the Assistant Secretary for Administration and Management and the IG believed that audited departmentwide consolidated financial statements would indicate that the financial management operations of DOL were reliable and that they contained the necessary discipline and accountability to provide useful information and support to management. Subsequently, Secretary Brock announced DOL's intent to have its consolidated financial statements audited with an opinion expressed on them.

Mr. McGregor also discussed DOL's experiences in working toward consolidated DOL audited financial statements. The approach was divided into phases which involved preparing a plan

(1) identifying the components of DOL and the related risk and materiality involved in each,

(2) focusing on the degree and level of decentralization in DOL and the related risks and materiality involved,

(3) identifying the amount of effort involved in compiling financial statements of the major DOL components and the effort required to prepare consolidated DOL statements,

(4) estimating the audit resources needed to complete the examination of the financial statements, and

(5) coordinating with external organizations such as GAO, Treasury, and the audit community.

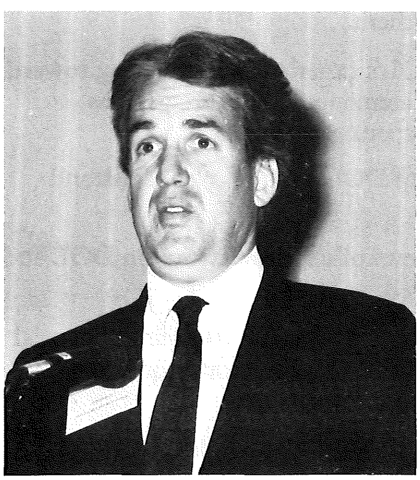
A phased-in approach was planned in which the actual audit of the overall DOL consolidated financial statements would not be done in total in the first year, but would instead follow after enough experience had been gained in audit of the component parts. The phased-in approach included proceeding on a pilot basis where parts of the work was done at major components of DOL. DOL also had to acquire audit resources (through contract and assignment of IG staff), coordinate the auditors' work, and assemble their work into a unified whole.

The second- and third-year audits (for fiscal years 1987 and 1988) took about 3 months or so less time than had the first-year effort. Beginning in fiscal year 1987, the audited financial statements were included in the Secretary's annual report.

The benefits gained from the audits helped improve DOL's accounting and financial management systems. A number of significant gaps and deficiencies in the existing accounting systems were identified and these provided bases for making improvements addressing the audit findings. Auditing implementation also helped ensure that full and accurate program cost information was captured, maintained, and reported so as to enhance DOL's accountability and provide the underlying discipline needed for effective financial management systems.

Employment and Training Administration of DOL

Mr. Rice divided his talk into several sections and explained how his firm, when auditing the Employment and Training Administration (ETA), assisted DOL in completing the audit of its financial statements. He began by discussing the relative size and materiality of the ETA in relation to overall DOL. ETA is the largest agency within DOL and during fiscal year 1988 controlled approximately 95 percent of DOL's overall budget authority. ETA's total budget authority was about $31.4 billion for expenditures and about $30.1 billion for financing sources which included about $23.2 billion in employer taxes, $2.6 billion in interest, and about $4.3 billion in appropriations. Total assets of ETA were about $50.6 billion comprised mostly of investments—$36.2 billion, funds on deposit with Treasury—$7.0 billion, and receivables—$6.3 billion. Total liabilities were about $13.4 billion which included about $11.2 billion of accrued unemployment benefits payable.



Hunter Rice
Metcalf, Rice, Fricke, Davis and Associates

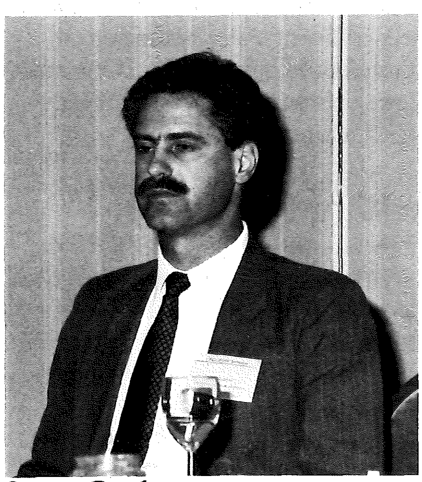
Mr. Rice talked about the five major accounting systems that had to be consolidated into the summary ETA financial statements. These systems included the DOL general ledger, the ETA subsidiary grant ledger, the unemployment trust fund general ledger, DOL contractor property management system, and the accounts receivable system. The first step was to generate trial balances relating to ETA from all the systems and identify the necessary adjusting and closing entries. Adjusting entries mainly revolved around noncash items such as allowances, depreciation, financing sources, and unfunded liabilities. For closing entries, attention had to be paid to M account transfers and withdrawals to Treasury.

The requirements and criteria under which the financial statements of ETA were prepared had to be reviewed carefully. The criteria mainly included GAO *Policy and Procedures Manual for Guidance of Federal Agencies, Title 2*, requirements and Treasury requirements from chapter 4100 of the *Treasury Financial Manual*.

Lastly, Mr. Rice discussed the accounting and auditing issues that needed additional consideration. The accounting issues included defining the DOL and ETA reporting entity, unfunded liabilities, and program year consolidation. The main audit issue that needed attention was the compliance testing required under generally accepted government auditing standards. The compliance testing segment involved reviewing the requirements of several laws and regulations and verifying DOL's compliance with the numerous requirements.

Overall Consolidation of DOL's Financial Statements

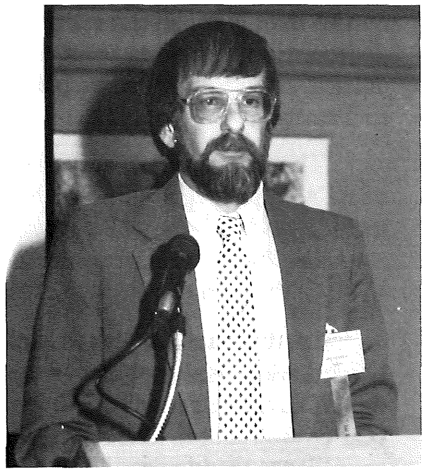
Steven Censky talked about two main topics for which his firm was responsible in the audit of DOL's financial statements. The first item involved coordinating the audit testing of the departmentwide integrated systems. DOL's systems basically contain decentralized input of accounting data from central locations and numerous regions. Considering the numbers and types of audit staffs (different audit contractors and the IG staff), coordination of the testing of the systems was necessary to avoid disrupting normal DOL operations and to maximize the efficiency of audit testing.

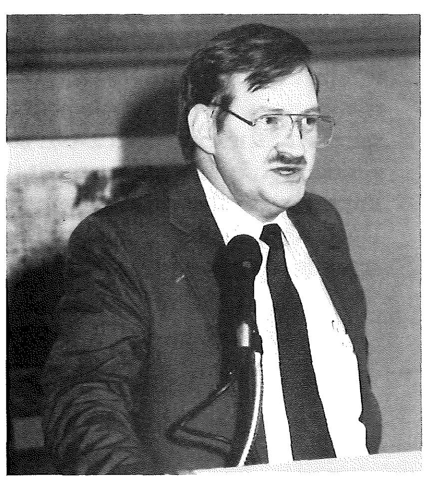


Steven Censky
Williams, Young and Associates

The second item was the process of consolidating all of DOL's agencies' financial statements—which included opinions on the agency's statements as provided by the numerous audit contractors. A critical area to identify in the process was occurrence of interdepartmental transactions. In the supplementary schedules, an overall financial statement showing each DOL component and the overall DOL elimination of interdepartment transactions was included. It was felt very important to show this statement so that the individual components of DOL were shown in total and the items eliminated were highlighted in arriving at the consolidated DOL statements.

Workshop on Financial Statements: Social Security Administration





Panel members included:

(top left): Matthew Schwienteck
(top right): Steven Schaeffer
(middle left): Elizabeth Lawson
(middle right): Charles Lewis
Social Security Administration
(bottom left): Dennis Snyder
(bottom right): James Nycum
DHHS, Office of Inspector General

Prior to 1983, the Old-Age, Survivors, and Disability Insurance (OASDI) program was funded on a "pay as you go" basis, meaning that the benefits of current retirees were paid by current workers. In 1983, Congress passed legislation that revised the funding basis. Workers now pay enough to fund both current retirees and to help build up reserves which will be needed later to pay benefits to the "baby boom" generation. Currently, these reserves total approximately $157 billion.

Since the new legislation focused attention on SSA's management of the OASDI program, the Commissioner of SSA decided to produce audited financial statements. Such statements would show both the Congress and the public that the trust funds were being soundly managed in a businesslike fashion. The first set of audited financial statements were produced for fiscal year 1987; and audited financial statements have been produced for each subsequent fiscal year.

Major Decisions

In order to produce audited financial statements, SSA believes all agencies will have to make decisions regarding the following issues:

- Will the auditor render an opinion on the financial statements? SSA decided to obtain an opinion.
- Who will audit the statements? Inspector General (IG)? General Accounting Office (GAO)? Private Certified Public Accountant (CPA) firm? SSA chose to use the IG.
- What will be the scope of the audit? All operations? Selected operations? SSA included all of their operations within the audit scope.
- What will be the vehicle for publication of the audited financial statements? SSA incorporated the audited financial statements into their annual report to the Congress.

SSA's Approach

Because the annual report to the Congress must be produced by March 1, SSA has approximately 150 days from the end of the fiscal year to produce the audited financial statements. This time period is utilized as follows:

- 45 days (Oct 1 - Nov 15) Close books and produce reports for Treasury and the Office of Management and Budget (OMB).
- 30 days (Nov 15 - Dec 15) Prepare audited financial statements, footnotes, and supplemental schedules.
- 45 days (Dec 15 - Feb 1) Complete audit and resolve audit recommendations.
- 30 days (Feb 1 - Mar 1) Print audit report.

Each March, SSA plans the coming audit by doing the following:

- Identifies SSA components.
- Develops timeline for key events.
- Coordinates audit plan with auditors and SSA Deputy Commissioners.
- Begins process necessary to obtain actuary reports.
- Prompts General Counsel about legal issues that may affect financial statements.

As stated above, SSA does not begin the production of the audited financial statements until November 15. A three-person staff produces the statements in accordance with a documented process. SSA downloads "general ledger" information from their mainframe accounting system into a personal computer (PC). The PC contains programs that produce both the SF 220 Report and the audited financial statements. During this time, financial information received from Treasury is reconciled with SSA financial records. SSA prepared the financial statements in accordance with the accounting principles in GAO's *Policy and Procedures Manual for Guidance of Federal Agencies, Title 2.*

Lessons Learned

Document the process of producing audited financial statements during the first year. SSA neglected to do this until the second year.

Involve the auditors as early as possible, so that they may express their views on how the footnotes are worded.

IG Perspective

The IG followed the auditing standards set forth by GAO's *Government Auditing Standards* ("Yellow Book") and the AICPA's "Statements on Auditing Standards" (SAS). A great emphasis was placed on ensuring that the audit staff was experienced and professionally competent. Several auditors were CPAs and all auditors obtained continuing professional education (CPE) in accordance with the "Yellow Book." Although actuarial projections were obtained from outside consultants, the IG staff completed most of the field work.

The first audit (fiscal year 1987) required the involvement of 60 auditors for a total of about 14 staff years. The fiscal year 1989 audit required only 8 staff years. Some of the auditing effort will be contracted out for fiscal year 1990.

Before undertaking the first audit, the IG reviewed prior audits issued by GAO and other government audit agencies. The IG places great importance on understanding and testing SSA's internal controls. At the completion of the audit, the IG produced the following reports:

- Opinion report.
- Report on internal controls.
- Report on compliance with laws and regulations.
- Management letter.

Financial Statements

In accordance with the "Yellow Book," SSA produces three audited financial statements:

- Combined Statement of Financial Position (Balance Sheet).
- Combined Statement of Financing Sources and Expenses and Trust Fund Balances (Income Statement).
- Combined Statement of Cash Flows and Reconciliation (Statement of Changes in Financial Position).

In addition, SSA produces footnotes and supplementary schedules that accompany the financial statements.

Balance Sheet—SSA Perspective

The balance sheet shows SSA's assets, liabilities, and government equity. Because SSA allows for 4.4 days of check float, the fiscal year 1988 Fund Balance with U.S. Treasury line has a negative balance. Government securities reflected in the Investment category will be sold after 4.4 days to cover checks written to beneficiaries. Accounts receivable are reflected at net of an allowance for uncollectible accounts. Most accounts receivable arise from benefit overpayments. Capital assets are shown net of depreciation. SSA owns most of its own buildings. Unfunded liabilities are not shown on the balance sheet. These liabilities are disclosed in the supplementary information section. Both the IG and GAO concur with this approach.

Balance Sheet—IG Perspective

The IG used Treasury statements to confirm the Fund Balance amount. To verify the Investment amount, the IG used confirmations and performed analytical reviews on Treasury Advice Slips. Liabilities were verified via analytical reviews. In addition, the IG obtained a Legal Representation Letter from the General Counsel.

Income Statement—SSA Perspective

The income amount is based on SSA estimates that are reconciled to actual earnings data (W-2s) certified by SSA. Expense amounts are based on actual activity measured by SSA's accounting systems during the year. This is the easiest statement to produce.

Income Statement—IG Perspective

To verify income, the IG reviews the adjustments to the estimated data based on actual wage data (941s) provided to SSA by the IRS and the reconciling of any differences between the W-2s and the 941s. With respect to expenses, the IG performs tests to ensure that the income statement reflects them in the correct amount and for the proper fiscal year.

Statement of Cash Flows

The statement reconciles the cash based Treasury statements to the accrual based SSA statements.

Footnotes

SSA prepared the footnotes to the financial statements in accordance with GAO's Title 2. The IG reviewed the footnotes very closely.

Supplemental Information

In preparing this information, SSA tried to present useful information to the reader of the financial statements. They relied on their judgment, not regulations, in compiling this information.

Opinion Letter

The IG presented three qualifications in the 1989 Opinion Letter:

- Uncertainty of revenue amounts due to discrepancy between amounts reported to IRS and SSA.
- Uncertainty of accounts receivable due to benefit overpayments, i.e., the subsidiary accounting records did not reconcile with the General Ledger balances.
- Uncertainty of equipment balances, i.e., the subsidiary accounting records did not reconcile with the General Ledger balances.

The qualifications expressed by the IG prompted SSA to take corrective actions for each area. SSA has requested a Comptroller General decision regarding the expression of revenue in the financial statements. To better track accounts receivable, SSA is installing a new Debt Management System. Equipment balances are being verified with physical inventories. In addition, individual items of equipment are being bar coded.

IG's Conclusions

- Auditors must be adequately trained. In addition to meeting the minimum CPE requirements, special training for financial auditing should be given to each auditor. The auditors involved with this audit received 1 week of classroom instruction. This instruction was based on GAO's CARE approach to financial auditing.
- Skilled, experienced auditors must lead the audit effort.

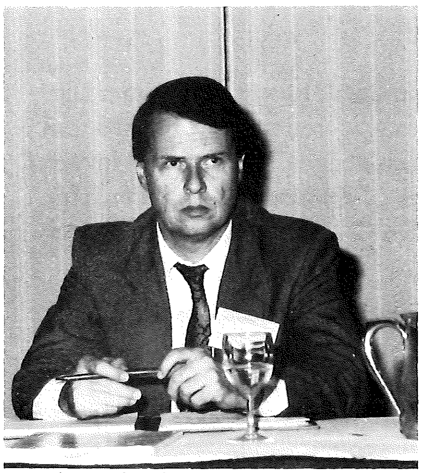
SSA's Conclusions

Audited financial statements are a driving force behind management improvements in both the financial management and program management areas. The following reports focus management's attention on problem areas:

- Qualifications expressed in the Opinion Letter.
- Report on Compliance with Laws and Regulations.
- Report on internal controls.

Audited financial statements often help justify financial and program system improvements.

Workshop on Financial Statements: Department of Veterans Affairs



Gordon Chapin
Department of Veterans Affairs

Gordon Chapin began the discussion with an overview of the effort involved in compiling the Department of Veterans Affairs' (VA) Treasury reports and financial statements. He described the complexity and scope of the VA's operations and cited the diverse types of funding at the VA which include annual, no-year, and multi-year appropriations, revolving funds, and trust revolving funds. Additionally, the VA uses six to eight miscellaneous deposit funds and maintains a separate series of accounts for personal property, buildings, and equipment.

The financial reporting process at the VA begins with an analysis of the general ledger trial balance and adjustments to accounts as appropriate. Note that this review and correction process also is done on a monthly basis to address any problems as they occur. Once the VA is satisfied with the accuracy of the corrected trial balance, the financial report preparation phase begins. The first report prepared at year-end is the SF-133, "Report on Budget Execution," in preliminary and final forms. Next, the TFS-2108, "Year-End Closing Statement," is prepared. The VA places significant emphasis on verifying the accuracy of the data entered on the TFS-2108, since it is a certified statement and the agency is locked into these numbers when preparing the remaining year-end reports. The final step is the production of the SF-220 series of reports. The SF-220 series is currently prepared on a manual basis at the VA. Personal computer spreadsheets are used in this effort to combine the various appropriations into the Treasury reporting entities.

The VA feels that the extension of the FAFR deadline to January 31st will allow for further verification of balances and confidence in the accuracy of amounts reported.

John Gartner
Department of Veterans Affairs

John Gartner provided a detailed look at the preparation of VA's departmental financial statements and footnote disclosures. He distributed handouts showing the following three statements prepared by the VA and contrasted these statements to the SF-220 series financial reports.

Schedule of Assets, Liabilities, and Equity

The Schedule of Assets, Liabilities, and Equity is a balance sheet similar to the SF-220, "Report on Financial Position." Receivables and Advances tie to the SF-220 and the SF-220-9, with the exception of an additional $1.2 million Reserve for Bad Debts on the VA statement. One notable difference on the VA statement's asset section is the inclusion of a line titled "Foreclosed Property Held for Sale," which is not a separate line item on the SF-220.

The presentation of property, plant, and equipment on the statements is an area of concern for the VA. GAO has issued a qualified opinion on the VA statements because of its inability to attest to the accuracy of plant and equipment balances. The VA keeps manual records of equipment values which they agree are essentially unauditable.

Another difference between the VA statement and the SF-220 is the addition of a line titled "Other Financing Sources" to the asset section. This amount represents future appropriations that will come in to the VA to pay liabilities (obligations) incurred. Mr. Gartner noted that an alternative approach used in some agencies is to disclose this activity as negative equity.

The liability section of the VA schedule includes a separate line item for the Liability for Losses on Guaranteed Loans. In 1989, this figure amounted to $2.6 billion. This liability is a result of VA's guarantee of home loan mortgages to veterans and represents the cost in future years for guarantees outstanding at the end of the current fiscal year. The large liability has evolved because the loan guarantee fund was never adequately financed. The funding was not made as the guarantees were made, but instead was funded as the defaults occurred.

GAO had further qualified VA's statements in the past because of the VA's presentation of its insurance reserves on the Schedule of Assets, Liabilities, and Equity. The VA was reporting its insurance reserves based on statutory insurance principles rather than on a GAAP basis. For 1989's reporting, the VA's presentation was converted to GAAP and this particular qualification was eliminated.

Schedule of Expenses, Dividends, Revenue, and Financing Sources

Mr. Gartner pointed out that the presentation of this statement really does not look at all like the SF-221. The statement presents the activities of the VA as a self-balancing operation. The VA has attempted to give the reader an appreciation of the VA's expenses and revenues by object class. This presentation makes it clear, for example, that the VA is heavily personnel-intensive, especially with services in the medical environment.

The line item titled "Future Financing Sources" is the balancing figure that makes this report balance from top to bottom. The Future Financing Sources shown on this statement ties to the net change in Future Financing Sources on the balance sheet from year to year.

Schedule of Sources and Uses of Resources and Reconciliation to Budget

Mr. Gartner described this VA statement as a combination of the SF-222, "Report on Cash Flow," and the SF-223, "Report on Reconciliation." VA's statement includes a line titled "Net Use of Budgetary Resources," which is an exact tie to the VA budget that goes forward.

Mr. Gartner noted that the VA also prepares a fourth statement which summarizes the activity in the "M" accounts. It shows the balance at the beginning of the year, new monies sent back to Treasury, and the resulting balance at the end of the year. GAO may be considering this type of statement as a new reporting requirement.

It was emphasized throughout Mr. Gartner's presentation that one of the primary benefits of audited financial statements for the VA was the identification of unusual activity and/or potential reporting problems.

Finally, Mr. Gartner discussed the footnote disclosures to the Veterans Affairs' financial statements. There are essentially 10 different disclosure items:

- Significant accounting policies: defines the entity, basis of consolidation, financing sources, property and equipment, accrued compensation and pension benefits, losses on guaranteed loans, dividends payable, and worker's compensation.
- Intragovernmental financial accounting: stresses that the VA is not a stand-alone entity but is part of the whole federal government, that the national debt is not reflected in their financial statements, and that the OPM and not VA reports on the financial condition of the CSRS and FERS.
- Restatement of fiscal year 1988 statements: discloses that the fiscal year 1988 statements were restated to record life insurance reserves on a GAAP basis (thus eliminating one of GAO's qualifications).
- Future liability for compensation and pension: reports the present value of unrecorded estimates for future compensation and pension liability.
- Housing credit programs: discloses the provision for losses on guaranteed loans as well as the components of the provisions.

- Insurance programs: VA has $27 billion in insurance outstanding. This footnote discloses the difference that exists between the statutory and GAAP presentations of insurance reserves. The statutory method assumes a 3 percent return on investment and uses 1950 life expectancy tables. GAAP method uses current rate of interest (between 8 and 9 percent) as well as current life expectancy tables.
- Investments: discloses makeup of investments and rates.
- Receivables: accounts, loans receivables, and advances.
- Property and equipment: presents the net book value of land, buildings, equipment, and construction in process. Discloses that land is carried at historical cost.
- Contingencies: based on legal representation letter and includes Department of Justice cases as well as class action suits.

Gregory Ziombra
General Accounting Office

Next, Greg Ziombra from the General Accounting Office explained GAO's basic financial audit approach, the results of the VA audits, and outstanding issues to be resolved at the VA. The scope of GAO's audit was wide-ranging and included audits at various VA locations including the central office, medical centers, regional offices, ADP centers, and accounting and finance centers.

There are four components of GAO's financial audits:

1. Agency profile: a document based on a brief survey that summarizes the entity, organization structure, and operations.

2. Control and risk evaluation (CARE) methodology: includes general risk analysis, transaction flow review and analysis, control testing, and substantive testing.

3. Financial statement consolidation: consolidation of data by appropriation, comparison of financial statement data to Treasury reports, and reconciliation of differences.

4. Financial reporting: required reports include the "Opinion on the Financial Statements," "Report on Internal Control Structure," "Report on Compliance with Laws and Regulations," and an optional "Management Letter."

The major results of financial audits of the VA indicate that property accounts are not fairly presented and that several key internal control weaknesses exist (including consistent failure to reconcile subsidiary accounts to general ledger control accounts and the use of obsolete and inefficient financial management systems).

Outstanding issues to be addressed by the VA as a result of the audits include the implementation of a property accounting system, the improvement of data processing security controls, and the improvement of various internal accounting controls.

John Johnston
Office of Inspector General
Department of Veterans Affairs

Finally, John Johnston of the Office of the Inspector General described his office's participation in the fiscal year 1989 VA audit. Basically, his purpose was limited to the attestation of internal accounting controls through audits at various VA locations. His findings of control weaknesses were similar to those reported by GAO and included a lack of proper reconciliations, the lack of proper methods for identifying and collecting accounts receivables, and inadequate procedures for recording real property. Mr. Johnston discussed the VA's plan for meeting the audit objective for fiscal year 1990. The IG's office is planning to contract the rest of the audit work out to a public accounting firm since it would otherwise require approximately 10 to 15 percent of his existing staff. However, he acknowledged that contract funds currently are not available for this endeavor. Mr. Johnston stressed that while he fully supports audited financial statements, the auditing costs should not divert funds from existing VA programs.

This concluded the VA's presentation; questions were then solicited from the audience.

Q - How is the CFO working with GAO and the IG with the task of audited financial statements?

A - The CFO will run interference with OMB trying to get funding for the audit of financial statements. The IG will go out and contract the actual audit work.

Q - If audit work is contracted out by the IG's office, who signs the opinion?

A - The contractor CPA firm would sign the opinion, presuming they do the preponderance of the field work.

Q - Is the audit of financial statements cost-beneficial?

A - Yes, the audit costs decrease each year. The benefits are many, specifically, the precision and expertise that it drives into the process.

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