

GAO

Report to the Secretary of the Treasury
and the Director of the Office of
Management and Budget

September 2004

FINANCIAL AUDIT

Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Further Improvement



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-04-866](#), a report to the Secretary of the Treasury and the Director of the Office of Management and Budget

Why GAO Did This Study

For the past 7 years, since the first audit of the consolidated financial statements of the U.S. government (CFS), certain material weaknesses in internal control and financial reporting have resulted in conditions that have prevented GAO from expressing an opinion on the CFS. Specifically, GAO has reported that the federal government did not have adequate systems, controls, and procedures to properly prepare the CFS. In October 2003, GAO reported on weaknesses identified during the fiscal year 2002 audit regarding financial reporting procedures and internal control over the process for preparing the CFS. The purpose of this report is to (1) discuss additional weaknesses identified during the fiscal year 2003 audit, (2) recommend improvements to address those weaknesses, and (3) provide the status of corrective actions to address the 129 recommendations contained in the October 2003 report.

What GAO Recommends

GAO is making 25 new recommendations to address weaknesses identified during the fiscal year 2003 CFS audit, including 11 recommendations related to four disclosure areas required under U.S. generally accepted accounting principles. Treasury and the Office of Management and Budget stated that they generally concur with the findings in the report, however Treasury disagrees with some recommendations in two areas.

www.gao.gov/cgi-bin/getrpt?GAO-04-866.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gary T. Engel at (202) 512-3406 or engelg@gao.gov.

FINANCIAL AUDIT

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What GAO Found

Many of the weaknesses in internal control that have contributed to GAO's continuing disclaimers of opinion on the CFS were identified by agency financial statement auditors during their audits of federal agencies' financial statements and have been reported in detail with recommendations to agencies in separate reports. However, some of the weaknesses we reported were identified during GAO's tests of the Department of the Treasury's process for preparing the CFS. Such weaknesses impair the federal government's ability to ensure that the CFS is consistent with the underlying audited agency financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles.

In addition to the compilation and reporting weaknesses that GAO reported in October 2003, GAO found additional weaknesses in the compilation and reporting process in the following seven areas during the fiscal year 2003 CFS audit:

- allocation methodology for certain costs in the statement of net cost,
- statement of changes in cash balance from unified budget and other activities,
- reporting of criminal debt,
- recording and disclosing contingencies,
- directly linking audited federal agency financial statements to the CFS,
- prior period adjustments, and
- conformity with U.S. generally accepted accounting principles.

GAO found that with respect to four required disclosure areas, information was either not included in the CFS or was not presented in conformity with U.S. generally accepted accounting principles. As a result of this and certain other weaknesses we identified, we were unable to determine if the missing information was material to the CFS. The four disclosure areas were (1) federal employee and veteran benefits payable, (2) environmental and disposal liabilities, (3) research and development, and (4) deferred maintenance.

GAO's October 2003 report contained 129 recommendations. Of those recommendations, 118 remained open as of February 20, 2004, the end of GAO's fieldwork for the fiscal year 2003 CFS audit.

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United States Government Accountability Office
Washington, D.C. 20548

September 10, 2004

The Honorable John W. Snow
The Secretary of the Treasury

The Honorable Joshua B. Bolten
Director, Office of Management and Budget

In February 2004, we issued our disclaimer of opinion on the consolidated financial statements of the U.S. government (CFS) for the fiscal years ended September 30, 2003 and 2002. For the past 7 years, certain material weaknesses in internal control and financial reporting resulted in conditions that prevented us from expressing an opinion on the CFS. Specifically, we have reported that the federal government did not have adequate systems, controls, and procedures to properly prepare its consolidated financial statements. Many of these weaknesses in internal control that contributed to our continuing disclaimers of opinion were identified by agency financial statement auditors during their audits of federal agencies' financial statements and were reported in detail with recommendations to the agencies in separate reports. However, some of the internal control weaknesses were identified during our tests of the Department of the Treasury's (Treasury) process for preparing the CFS. Such weaknesses impair the federal government's ability to ensure that the CFS is consistent with the underlying audited agency financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). Consequently, these weaknesses also contributed to our inability to render an opinion on the CFS.

In October 2003, we reported to you detailed weaknesses we identified during our fiscal year 2002 audit regarding financial reporting procedures and internal control over the process for preparing the CFS.¹ The purpose of this report is to (1) discuss in greater detail additional weaknesses we identified during our fiscal year 2003 audit regarding financial reporting procedures and internal control over the process for preparing the CFS, (2) recommend improvements to address those weaknesses, and (3) provide the status of corrective actions to address the 129 recommendations contained in our October 2003 report and that are listed

¹GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, [GAO-04-45](#) (Washington, D.C.: Oct. 30, 2003).

in appendix II. We have discussed each of the new weaknesses we identified during our fiscal year 2003 audit with your staff.

Results in Brief

In addition to the compilation and reporting processes weaknesses we reported in October 2003, we found more weaknesses in the compilation and reporting processes during our fiscal year 2003 audit, involving the following seven areas: (1) allocation methodology for certain costs in the statement of net cost, (2) statements of changes in cash balance from unified budget and other activities, (3) reporting of criminal debt, (4) recording and disclosing contingencies, (5) directly linking audited federal agency financial statements to the CFS, (6) prior period adjustments, and (7) conformity with GAAP.

This report includes 25 new recommendations to address weaknesses we identified, including 11 recommendations related to four required GAAP disclosure areas identified in appendix I. We are recommending that the required disclosures that are not included in the fiscal year 2003 CFS either be included in future years' CFS or that the specific rationale for their exclusion be documented. Appendix II of this report reflects the status of actions taken as of February 20, 2004, the end of our fieldwork, on our fiscal year 2003 CFS audit, to address the recommendations from our October 2003 report. Of the 129 recommendations contained in our October 2003 report, 118 are still open.

The Office of Management and Budget (OMB) stated that it generally concurred with the findings in the report and would work with Treasury and other executive departments and agencies to address these findings. Treasury stated that our report identified issues regarding certain federal financial reporting procedures and internal controls and provided valuable advice and recommendations for improvements. It also stated that many of the concerns we raised are in critical areas where federal financial reporting can be improved. While Treasury stated that it generally agreed with our concerns on most of the major issues, in some cases it disagreed with either our finding or our recommended approach to addressing the problem. We continue to believe that our findings and recommendations are sound. Treasury's disagreements involve two areas of weaknesses we identified and reported on as part of our fiscal year 2003 audit and are discussed in this report (1) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (2) Treasury's allocation methodology for certain costs in the Statement of Net Cost. In addition, Treasury disagreed with certain matters involving three areas we identified

and reported on as part of our fiscal year 2002² audit (1) unreconciled transactions affecting the change in net position, (2) Reconciliation of Net Operating Cost and Unified Budget Surplus/Deficit, and (3) management representation letters.

Scope and Methodology

As part of our audit of the fiscal years 2003 and 2002 CFS, we evaluated Treasury's financial reporting procedures and related internal control. In our report, which is included in the fiscal year 2003 *Financial Report of the United States Government*,³ we reported material deficiencies relating to Treasury's financial reporting procedures and internal control. These material deficiencies contributed to our disclaimer of opinion on the CFS and also constitute material weaknesses in internal control, which contributed to our adverse opinion on internal control. We performed our work in accordance with U.S. generally accepted government auditing standards. This report provides the details of the additional weaknesses we identified in our audit of the fiscal year 2003 and 2002 CFS and recommendations to correct those weaknesses.

We requested comments on a draft of this report from the Director of OMB and the Secretary of the Treasury or their designees. OMB's and Treasury's comments are reprinted in appendix III and IV, respectively, and discussed in the Agency Comments and Our Evaluation section of this report. Treasury also provided an attachment to its written comments that we did not reprint in appendix IV. This attachment was a detailed reconciliation spreadsheet that was an expanded version of the information we had already taken into account in our review of the fiscal year 2003 reconciliation statement.

²See footnote 1.

³The fiscal year 2003 *Financial Report of the United States Government* was issued by Treasury on February 27, 2004, and is available through GAO's Web site at www.gao.gov and Treasury's Web site at www.fms.treas.gov/fr/index.html.

Allocation Methodology for Certain Costs in the Statement of Net Cost

Statement of Federal Financial Accounting Standard (SFFAS) No. 4, *Managerial Cost Accounting Standards and Concepts*, states that a fundamental element of managerial cost accounting for the federal government is the use of appropriate costing methodologies to accumulate and assign costs to outputs. The standard further states that costs should be allocated on a reasonable and consistent basis. Without consistently applying an allocation methodology, the net cost amounts by federal agency, as shown on the Statement of Net Cost, may be misstated.

The Statement of Net Cost is intended to present the net cost of the U.S. government's operations. These costs are presented in the statement by individual federal agencies rather than by significant federal government program. The reported net cost amounts by federal agency include an allocated portion of the Office of Personnel Management (OPM) costs. This allocation is made to reflect the fair share of the cost of the functions performed by OPM that benefit other federal agencies, most notably, pension payments to federal retirees. As the basis for allocating OPM costs to each federal agency, Treasury's written procedures call for the use of full-time equivalents (FTE). Those FTEs are published in the *Analytical Perspectives, Budget of the United States Government*, fiscal year 2005.

During our fiscal year 2003 audit, we found that the FTEs used for allocating OPM costs to some of the federal agencies listed in the Statement of Net Cost did not always agree with the respective agencies' FTEs in the *Analytical Perspectives, Budget of the United States Government*, fiscal year 2005. In addition, we found that there was no review of the underlying support used to compile the Statement of Net Cost by Treasury management to ensure that OPM costs were allocated accurately. Treasury was not able to explain the differences we identified. We also found that Treasury's written procedures for allocating OPM costs on the Statement of Net Cost were not updated to reflect the changes Treasury made to its allocation methodology during fiscal year 2003.

We also found that Treasury made errors in allocating OPM costs to the Department of Homeland Security (DHS). Most of the errors occurred because Treasury allocated a full year of OPM costs to DHS, even though DHS did not begin operations until March 2003. DHS was originally allocated 5.3 percent of OPM costs and after we notified Treasury of the errors we identified, DHS was correctly allocated 2.6 percent.

Recommendations for Executive Action. We recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to

- ensure that, if FTEs are used as part of Treasury’s methodology for allocating OPM costs, the FTEs used for the agencies listed on the Statement of Net Cost agree with the FTEs listed in the *Analytical Perspectives, Budget of the United States Government* as currently stated in Treasury’s methodology;
- document any changes to the stated methodology for allocating OPM costs and the rationale for these changes; and
- require reviews by Treasury management of the accuracy of the allocated OPM costs.

Statement of Changes in Cash Balance from Unified Budget and Other Activities

As part of our fiscal year 2003 audit of the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Statement of Changes in Cash Balance), we found (1) material differences between the net outlay records used by Treasury to prepare the Statement of Changes in Cash Balance and the total net outlays reported in selected federal agencies’ audited Statements of Budgetary Resources (SBR);⁴ (2) that the Statement of Changes in Cash Balance reported only the changes in the “operating” cash of the U.S. government rather than all cash, as it is reported on the U.S. government’s Balance Sheet; and (3) that the major program activities of the U.S. government relating to direct and guaranteed loans extended to the public were reported as a net amount on the Statement of Changes in Cash Balance rather than disclosed as gross amounts for receipts and disbursements of cash related to direct loans and loan guarantees.

Net Outlays

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*,⁵ states that outlays in federal agencies’ SBRs should agree with each

⁴OMB and GAAP require agencies to report net outlays in their SBRs. The Statement of Changes in Cash Balance also reports unified budget outlays-actual. Both are intended to represent the same amount and be consistent with the information presented in the budget of the U.S. government.

⁵OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements* (Washington, D.C.: Sept. 25, 2001), is OMB’s official guidance for the form and content of federal agencies’ financial statements.

agency's net outlays reported in the budget of the U.S. government. In addition, SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires explanation of any material differences between the information required to be disclosed (including net outlays) and the amounts described as "actual" in the budget of the U.S. government.

As part of our fiscal year 2003 audit of the Statement of Changes in Cash Balance, we found material differences between the net outlay records used by Treasury to prepare the Statement of Changes in Cash Balance and the total net outlays reported in selected federal agencies' audited SBRs. These differences totaled about \$140 billion and \$186 billion for fiscal years 2003 and 2002, respectively.⁶

Two agencies—Treasury and the Department of Health and Human Services (HHS)—accounted for about 83 percent and 75 percent of the differences identified in fiscal years 2003 and 2002, respectively. We found that the major cause of the differences for the two agencies was the treatment of offsetting receipts.⁷ Some offsetting receipts for these two agencies had not been included in the agencies' SBRs, which would have reduced the agencies' net outlays and made the amounts more consistent with Treasury records used to prepare the Statement of Changes in Cash Balance.⁸ We found that Treasury publishes offsetting receipts by agency or department monthly, including fiscal year-to-date information in the *Monthly Treasury Statement*. Nevertheless, material differences between the two agencies' and Treasury's records remained at the end of the fiscal year.⁹ For example, we found that HHS reported net outlays for fiscal year 2003 as \$596 billion on its audited SBR, while the records that Treasury

⁶In some agencies' fiscal year 2003 financial statements, the comparable fiscal year 2002 amounts were restated.

⁷Offsetting receipts are collections that are credited to general fund, special fund, or trust fund receipt accounts and that offset gross outlays at the agency or governmentwide level.

⁸These two agencies did not adequately explain their fiscal year 2002 differences between the net outlays reported on their SBRs and the budget of the U.S. government in the notes to their fiscal year 2003 financial statements.

⁹Treasury publishes the *Monthly Treasury Statement*, which contains year-to-date information for budget receipts and outlays. These reports present the same amounts that Treasury reports as the unified budget outlays in the Statement of Changes in Cash Balance and contain summary offsetting receipts information by agency or department.

used to prepare the fiscal year 2003 Statement of Changes in Cash Balance showed net outlays of \$505 billion for HHS.

Until the differences between the total net outlays reported in the federal agencies' SBRs and the records used to prepare the Statement of Changes in Cash Balance are reconciled, the effect of these differences on the CFS will be unknown. OMB has stated that it plans to work with the agencies to address this issue.

Recommendations for Executive Action. We recommend that the Director of OMB direct the Controller of OMB, in coordination with Treasury's Fiscal Assistant Secretary, to work with the federal agencies so that the differences between net outlays the agencies report in their SBRs and the net outlay records Treasury uses to prepare the Statement of Changes in Cash Balance are reconciled.

In addition, we recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to determine and address the effects that any of the differences between net outlays the agencies report in their SBRs and Treasury's net outlay records may have on the CFS.

Reporting the Change in Cash

The Statement of Changes in Cash Balance reported only the changes in the "operating" cash of the U.S. government of \$35 billion rather than the changes in all cash reported on the U.S. government's Balance Sheet of \$62.2 billion, as of September 30, 2003. We also found that the total operating cash amount reported in the Statement of Changes in Cash Balance did not link to the underlying agencies' operating cash reported in their financial statements. For example, Treasury reported \$51 billion of operating cash in Treasury's own fiscal year 2003 audited financial statements. This amount, by itself, exceeded the \$35 billion operating cash balance reported in the Statement of Changes in Cash Balance.

SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, defines nonentity cash as cash that a federal entity collects and holds on behalf of the U.S. government or other entities. In some circumstances, the entity deposits the cash in its accounts in a fiduciary capacity for Treasury or other entities. Several provisions of SFFAS No. 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, require the Statement of Changes in Cash Balance to explain changes in the U.S. government's cash balance.

Recommendation for Executive Action. We recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to develop a process that will allow full reporting of the changes in cash balance of the U.S. government. Specifically, the process should provide for reporting on the change in cash reported on the consolidated Balance Sheet, which should be linked to cash balances reported in federal agencies' audited financial statements.

Net Direct and Guaranteed Loans

We found that the major program activities of the U.S. government relating to direct and guaranteed loans extended to the public were reported as a net amount on the Statement of Changes in Cash Balance rather than disclosed as gross amounts for receipts and disbursements of cash related to direct loans and loan guarantees.

In this regard, the illustrative financial statement for the Statement of Changes in Cash Balance provided in SFFAS No. 24, while not prescriptive, shows gross reporting of direct loans and guarantees activities. In addition, gross reporting is consistent with the reporting advocated in Financial Accounting Standards Board¹⁰ Statement No. 95, *Statement of Cash Flows*.

Treasury does not have a process for obtaining receipt and disbursement amounts for direct and guaranteed loans. As a result, the Statement of Changes in Cash Balance does not show the magnitude of these major government loan programs. Net reporting of direct and guaranteed loan program activity does not disclose how much cash the government disbursed to promote the nation's welfare by making these loans available to the general population or how much in related repayments the government received. For example, in fiscal year 2003, the Statement of Changes in Cash Balance reported a net \$1.2 billion of direct loan activity, while the Department of Education alone disbursed approximately \$18 billion in direct loans to eligible borrowers and received approximately \$15 billion in loan repayments.

Recommendation for Executive Action. We recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to report gross

¹⁰The Financial Accounting Standards Board (FASB) sets financial reporting standards for privately owned entities in the United States. FASB pronouncements that are specifically made applicable to the federal government by the Federal Accounting Standards Advisory Board (FASAB) are part of federal GAAP hierarchy.

amounts for receipts and disbursements of cash related to direct loans and loan guarantees.

Reporting of Criminal Debt

We found that the CFS did not report criminal debt, as determined through the U.S. Courts, in accordance with GAAP. SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, and SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, require that a receivable and related revenue be recognized once amounts due to the U.S. government are assessed. Further, these standards require that an allowance for uncollectible accounts be used to reduce the gross amount of the receivable and revenue to its net realizable value. Also, in accordance with OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, agencies are to (1) service and collect debts in a manner that best protects the value of the U.S. government's assets and (2) provide accounting and management information for effective stewardship, including resources entrusted to the U.S. government (e.g., for nonfederal and federal restitution).

Criminal debt consists primarily of fines and restitution¹¹ related to a wide range of criminal activities, including domestic and international terrorism, drug trafficking, firearms activities, and white-collar fraud. The U.S. Courts assess these debts, and the Department of Justice's (Justice) U.S. Attorneys' Offices throughout the country are charged with enforcing collection. Although Justice and the U.S. Courts develop unaudited annual statistical data for informational purposes,¹² neither entity is accounting for any of these criminal debts as receivables, disclosing the debts in financial statements, or having the information subject to audit. The U.S. Courts, which serve as the assessor, depositor, and disbursing officer of most of the funds collected, are not required to prepare financial statements or disclose criminal debt information. In addition, Justice, which enforces criminal debt collection, prepares audited financial statements but does not record or disclose receivables for criminal debt. Therefore, criminal debt

¹¹The courts assess fines as punishment, whereas restitution is intended to make identifiable victims whole.

¹²*The United States Attorneys' Annual Statistical Report* summarizes and presents data related to criminal prosecutions and civil litigation conducted by the U.S. Attorneys for each fiscal year.

outstanding is not being reported to Treasury for inclusion in the CFS. Financial statement reporting of criminal debt would increase oversight of the debt collection process because amounts would be subject to audit. Such audits would include assessments of internal control and compliance with applicable laws and regulations related to the criminal debt collection process.

In our recently issued report on criminal debt,¹³ we reemphasized the need for Justice, the Administrative Office of the U.S. Courts, OMB, and Treasury to form a joint task force to develop a strategic plan that addresses managing, accounting for, and reporting criminal debt.¹⁴ We stated that the strategy should include (1) determining an approach for assessing the collectibility of outstanding criminal debt amounts so that a meaningful allowance for uncollectible criminal debts can be reported and used for measuring debt collection performance and (2) having OMB work with Justice and certain other executive branch agencies to ensure that these entities report and/or disclose relevant criminal debt information in their financial statements and subject such information to audit. As of the completion of our fieldwork, the task force had not yet been established and, therefore, a strategic plan had not been developed.

Recommendations for Executive Action. In the interim, until the joint task force is established and a strategic plan is developed, we recommend that the Director of OMB direct the Controller of OMB, in coordination with the Fiscal Assistant Secretary of the Treasury, to work with Justice and certain other executive branch agencies to ensure that these agencies report or disclose relevant criminal debt information in conformity with GAAP in their financial statements and have such information subjected to audit.

In addition, we recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to include relevant criminal debt information in the CFS or document the specific rationale for excluding such information.

¹³GAO, *Criminal Debt: Actions Still Needed to Address Deficiencies in Justice's Collection Processes*, [GAO-04-338](#) (Washington, D.C.: Mar. 5, 2004).

¹⁴In July 2001, we reported that criminal debt owed the federal government was not being reported in accordance with SFFAS No.1 and SFFAS No. 7 and recommended that Justice, the Administrative Office of the U.S. Courts, OMB, and Treasury form a joint task force to develop a strategic plan that addresses managing, accounting for, and reporting criminal debt. See GAO, *Criminal Debt: Oversight and Actions Needed to Address Deficiencies in Collection Process*, [GAO-01-664](#) (Washington, D.C.: July 16, 2001).

Recording and Disclosing Contingencies

As we have reported in previous years' audits, the U.S. government has not been able to determine whether loss contingencies were complete and properly reported in the CFS. Part of the problem is that Treasury has not requested all relevant information for loss contingencies required under the accounting standards from all applicable federal agencies. For fiscal year 2003, Treasury's primary means of compiling information for the CFS was through its system called Federal Agencies' Centralized Trial Balance System (FACTS). Under FACTS, federal agencies were instructed to enter information for legal contingencies that are assessed as both "reasonably possible" and "estimable." Treasury does not specifically request other information for loss contingencies that is required by accounting standards, such as loss contingencies assessed (1) to be probable, (2) as reasonably possible with estimated loss ranges, or (3) as uncertain.

For example, one federal agency provided Treasury with information regarding a legal claim amount of \$1.7 billion for which the agency's lawyers were unable to provide an assessment of the likelihood of an unfavorable outcome. Because FACTS does not allow for narrative descriptions of amounts provided to Treasury and only classifies loss contingencies as reasonably possible and estimable, the agency was unable to properly report to Treasury that the assessment of the likelihood of an unfavorable outcome was uncertain. Consequently, Treasury incorrectly considered this amount as reasonably possible and estimable and therefore overstated its estimated possible losses for legal contingencies in the CFS by this federal agency's claimant amount of \$1.7 billion. We notified Treasury of this error and a correction was made in the final version of the CFS.

SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, as amended by SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS No. 5*, contains accounting and reporting standards for loss contingencies, including those arising from litigation, claims, and assessments. A contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote.

SFFAS Nos. 5 and 12 use the terms probable, reasonably possible, and remote to identify three areas within the range of potential loss, as follows:

- **Probable.** For contingencies, the future event or events are more likely than not to occur. In addition, for contingencies related to pending or threatened litigation and unasserted claims, the future confirming event or events are those likely to occur.
- **Reasonably possible.** The chance of the future confirming event or events occurring is more than remote but less than probable.
- **Remote.** The chance of the future event or events occurring is slight.

Under SFFAS Nos. 5 and 12, a liability and the related cost for an estimated loss from a loss contingency should be recognized (accrued by a charge to income) when (1) a past event or exchange transaction has occurred, (2) a future outflow or other sacrifice of resources is probable, and (3) the future outflow or sacrifice of resources is measurable.

Disclosure of the nature of an accrued liability for loss contingencies, including the amount accrued, may be necessary for the financial statements not to be misleading. For example, if the amount recognized is large or unusual, disclosure should be considered. However, if no accrual is made for a loss because one or more of the conditions in SFFAS No. 12 are not met, disclosure of the contingency should be made when there is at least a reasonable possibility that a loss has been incurred. The disclosure should include the nature of the contingency and an estimate of the possible liability or range of possible liability, if estimable, or a statement that such an estimate cannot be made.

Recommendation for Executive Action. Because the limited information requested through Treasury's FACTS does not capture all the disclosure requirements under the accounting standards, the contingency note disclosure for the CFS may have been inaccurate and unreliable. For fiscal year 2004, Treasury is completing the design of and will be implementing a new system for compiling the CFS. We recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to include in the new system a request for federal agencies to provide the following contingency loss information to assist Treasury in disclosing contingencies in the CFS in accordance with GAAP:

-
- contingency losses assessed as probable and for which possible losses and estimated loss ranges are measurable,
 - contingency losses assessed as probable and for which possible losses cannot be estimated,
 - contingency losses assessed as reasonably possible and for which losses and estimated loss ranges are measurable,
 - contingency losses assessed as reasonably possible and for which possible losses are not measurable, and
 - the nature and extent of significant contingency losses for which the agency is unable to provide an assessment on the likelihood of an unfavorable outcome.

Directly Linking Audited Federal Agency Financial Statements to the CFS

As we have reported in the past, Treasury's current process for compiling the CFS did not directly link information from federal agencies' audited financial statements to amounts reported in the CFS, and therefore Treasury could not fully ensure that the information in the CFS was consistent with the underlying information in federal agencies' audited financial statements and other financial data. For fiscal year 2004 reporting, Treasury is planning a new process to compile the CFS. We reviewed Treasury's plans for the new process and found that there is a plan to link most of the agencies' audited financial statements to the consolidated financial statements through the use of a new closing package. Treasury will require each significant agency¹⁵ to prepare the closing package and to certify its accuracy.

However, we found that the planned closing package does not require federal agencies to directly link their audited financial statement notes to the closing package notes. Treasury plans to rely on note templates it designed that call for predefined information from the federal agencies. We

¹⁵Treasury refers to the significant agencies as "verifying agencies." They are the 23 Chief Financial Officers Act agencies, the Department of Homeland Security, the Export-Import Bank of the United States, the Farm Credit System Insurance Corporation, the Federal Communications Commission, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the U.S. Postal Service, the Pension Benefit Guaranty Corporation, the Railroad Retirement Board, the Securities and Exchange Commission, the Smithsonian Institution, and the Tennessee Valley Authority.

found that these templates are too restrictive and that important information reported at the agency level may not be included in the CFS because it is not specifically called for in the closing package. The use of such predefined templates increases the risk that Treasury will continue to produce consolidated financial statements that are not in conformity with GAAP.

We also found that the planned closing package does not require the necessary information to compile all five of the required consolidated financial statements. For example, as noted earlier, we found that there were significant differences between the total net outlays reported in selected agencies' audited financial statements and the records Treasury uses to prepare its Statement of Changes in Cash Balance from Unified Budget and Other Activities. Because the planned closing package does not call for agencies to provide information to compile this statement that is consistent with underlying information in the agencies' audited financial statements, the risk of differences between the CFS and the underlying agency financial statements is increased. The lack of direct linkage also affects the efficiency and effectiveness of the audit of the CFS.

Statement of Federal Financial Accounting Concepts No. 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, states that the consolidated financial report should be a general purpose report that is aggregated from agency reports and that it should tell users where to find information in other formats, both aggregated and disaggregated, such as in individual agency reports, on agency Web sites, and in the President's Budget.

Recommendations for Executive Action. As Treasury is still designing its new compilation process, which it expects to implement beginning with the fiscal year 2004 CFS, we recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to modify Treasury's plans for the new closing package to

- require federal agencies to directly link their audited financial statement notes to the CFS notes and
- provide the necessary information to demonstrate that all of the five principal consolidated financial statements are consistent with the underlying information in federal agencies' audited financial statements and other financial data.

Prior Period Adjustments

According to SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amending SFFAS 7, Accounting for Revenue and Other Financing Sources*, an entity should restate the prior year to report correction of errors that are material and should disclose the nature of the prior period adjustments. If errors are not material, they should be included in the current year results and not cited as prior period adjustments on the Statement of Operations and Changes in Net Position, and no disclosure is required. Also, according to SFFAS No. 21, an entity should adjust the beginning balance of cumulative results of operations for changes in accounting principles and disclose the nature of those changes.

Treasury did not fully comply with the requirements of SFFAS No. 21 in connection with certain identified errors relating to prior periods. Treasury did not restate the prior year to correct net errors of \$2.6 billion because it determined the errors to be immaterial, which was the correct accounting treatment. However, Treasury reported the \$2.6 billion amount as a prior period adjustment on the Statement of Operations and Changes in Net Position and adjusted the beginning balance of cumulative results of operations as would be required if these amounts were material. Therefore, Treasury was inconsistent when implementing the requirements of SFFAS No. 21.

Treasury also did not initially comply with the requirements of SFFAS No. 21 in connection with reporting a change in accounting principle. Treasury reported in several drafts of the CFS a change in accounting principle of \$383 billion as an error relating to prior periods because Treasury did not specifically require federal agencies to separately identify changes in accounting principles. Instead, Treasury allowed federal agencies to report changes in accounting principles together with prior period adjustments, which made them difficult to differentiate. Changes in accounting principles are not errors and have different reporting requirements. We brought this to Treasury's attention and it corrected the mistake in the final version of the CFS.

Recommendations for Executive Action. We recommend that the Secretary of the Treasury direct the Fiscal Assistant Secretary to

- report prior period adjustments in accordance with SFFAS No. 21 by (1) restating the prior year for corrections of material errors and adjusting the beginning balance of cumulative results of operations and disclosing the nature of the errors in the notes to the CFS and

(2) including corrections of immaterial errors in the current year and not citing them as prior period adjustments on the Statement of Changes in Net Position and not disclosing them in the notes to the CFS and

- include in Treasury's new closing package a process that will allow federal agencies to clearly distinguish between prior period adjustments and changes in accounting principles in accordance with SFFAS No. 21.

Conformity with U.S. Generally Accepted Accounting Principles

As we reported as part of our fiscal year 2002 audit, and found again during our fiscal year 2003 audit, Treasury lacks an adequate process to ensure that the financial statements, related notes, stewardship, and supplemental information in the CFS are presented in conformity with GAAP. SFFAS No. 24 states that the Federal Accounting Standards Advisory Board (FASAB) standards apply to all federal agencies, including the U.S. government as a whole, unless provision is made for different accounting treatment in a current or subsequent standard.

Specifically, we found that Treasury did not (1) timely identify applicable GAAP requirements; (2) make timely modifications to agency data calls to obtain information needed; (3) assess, qualitatively and quantitatively, the materiality of omitted disclosures;¹⁶ or (4) document decisions reached with regard to omitted disclosures and the rationale for such decisions. During our fiscal year 2002 audit, we identified 16 disclosure areas consisting of 86 specific disclosures that may not have been in conformity with applicable standards. During our fiscal year 2003 audit, we found 4 disclosure areas involving an additional 11 specific disclosures that may not have been in conformity with applicable standards. As a result of this and certain other weaknesses we identified, we were unable to determine if the missing information was material to the CFS. These additional required disclosures are described in appendix I. We did note that Treasury is requesting certain information in its planned closing package for fiscal year 2004 that may address some of the needed disclosures.

Recommendations for Executive Action. We reaffirm our recommendation that the Secretary of the Treasury direct the Fiscal Assistant Secretary to establish a formal process that will allow the financial statements, related

¹⁶An item's omission or error is considered material if the surrounding circumstances make it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.

notes, stewardship information, and supplemental information in the CFS to be presented in conformity with GAAP, in all material respects. The process should

- timely identify GAAP requirements;
- make timely modifications to Treasury's closing package requirements to obtain information needed;
- assess, qualitatively and quantitatively, the impact of any omitted disclosures; and
- document decisions reached and the rationale for such decisions.

With respect to the 11 required disclosures identified in appendix I for which information was either not included in the CFS or was presented in a way that did not meet GAAP standards, we recommend that each of these disclosures be included in the CFS or that the specific rationale for excluding any of them be documented.

Agency Comments and Our Evaluation

OMB and Treasury provided written comments on a draft of this report; these comments are reprinted in appendixes III and IV, respectively. OMB stated that it generally concurred with the findings in the report and would work with Treasury and other executive departments and agencies to address these findings. Treasury stated that our report identified issues regarding certain federal financial reporting procedures and internal controls and provided valuable advice and recommendations for improvements. It also stated that many of the concerns we raised are in critical areas where federal financial reporting can be improved. While Treasury stated that it generally agreed with our concerns on most of the major issues, in some cases it disagreed with either our finding or our recommended approach to addressing the problem. We continue to believe that our findings and recommendations are sound. Treasury's disagreements involve two areas of weaknesses we identified and reported on as part of our fiscal year 2003 audit and are discussed in this report (1) Statement of Changes in Cash Balance from Unified Budget and Other Activities, and (2) Treasury's allocation methodology for certain costs in the Statement of Net Cost. In addition, Treasury disagreed with certain matters involving three areas we identified and reported on as part of our

fiscal year 2002¹⁷ audit (1) unreconciled transactions affecting the change in net position, (2) Reconciliation of Net Operating Cost and Unified Budget Surplus/Deficit, and (3) management representation letters. We will address each of Treasury's points relating to these five areas, beginning with the two related to this report.

Statement of Changes in Cash Balance

Treasury expressed disagreement with certain issues we identified with the Statement of Changes in Cash Balance. Treasury disagreed with our position that it should determine and address the effects on the accuracy of the CFS of differences between net outlays the federal agencies report in their individual audited SBRs and Treasury's net outlay records used to prepare the Statement of Changes in Cash Balance. As stated in this report, OMB and GAAP require federal agencies to report net outlays in their SBRs. The Statement of Changes in Cash Balance also reports actual unified budget outlays. Both are intended to represent the same amount and be consistent with the information in the budget of the U.S. government. We found material differences between these amounts for selected federal agencies for fiscal year 2003. Until these types of significant differences are reconciled, the effect on the CFS will be unknown. OMB has stated that it has begun working with the federal agencies to address this issue and we continue to believe that Treasury, in coordination with OMB, should work with the federal agencies on this matter as well.

Treasury also stated that it believes it is not required to report both budget receipts and budget outlays in the Statement of Changes in Cash Balance but only the budget deficit or surplus, as required by SFFAS No. 24. We understand that SFFAS No. 24 calls for a financial statement that explains how the annual budget surplus or deficit relates to the change in the government's cash, and does not prescribe the individual reporting of budget receipts and outlays. However, the budget deficit or surplus is the simple calculation of netting the budget receipt and outlay amounts. Also, Treasury does not maintain "budget deficit or surplus" records; rather Treasury maintains separate budget receipt and outlay records and relies on these records to calculate the budget deficit or surplus. As such, regardless of whether Treasury continues to separately report budget receipts and budget outlays or elects to only report the budget deficit or

¹⁷See footnote 1.

surplus, Treasury and OMB will still need to determine the effects of the types of net outlay differences described above on the CFS.

While Treasury agreed that the illustrative statement for the Statement of Changes in Cash Balance provided in SFFAS No. 24 shows total cash and the gross amounts for receipts and disbursements of cash related to direct loans and loan guarantees, it stated that presentation of this amount of detail is not required. As such, Treasury states that, at this time, it will not report the gross amounts for receipts and disbursements of cash related to direct loans and loan guarantees as we recommend. As stated in this report, we recognize that the illustrative statement is not prescriptive. However, we also note that the gross reporting is consistent with the reporting encouraged in Financial Accounting Standards Board Statement No. 95, *Statement of Cash Flows*. We also stated in this report that net reporting of direct and guaranteed loan program activity does not disclose how much cash the government disbursed to promote the nation's welfare by making these loans available to the general population or how much in related repayments the government received. Therefore, we continue to believe that gross reporting of this information is more meaningful and useful to a reader of the CFS.

Allocation Methodology for Certain Costs in the Statement of Net Cost

In its comments on a draft of this report, Treasury implied that we disagreed with Treasury for amending its methodology for allocating OPM costs in the Statement of Net Cost to reflect a new law mandating fully funded pension cost recognition at the U.S. Postal Service (USPS). We did not take issue with Treasury modifying its methodology for the change, but rather that Treasury had not updated its written procedures to reflect the modification and had made errors in applying the methodology. Specifically, as stated in our report, we found that Treasury did not update its methodology in its written procedures for allocating OPM costs to reflect the change caused by the USPS pension cost recognition and DHS' partial year existence. Our review found that Treasury did modify its methodology for allocating OPM costs based on the changes caused by USPS; however, it was not documented in its standard operating procedures and the spreadsheet used to apply the methodology had several significant errors—none of which were identified by Treasury. One significant error was that the FTEs used by Treasury for some agencies did not agree with the respective agencies' FTEs in the *Analytical Perspectives, Budget of the United States Government* as prescribed by Treasury's methodology. As such, we continue to recommend that Treasury (1) ensure that, if FTEs are used as part of Treasury's methodology for

allocating OPM costs, the FTEs used for the agencies listed on the Statement of Net Cost agree with the FTEs listed in the *Analytical Perspectives, Budget of the United States Government* as currently stated in Treasury's methodology; (2) document any changes to the stated methodology for allocating OPM costs and the rationale for these changes; and (3) require reviews by Treasury management of the accuracy of the allocated OPM costs.

Unreconciled Transactions Affecting the Change in Net Position

Treasury stated that it agreed that reconciling net position is a problem and that eliminations of intragovernmental activity and balances are not performed through balanced accounting entries but expressed concern that we are over emphasizing the elimination process. Treasury also stated that it agrees that increasing the granularity of the eliminations will help Treasury focus on where the problem exists as we reported as part of our fiscal year 2002 audit.¹⁸

We are not unduly emphasizing the elimination process. Our focus is on Treasury to identify and quantify all components of the activity in the net position line item and reconcile the change in the U.S. government's net position from year to year. During our fiscal year 2002 audit, we recommended that Treasury develop reconciliation procedures that will aid in understanding and controlling the net position balance, including the need to understand the components, including intragovernmental transactions, that are presently causing the net unreconciled transactions. These actions would allow the use of balanced accounting entries to account for the change in net position rather than simple subtraction of liabilities from assets and should narrow the amount of unexplained differences that comprise the net unreconciled transactions. Treasury added that it has a new process that will involve (1) use of reciprocal categories in performing eliminations and (2) a net position tracking methodology that will identify both the nature and source of the unreconciled transactions "plug" by financial area and by agency. We will evaluate this new process as part of the fiscal year 2004 audit.

¹⁸See footnote 1.

Reconciliation of Net Operating Cost and Unified Budget Surplus/Deficit (Reconciliation Statement)

Treasury stated that it does not agree with the recommendation in our report on the fiscal year 2002 audit¹⁹ that Treasury report “net unreconciled transactions” included in the net operating results line item as a separate reconciling activity in the Reconciliation Statement because it does not know whether it belongs in the statement. The Reconciliation Statement begins with the net operating cost amount reported in the Statement of Operations and Changes in Net Position. The fiscal year 2003 amount includes a net \$24.5 billion labeled as “unreconciled transactions,” which was needed to balance the consolidated financial statements. The Reconciliation Statement ends with the budget deficit amount, and is intended to show key reconciling items between the two amounts. For fiscal year 2003, Treasury included this \$24.5 billion net unreconciled transactions balance as part of the net operating cost, which indicated that this amount is attributable to fiscal year 2003 activity. We maintain that the \$24.5 billion should have been included as a reconciling item in the Reconciliation Statement because the fiscal year 2003 budget deficit, the amount being reconciled to, did not include this \$24.5 billion amount.

While Treasury agreed that it could always improve its Reconciliation Statement, Treasury stated that it took exception to our finding that the amounts identified as changes in the balance sheet items are incorrect. We did not report such a finding. Instead, as part of the fiscal year 2002 audit, we reported that Treasury’s process for preparing the Reconciliation Statement did not ensure completeness of reporting or ascertain the consistency of all the amounts reported in the Reconciliation Statement with the related balance sheet line items, related notes, or federal agencies’ financial statements. We stated that we performed an analysis to determine whether all applicable components reported in the other statements (and related note disclosures) included in the CFS were properly reflected in the Reconciliation Statement. For the fiscal year 2002 audit, we found about \$21 billion of net changes in various line item account balances on the balance sheet between fiscal year 2002 and 2001 that were not explained on either the Reconciliation Statement or the Statement of Changes in Cash Balance. For example, the Reconciliation Statement reported annual depreciation expense (\$20.5 billion) and total capitalized fixed assets (\$40.9 billion) as the components of the net change in property, plant, and equipment from fiscal year 2001. Although these activities accounted for a net increase of \$20.4 billion, the balance sheet reflected a smaller net

¹⁹See footnote 1.

increase, \$18 billion; Treasury was unable to explain the remaining \$2.4 billion of the net change.

Treasury stated that our preference for more detail flow information in the statements is not something that it plans to do. We did not state this as a preference. Instead, as part of our fiscal year 2002 audit, we reported that Treasury did not establish a reporting materiality threshold for purposes of collecting and reporting information in the Reconciliation Statement. For example, some items were reported simply as a net “increase/decrease” without considering how material, both quantitatively and qualitatively, the gross changes were. Treasury was unable to demonstrate whether material, informative amounts were netted, and pertinent information may therefore not be disclosed.

Management Representation Letters

Treasury disagreed with several of the statements related to management representation letters that we made in our report on the fiscal year 2002 audit.²⁰ Based on Treasury’s comments, it appears that it misunderstood our primary point which is that without performing an adequate review and analysis of federal agencies’ management representation letters, Treasury and OMB management may not be fully informed of matters that may affect their representations made with respect to the audit of the CFS.

For each agency financial statement audit, generally accepted government auditing standards require that agency auditors obtain written representations from agency management as part of the audit. In turn, Treasury and OMB are to receive all the required management representation letters and the related summaries of unadjusted misstatements from the federal agencies. This is important because generally accepted government auditing standards require Treasury and OMB to provide us, as their auditor, a management representation letter for the CFS. To prepare their representations on the CFS, Treasury and OMB rely on the information within agencies’ management representation letters. However, we found that Treasury and OMB did not have policies or

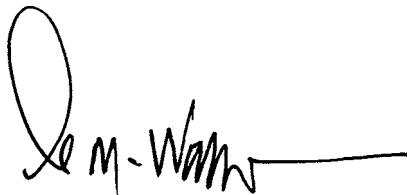
²⁰See footnote 1.

procedures to adequately review and analyze federal agencies' management representation letters.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations. You should submit your statement to the Senate Committee on Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this report. A written statement must also be sent to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs; the Subcommittee on Financial Management, the Budget, and International Security, Senate Committee on Governmental Affairs; the House Committee on Government Reform; and the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform. In addition, we are sending copies to the Fiscal Assistant Secretary of the Treasury and the Controller of OMB. Copies will be made available to others upon request. This report is also available at no charge on GAO's Web site at www.gao.gov.

We acknowledge and appreciate the cooperation and assistance provided by Treasury and OMB during our audit. If you or your staff have any questions or wish to discuss this report, please contact Jeffrey C. Steinhoff, Managing Director, Financial Management and Assurance, on (202) 512-2600 or Gary T. Engel, Director, Financial Management and Assurance, on (202) 512-3406.

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

Disclosure Issues

U.S. generally accepted accounting principles (GAAP) require the 11 disclosures described below to be included in the consolidated financial statements (CFS) or, if they are excluded, that the specific rationale for their exclusion be documented. However, the Department of the Treasury (Treasury) neither included nor documented the exclusion of these disclosures.

Federal Employee and Veteran Benefits Payable

The note disclosure for federal employee and veteran benefits payable departed from the following disclosure requirements of Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*.

SFFAS No. 5, paragraph 65, states that actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long-term future trends rather than give undue weight to recent experience. However, the fiscal year 2003 military rates of inflation and projected salary increases included in the CFS were the actual fiscal year 2003 rates disclosed in the Department of Defense's audited financial statements rather than the long-term rates.

For other retirement benefits, SFFAS No. 5, paragraph 83, states that the entity should disclose the assumptions used. However, assumptions were not shown for the liability for veterans' compensation and burial benefits.

According to SFFAS No. 5, paragraph 72, the entity should report a pension expense for the net of the following components: normal costs; interest on the pension liability during the period; prior (and past) service cost from plan amendments (or the initiation of a new plan) during the period, if any; and actuarial gains and losses during the period, if any. The individual components should be disclosed. However, the CFS did not disclose prior service costs from plan amendments as a separate component.

According to SFFAS No. 5, paragraph 88, the entity should report an other retirement benefits expense for the net of the following components: normal cost; interest on the other retirement benefits liability during the period; prior (and past) service costs from plan amendments (or the initiation of a new plan) during the period, if any; any gains or losses due to a change in the medical inflation rate assumption; and other actuarial gains or losses during the period, if any. The individual components should be disclosed. However, the CFS did not disclose any gains or losses due to a

change in the medical inflation rate assumption for health benefits as a separate component.

Environmental and Disposal Liabilities

The CFS note disclosure for environmental and disposal liabilities departed from the requirements of paragraphs 108, 109, and 111 of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, in the following ways:

- The CFS does not disclose the method for assigning estimated total cleanup costs to current operating periods (i.e., physical capacity versus passage of time).
- For cleanup costs associated with general property, plant, and equipment (PP&E), the CFS does not disclose the unrecognized portion of estimated total cleanup costs.
- The CFS does not describe the nature of estimates and the disclosure of information regarding possible changes to the estimates resulting from inflation, deflation, technology, or applicable laws and regulations.

In addition, Treasury should consider whether the reader would be interested in understanding why the environmental and disposal liabilities amount significantly changed during the year and include the explanation for the change in the note disclosure.

Research and Development

The information in stewardship information for research and development departed from the disclosure requirements of SFFAS No. 8, *Supplementary Stewardship Reporting*, paragraph 99, in the following ways:

- Information on the program outcomes (i.e., program outcome data or output data) for the investments in research and development are not properly reported. Outcome data are expected to consist typically of a narrative discussion of the major results achieved by the program along the lines of basic research, applied research, and development—as defined in the standard. If outcome data are not available (for example, the agency has not agreed on outcome measures for the program, the agency is unable to collect reliable outcome data, or the outcomes will not occur for several years), the outputs that best provide indications of the intended program outcomes shall be used to justify continued treatment of expenses as investments until outcome data are available.

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- The CFS does not include a narrative description of the major results achieved through the investments in basic research, applied research, and development.

Deferred Maintenance

The required supplemental information for deferred maintenance departed from the disclosure requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 83, by not disclosing the identification of each major class of asset (i.e., building and structures, furniture and fixtures, equipment, vehicles, and land) for which maintenance has been deferred.

Status of Treasury's and OMB's Progress in Addressing GAO Recommendations for Preparing the CFS

No.	Recommendation	Status
1	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in connection with Treasury's current compilation process and the development of Treasury's new compilation system and process, to segregate the duties of individuals who have the capability to enter, change, and delete data within the Federal Agencies' Centralized Trial Balance System and the Hyperion database and post adjustments to the consolidated financial statements (CFS).	Open.
2	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in connection with Treasury's current compilation process and the development of Treasury's new compilation system and process, to develop and fully document policies and procedures for the CFS preparation process so that they are proper, complete, and consistently applied by staff members.	Open.
3	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in connection with Treasury's current compilation process and the development of Treasury's new compilation system and process, to require and document reviews by management of all procedures that result in data changes to the CFS.	Closed. Management reviews were implemented in fiscal year 2003 under the current compilation environment. GAO will review management reviews in the new compilation environment.
4	As Treasury is designing its new financial statement compilation process to begin with the fiscal year 2004 CFS, the Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of the Office of Management and Budget (OMB), to develop reconciliation procedures that will aid in understanding and controlling the net position balance as well as eliminate the plugs previously associated with compiling the CFS.	Open.
5	As Treasury is designing its new financial statement compilation process to begin with the fiscal year 2004 CFS, the Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to use balanced accounting entries to account for the change in net position rather than simple subtraction of liabilities from assets.	Open.
6	As OMB continues to make strides to address issues related to intragovernmental transactions, the Director of OMB should direct the Controller of OMB to develop policies and procedures that document how OMB will enforce the business rules provided in OMB Memorandum M-03-01, <i>Business Rules for Intragovernmental Transactions</i> .	Open.
7	As OMB continues to make strides to address issues related to intragovernmental transactions, the Director of OMB should direct the Controller of OMB to require that significant differences noted between business partners be resolved and the resolution be documented.	Open.
8	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to implement the plan to require federal agencies to report in Treasury's new closing package, beginning with fiscal year 2004, intragovernmental activity and balances by trading partner and to indicate amounts that have not been reconciled with trading partners and amounts, if any, that are in dispute.	Open.

Appendix II
Status of Treasury's and OMB's Progress in
Addressing GAO Recommendations for
Preparing the CFS

(Continued From Previous Page)

No.	Recommendation	Status
9	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to design procedures that will account for the difference in intragovernmental assets and liabilities throughout the compilation process by means of formal consolidating and elimination accounting entries.	Open.
10	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to develop solutions for intragovernmental activity and balance issues relating to federal agencies' accounting, reconciling, and reporting in areas other than those OMB now requires be reconciled, primarily areas relating to appropriations.	Open.
11	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to reconcile the change in intragovernmental assets and liabilities for the fiscal year, including the amount and nature of all changes in intragovernmental assets or liabilities not attributable to cost and revenue activity recognized during the fiscal year. Examples of these differences would include capitalized purchases, such as inventory or equipment, and deferred revenue.	Open.
12	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to develop and implement a process that adequately identifies and reports items needed to reconcile net operating cost and unified budget surplus (or deficit). Treasury should report "net unreconciled differences" included in the net operating results line item as a separate reconciling activity in the reconciliation statement.	Open.
13	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to develop and implement a process that adequately identifies and reports items needed to reconcile net operating cost and unified budget surplus (or deficit). Treasury should develop policies and procedures to ensure completeness of reporting and document how all the applicable components reported in the other consolidated financial statements (and related note disclosures included in the CFS) were properly reflected in the reconciliation statement.	Open.
14	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to develop and implement a process that adequately identifies and reports items needed to reconcile net operating cost and unified budget surplus (or deficit). Treasury should establish reporting materiality thresholds for determining which agency financial statement activities to collect and report at the governmentwide level to assist in ensuring that the reconciliation statement is useful and conveys meaningful information.	Open.
15	If Treasury chooses to continue using information from both federal agencies' financial statements and the Central Accounting and Reporting System (STAR), Treasury should demonstrate how the amounts from STAR reconcile to federal agencies' financial statements.	Open.
16	If Treasury chooses to continue using information from both federal agencies' financial statements and from STAR, Treasury should identify and document the cause of any significant differences, if any are noted.	Open.
17	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to develop and implement a process to ensure that the Statement of Changes in Cash Balance from Unified Budget and Other Activities properly reflects the activities reported in federal agencies' audited financial statements. Treasury should document the consistency of the significant line items on this statement to agencies' audited financial statements.	Open.

Appendix II
Status of Treasury's and OMB's Progress in
Addressing GAO Recommendations for
Preparing the CFS

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No.	Recommendation	Status
18	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to develop and implement a process to ensure that the Statement of Changes in Cash Balance from Unified Budget and Other Activities properly reflects the activities reported in federal agencies' audited financial statements. Treasury should request, through its closing package, that federal agencies provide the net outlays reported in their Combined Statement of Budgetary Resources and explanations for any significant differences between net outlay amounts reported in the Combined Statement of Budgetary Resources and the budget of the U.S. government.	Open.
19	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to develop and implement a process to ensure that the Statement of Changes in Cash Balance from Unified Budget and Other Activities properly reflects the activities reported in federal agencies' audited financial statements. Treasury should investigate the differences between net outlays reported in federal agencies' Combined Statement of Budgetary Resources and Treasury's records in STAR to ensure that the proper amounts are reported in the Statement of Changes in Cash Balance from Unified Budget and Other Activities.	Open.
20	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to develop and implement a process to ensure that the Statement of Changes in Cash Balance from Unified Budget and Other Activities properly reflects the activities reported in federal agencies' audited financial statements. Treasury should explain and document the differences between the operating revenue amount reported on the Statement of Operations and Changes in Net Position and unified budget receipts reported on the Statement of Changes in Cash Balance from Unified Budget and Other Activities.	Open.
21	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to develop and implement a process to ensure that the Statement of Changes in Cash Balance from Unified Budget and Other Activities properly reflects the activities reported in federal agencies' audited financial statements. Treasury should provide support for how the line items in the "other activities" section of this statement relate to either the underlying Balance Sheet or related notes accompanying the CFS.	Open.
22	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to perform an assessment to define the reporting entity, including its specific components, in conformity with the criteria issued by the Federal Accounting Standards Advisory Board. Key decisions made in this assessment should be documented, including the reason for including or excluding components and the basis for concluding on any issue. Particular emphasis should be placed on demonstrating that any financial information that should be included, but is not included, is immaterial.	Open.
23	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to provide in the financial statements all the financial information relevant to the defined reporting entity, in all material respects. Such information would include, for example, the reporting entity's assets, liabilities, and revenues.	Open.
24	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to disclose in the financial statements all information that is necessary to inform users adequately about the reporting entity. Such disclosures should clearly describe the reporting entity and explain the reason for excluding any components that are not included in the defined reporting entity.	Open.
25	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to establish a formal process that will allow the financial statements, related notes, and stewardship and supplemental information in the CFS to be presented in conformity with U.S. generally accepted accounting principles (GAAP). The process should timely identify GAAP requirements.	Open.

Appendix II
Status of Treasury's and OMB's Progress in
Addressing GAO Recommendations for
Preparing the CFS

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No.	Recommendation	Status
26	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to establish a formal process that will allow the financial statements, related notes, and stewardship and supplemental information in the CFS to be presented in conformity with GAAP. The process should make timely modifications to Treasury's closing package requirements to obtain information needed.	Open.
27	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to establish a formal process that will allow the financial statements, related notes, and stewardship and supplemental information in the CFS to be presented in conformity with GAAP. The process should assess, qualitatively and quantitatively, the impact of the omitted disclosures.	Open.
28	The Secretary of the Treasury should direct the Fiscal Assistant Secretary to establish a formal process that will allow the financial statements, related notes, and stewardship and supplemental information in the CFS to be presented in conformity with GAAP. The process should document decisions reached and the rationale for such decisions.	Open.
29	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures for preparing the governmentwide management representation letter to help ensure that it is properly prepared and contains sufficient representations. Specifically, these policies and procedures should require an analysis of the agency management representations to determine if discrepancies exist between what the agency auditor reported and the representations made by the agency, including the resolution of such discrepancies.	Open.
30	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures for preparing the governmentwide management representation letter to help ensure that it is properly prepared and contains sufficient representations. Specifically, these policies and procedures should require a determination that the agency management representation letters have been signed by the highest-level agency officials who are responsible for and knowledgeable about the matters included in the agency management representation letters.	Open.
31	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures for preparing the governmentwide management representation letter to help ensure that it is properly prepared and contains sufficient representations. Specifically, these policies and procedures should require an assessment of the materiality thresholds used by federal agencies in their respective management representation letters.	Open.
32	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures for preparing the governmentwide management representation letter to help ensure that it is properly prepared and contains sufficient representations. Specifically, these policies and procedures should require an assessment of the impact, if any, of federal agencies' materiality thresholds on the management representations made at the governmentwide level.	Open.
33	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures for preparing the governmentwide management representation letter to help ensure that it is properly prepared and contains sufficient representations. Specifically, these policies and procedures should require an evaluation and assessment of the omission of representations ordinarily included in agency management representation letters.	Open.

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34	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures for preparing the governmentwide management representation letter to help ensure that it is properly prepared and contains sufficient representations. Specifically, these policies and procedures should require an analysis and aggregation of the agencies' summary of unadjusted misstatements to determine the completeness of the summaries and to ascertain the materiality, both individually and in the aggregate, of such unadjusted misstatements to the CFS taken as a whole.	Open.
35	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to help ensure that agencies provide adequate information in their legal representation letters regarding the expected outcome of the cases.	Open.
36	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to help ensure that agencies provide related management schedules.	Open.
37	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that agencies develop a detailed schedule of all major treaties and other international agreements that obligate the U.S. government to provide cash, goods, or services, or that create other financial arrangements that are contingent on the occurrence or nonoccurrence of future events (a starting point for compiling these data could be the State Department's <i>Treaties in Force</i>).	Open.
38	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that agencies classify all such scheduled major treaties and other international agreements as commitments or contingencies.	Open.
39	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that agencies disclose in the notes to the CFS amounts for major treaties and other international agreements that have a reasonably possible chance of resulting in a loss or claim as a contingency.	Open.
40	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that agencies disclose in the notes to the CFS amounts for major treaties and other international agreements that are classified as commitments and that may require measurable future financial obligations.	Open.
41	The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS. Specifically, these policies and procedures should require that agencies take steps to prevent major treaties and other international agreements that are classified as remote from being recorded or disclosed as probable or reasonably possible in the CFS.	Open.
42	As Treasury is designing its new compilation process, which it expects to implement beginning with the fiscal year 2004 CFS, the Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to design the new compilation process to directly link information from federal agencies' audited financial statements to amounts reported in all the applicable CFS and related footnotes.	Open.

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43	As Treasury is designing its new compilation process, which it expects to implement beginning with the fiscal year 2004 CFS, the Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB, to consider the other applicable recommendations in this report when designing and implementing the new compilation process.	Open.
44	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of Statement of Federal Financial Accounting Standards (SFFAS) No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 91, which requires the reporting entity to disclose the valuation basis for foreclosed property.	Open.
45	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 91, which requires the reporting entity to disclose the changes from the prior year's accounting methods, if any.	Open.
46	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 91, which requires the reporting entity to disclose the restrictions on the use/disposal of property.	Open.
47	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 91, which requires the reporting entity to disclose the balances by categories (i.e., pre-1992 and post-1991 foreclosed property).	Open.
48	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 91, which requires the reporting entity to disclose the number of properties held and average holding period by type or category.	Open.
49	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 91, which requires the reporting entity to disclose the number of properties for which foreclosure proceedings are in process at the end of the period for foreclosed assets acquired in full or partial settlement of a direct or guaranteed loan.	Open.
50	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 9, which requires credit programs to reestimate the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees. There are two kinds of reestimates: (1) interest rate reestimates and (2) technical/default reestimates. Entities should measure and disclose each program's reestimates in these two components separately.	Open.
51	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 10, which requires the reporting entity to display in the notes to the financial statements a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees reported on the entity's balance sheet.	Open.
52	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 11, which requires disclosure of the total amount of direct or guaranteed loans disbursed for the current reporting year and the preceding reporting year.	Open.

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53	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 11, which requires disclosure of the subsidy expense by components, recognized for the direct or guaranteed loans disbursed in the current reporting year and the preceding reporting year.	Open.
54	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 11, which requires disclosure of the subsidy reestimates by components for the current reporting year and the preceding reporting year.	Open.
55	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 11, which requires disclosure, at the program level, of the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs estimated for direct loans and loan guarantees in the current year's budget for the current year's cohorts.	Open.
56	The note disclosure for loans receivable and loan guarantee liabilities should meet the requirements of SFFAS No. 18, <i>Amendments to Accounting Standards for Direct Loans and Loan Guarantees</i> , paragraph 11, which requires the reporting entity to disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates.	Open.
57	The note disclosure for inventories and operating materials and supplies should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 30, which requires the difference between the carrying amount and the expected net realizable value to be recognized as a loss or gain and either separately reported or disclosed when inventory or operating materials and supplies are declared excess, obsolete, or unserviceable.	Open.
58	The note disclosure for inventories and operating materials and supplies should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraphs 35 and 50, that require disclosure of inventory and operating materials and supplies general composition.	Open.
59	The note disclosure for inventories and operating materials and supplies should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraphs 35 and 50, that require disclosure of any changes from the prior year in accounting methods for inventory and operating materials and supplies.	Open.
60	The note disclosure for inventories and operating materials and supplies should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraphs 35 and 50, which require the disclosure of any restrictions on the sale of inventory and the use of operating materials and supplies.	Open.
61	The note disclosure for inventories and operating materials and supplies should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraphs 35 and 50, which require disclosure of any changes in the criteria for categorizing inventory and operating materials and supplies.	Open.
62	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 56, which requires disclosure of the basis for valuing stockpile material, including valuation method and any cost flow assumptions.	Open.
63	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 56, which requires disclosure of any changes from the prior year's accounting methods.	Open.

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64	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 56, which requires disclosure of restrictions on the use of stockpile material.	Open.
65	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 56, which requires disclosure of the balances in each category of stockpile material (i.e., stockpile material held and held for sale).	Open.
66	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 56, which requires disclosure of the criteria for grouping stockpile material held for sale.	Open.
67	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 56, which requires disclosure of changes in criteria for categorizing stockpile material held for sale.	Open.
68	The note disclosure for stockpile material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 55, which requires disclosure of any difference between the carrying amount (i.e., purchase price or cost) of stockpile material held for sale and the estimated selling price of such assets.	Open.
69	The note disclosure for seized material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 66, which requires disclosure of the valuation method.	Open.
70	The note disclosure for seized material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 66, which requires disclosure of any changes from the prior year's accounting methods.	Open.
71	The note disclosure for seized material should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 66, which requires disclosure of the analysis of change in seized property (including dollar value and number of seized properties) that are on hand at the beginning of the year, seized during the year, disposed of during the year, and on hand at the end of the year, as well as known liens or other claims against the property. This information should be presented by type of seizure and method of disposition, when material.	Open.
72	The note disclosure for forfeited property should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 78, which requires disclosure of the valuation method.	Open.
73	The note disclosure for forfeited property should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 78, which requires disclosure of the analysis of the changes in forfeited property by type and dollar amount that includes (1) number of forfeitures on hand at the beginning of the year, (2) additions, (3) disposals and method of disposition, and (4) end-of-year-balances.	Open.
74	The note disclosure for forfeited property should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 78, which requires disclosure of any restriction on the use or disposition of the property.	Open.
75	The note disclosure for forfeited property should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 78, which requires disclosure, if available, of an estimate of the value of property to be distributed to other federal, state, and local agencies in future reporting periods.	Open.

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76	The note disclosure for goods held under price support and stabilization programs should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 98, which requires that if a contingent loss is not recognized because it is less than probable or it is not reasonably measurable, disclosure of the contingency shall be made if it is at least reasonably possible that a loss may occur.	Open.
77	The note disclosure for goods held under price support and stabilization programs should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 109, which requires disclosure of the basis for valuing commodities, including valuation method and cost flow assumptions.	Open.
78	The note disclosure for goods held under price support and stabilization programs should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 109, which requires disclosure of any changes from the prior year's accounting methods.	Open.
79	The note disclosure for goods held under price support and stabilization programs should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 109, which requires disclosure of any restrictions on the use, disposal, or sale of commodities.	Open.
80	The note disclosure for goods held under price support and stabilization programs should meet the requirements of SFFAS No. 3, <i>Accounting for Inventory and Related Property</i> , paragraph 109, which requires disclosure of the analysis of the change in dollar amount and volume of commodities, including those (1) on hand at the beginning of the year, (2) acquired during the year, (3) disposed of during the year listed by method of disposition, (4) on hand at the end of the year, (5) on hand at year-end and estimated to be donated or transferred during the coming period, and (6) received as a result of surrender of collateral related to nonrecourse loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments.	Open.
81	The note disclosure for property, plant, and equipment (PP&E) should meet the disclosure requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraph 45, which requires disclosure of the estimated useful lives for each major class of PP&E.	Open.
82	The note disclosure for PP&E should meet the disclosure requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraph 45, which requires disclosure of capitalization thresholds, including any changes in thresholds during the period.	Open.
83	The note disclosure for PP&E should meet the disclosure requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraph 45, which requires disclosure of restrictions on the use or convertibility of general PP&E	Open.
84	The note disclosure for PP&E should meet the disclosure requirements of SFFAS No. 10, <i>Accounting for Internal Use Software</i> , paragraph 35, which requires disclosure of the cost, associated amortization, and book value of internal use software.	Closed. Fiscal year 2003 CFS footnote for PP&E disclosed the cost, associated amortization, and book value of internal use software.
85	The note disclosure for PP&E should meet the disclosure requirements of SFFAS No. 10, <i>Accounting for Internal Use Software</i> , paragraph 35, which requires disclosure of the estimated useful life for each major class of software for internal use software.	Open.
86	The note disclosure for PP&E should meet the disclosure requirements of SFFAS No. 10, <i>Accounting for Internal Use Software</i> , paragraph 35, which requires disclosure of the method of amortization for internal use software.	Open.

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87	The note disclosure for PP&E should meet the disclosure requirements of SFFAS No. 16, <i>Amendments to Accounting for Property, Plant, and Equipment</i> , paragraph 9, which requires an appropriate PP&E note disclosure to explain that "physical quantity" information for the multiuse heritage assets is included in supplemental stewardship reporting for heritage assets.	Open.
88	The note disclosure for federal employee and veteran benefits payable should be completely and properly reported, specifically, that (1) it include a line for the valuation of plan amendments that occurred during the year and (2) the liability for military pensions and note disclosure related to the "change in actuarial accrued pension liability and components of related expenses" agree with the information presented in the Department of Defense's financial statements.	Open.
89	The note disclosure for environmental and disposal liabilities should meet the requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , that require (1) estimation and recognition of cleanup costs associated with general PP&E at the time the PP&E is placed in service and (2) recognition of a liability for the portion of the estimated total cleanup cost attributable to that portion of the physical capacity used or that portion of the estimated useful life that has passed since the general PP&E was placed in service.	Open.
90	The note disclosure for environmental and disposal liabilities should meet the requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , that require inclusion of material changes in total estimated cleanup costs due to changes in laws, technology, or plans.	Open.
91	The note disclosure for capital leases should meet the requirements of Federal Accounting Standards Board (FASB), Statement of Financial Accounting Standards (SFAS) No. 13, <i>Accounting for Leases</i> , paragraph 16, which requires future minimum lease payments as of the date of the latest balance sheet presented, in the aggregate and for each of the 5 succeeding fiscal years, with separate deductions from the total for the amount representing executory costs, including any profit thereon, included in the minimum lease payments, and for the amount of the imputed interest necessary to reduce the net minimum lease payments to present value.	Open.
92	The note disclosure for capital leases should meet the requirements of FASB, SFAS No. 13, <i>Accounting for Leases</i> , paragraph 16, which requires a summary of assets under capital lease by major asset category and the related total accumulated amortization.	Open.
93	The note disclosure for capital leases should meet the requirements of FASB, SFAS No. 13, <i>Accounting for Leases</i> , paragraph 16, which requires a general description of the lessee's leasing arrangements, including but not limited to (1) the basis on which contingent rental payments are determined, (2) the existence and terms of renewal or purchase options and escalation clauses, and (3) restrictions imposed by lease agreements, such as those concerning dividends, additional debt, and further leasing.	Open.
94	The note disclosure for life insurance liabilities should meet the requirements of SFFAS No. 5, <i>Accounting for Liabilities of the Federal Government</i> , paragraph 117, which requires all federal reporting entities with whole life insurance programs to follow applicable standards as prescribed in the private sector standards when reporting the liability for future policy benefits: FASB SFAS No. 60, <i>Accounting and Reporting by Insurance Enterprises</i> ; SFAS No. 97, <i>Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments</i> ; and SFAS No. 120, <i>Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts</i> ; and American Institute of Certified Public Accountants Statement of Position 95-1, <i>Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises</i> .	Open.

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95	The note disclosure for life insurance liabilities should meet the requirements of SFFAS No. 5, <i>Accounting for Liabilities of the Federal Government</i> , paragraph 5, which requires all components of the liability for future policy benefits (i.e., the net-level premium reserve for death and endowment policies and the liability for terminal dividends) to be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and reducing federal support in the form of appropriations related to administrative cost or subsidies).	Open.
96	The note disclosure on major commitments and contingencies be consistent with disclosed information in individual agencies' financial statements.	Open.
97	The note disclosure on major commitments and contingencies disclose sufficient information (detailed discussion) regarding certain major commitments and contingencies.	Open.
98	The note disclosure for collections and refunds of federal revenue should meet the requirements of SFFAS No. 7, <i>Concepts for Reconciling Budgetary and Financial Accounting</i> , paragraph 64, which requires, among other things, that collecting entities disclose the basis of accounting when the application of the general rule results in a modified cash basis of accounting.	Closed. The fiscal year 2003 CFS footnote for collections and refunds of federal revenue reflects that such information is accounted for using a modified cash basis of accounting.
99	The note disclosure for collections and refunds of federal revenue should meet the requirements of SFFAS No. 7, <i>Concepts for Reconciling Budgetary and Financial Accounting</i> , paragraph 69.2, which requires collecting entities to provide in the other accompanying information any relevant estimates of the annual tax gap that become available as a result of federal government surveys or studies.	Open.
100	The note disclosure for dedicated collections should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires inclusion of condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable to beneficiaries, other liabilities, and fund balance.	Open.
101	The note disclosure for dedicated collections should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires inclusion of condensed information on net cost and changes to fund balance, showing revenues by type (exchange/nonexchange), program expenses, other expenses, other financing sources, and other changes in fund balance.	Open.
102	The note disclosure for dedicated collections should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires inclusion of any revenues, other financing sources, or costs attributable to the fund under accounting standards but not legally allowable as credits or charges to the fund.	Open.
103	The note disclosure for Indian trust funds should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires a description of each fund's purpose, how the administrative entity accounts for and reports the fund, and its authority to use those collections.	Open.
104	The note disclosure for Indian trust funds should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires disclosure of the sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the government or the result of intragovernmental flows.	Open.

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105	The note disclosure for Indian trust funds should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable to beneficiaries, and other liabilities.	Open.
106	The note disclosure for Indian trust funds should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires condensed information on net cost and changes to fund balance, showing revenues by type (exchange/nonexchange), program expenses, other expenses, other financing sources, and other changes in fund balance.	Open.
107	The note disclosure for Indian trust funds should meet the requirements of SFFAS No. 7, Part I, <i>Accounting for Revenue and Other Financing Sources</i> , paragraph 85, which requires disclosure of any revenues, other financing sources, or costs attributable to the fund under accounting standards, but not legally allowable as credits or charges to the fund.	Open.
108	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 31, which requires the program descriptions for Hospital Insurance and Supplementary Medical Insurance and an explanation of trends revealed in Chart 11: Estimated Railroad Retirement Income (Excluding Interest) and Expenditures 2002-2076.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
109	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 24, which requires a description of statutory or other material changes, and the implications thereof, affecting the Medicare and Unemployment Insurance programs after the current fiscal year, and the implications thereof.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
110	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 25, which requires the significant assumptions used in making estimates and projections regarding the Black Lung and Unemployment Insurance programs.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
111	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 32(1)(b), which requires the total cash inflow from all sources, less net interest on intragovernmental borrowing and lending, and the total cash outflow to be shown in nominal dollars for the Hospital Insurance program.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.

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112	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 32(1)(a), which requires the narrative to accompany the cash flow data for Unemployment Insurance. The narrative should include the identification of any year or years during the projection period when cash outflow exceeds cash inflow, without interest, on intragovernmental borrowing or lending, and the presentation should include an explanation of material crossover points, if any, where cash outflow exceeds cash inflow and the possible reasons for this.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
113	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraphs 27(3)(h) and 27(3)(j), which require the estimates of the fund balances at the respective valuation dates of the social insurance programs (except Unemployment Insurance) to be included for each of the 4 preceding years. Only 1 year is shown.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
114	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 32(4), which requires individual program sensitivity analyses for projection period cash flow in present value dollars and annual cash flow in nominal dollars. The CFS includes only present value sensitivity analyses for Social Security and Hospital Insurance. Paragraph 32(4) states that, at a minimum, the summary should present Social Security, Hospital Insurance, and Supplementary Medical Insurance separately.	Open.
115	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 27(4)(a), which requires the individual program sensitivity analyses for Social Security and Hospital Insurance to include an analysis of assumptions regarding net immigration.	Open.
116	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , paragraph 27(4)(a), which requires the individual program sensitivity analysis for Hospital Insurance to include an analysis of death rates.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
117	The note disclosure for social insurance should meet the requirements of SFFAS No. 17, <i>Accounting for Social Insurance</i> , by not including financial interchange income (intragovernmental income from Social Security) in the actuarial present value information for the Railroad Retirement Board.	Closed. The fiscal year 2003 social insurance disclosures in the CFS provided the disclosures required in this recommendation.
118	The note disclosure for nonfederal physical property included in Stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 87, which requires disclosure of the annual investment, including a description of federally owned physical property transferred to state and local governments. This information should be provided for the year ended on the balance sheet date as well as for each of the 4 preceding years. If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. Reporting should be at a meaningful category or level.	Open.

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119	The note disclosure for nonfederal physical property included in stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 87, which requires a description of major programs involving federal investments in nonfederal physical property, including a description of programs or policies under which noncash assets are transferred to state and local governments.	Open.
120	The note disclosure for human capital included in stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 94, which requires a narrative description and the full cost of the investment in human capital for the year being reported on as well as the preceding 4 years (if full cost data are not available, outlay data can be reported).	Open.
121	The note disclosure for human capital included in stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 94, which requires the full cost or outlay data for investments in human capital at a meaningful category or level (e.g., by major program, agency, or department).	Open.
122	The note disclosure for human capital included in stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 94, which requires a narrative description of major education and training programs considered federal investments in human capital.	Open.
123	The note disclosure for research and development included in stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 94, which requires reporting of the annual investment made in the year ended on the balance sheet date as well as in each of the 4 years preceding that year. (As defined in this standard, "annual investment" includes more than the annual expenditure reported by character class for budget execution. Full cost shall be measured and accounted for in accordance with SFFAS No. 4, <i>Managerial Cost Accounting Standards for the Federal Government</i> .) If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. In those unusual instances when entities have no historical data, only current reporting year data need be reported. Reporting must be at a meaningful category or level, for example, a major program or department.	Open.
124	The note disclosure for research and development included in stewardship information should meet the requirements of SFFAS No. 8, <i>Supplementary Stewardship Reporting</i> , paragraph 94, which requires a narrative description of major research and development programs.	Open.
125	The note disclosure for deferred maintenance should meet the requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraphs 83 and 84, which require inclusion of the method of measuring deferred maintenance for each major class of PP&E.	Open.
126	The note disclosure for deferred maintenance should meet the requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraphs 83 and 84, which require that if the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each major class of PP&E: (1) description of requirements or standards for acceptable operating condition, (2) any changes in the condition requirements or standards, and (3) asset condition and a range estimate of the dollar amount of maintenance needed to return the asset to its acceptable operating condition.	Open.

Appendix II
Status of Treasury's and OMB's Progress in
Addressing GAO Recommendations for
Preparing the CFS

(Continued From Previous Page)

No.	Recommendation	Status
127	The note disclosure for deferred maintenance should meet the requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraphs 83 and 84, which require that if the total life-cycle cost method is used, the following should be presented for each major class of PP&E: (1) the original date of the maintenance forecast and an explanation for any changes to the forecast, (2) prior year balance of the cumulative deferred maintenance amount, (3) the dollar amount of maintenance that was defined by the professionals who designed, built, or managed the PP&E as required maintenance for the reporting period, (4) the dollar amount of maintenance actually performed during the period, (5) the difference between the forecast and actual maintenance, (6) any adjustments to the scheduled amounts deemed necessary by the managers of the PP&E and (7) the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance.	Open.
128	The note disclosure for deferred maintenance should meet the requirements of SFFAS No. 6, <i>Accounting for Property, Plant, and Equipment</i> , paragraphs 83 and 84, which require that if management elects to disclose critical and noncritical amounts, the disclosure is to include management's definition of these categories.	Open.
129	The note disclosure for stewardship responsibilities related to the risk assumed for federal insurance and guarantee programs should meet the requirements of SFFAS No. 5, <i>Accounting for Liabilities of the Federal Government</i> , paragraph 106, which requires that when financial information pursuant to FASB standards on federal insurance and guarantee programs conducted by government corporations is incorporated in general purpose financial reports of a larger federal reporting entity, the entity should report as required supplementary information what amounts and periodic change in those amounts would be reported under the "risk assumed" approach.	Open.

Source: GAO.

Note: During the fiscal year 2003 CFS audit, Treasury and OMB did not provide GAO with an action plan for addressing these recommendations. In May 2004, Treasury provided GAO with a draft corrective action plan to address the recommendations made to both Treasury and OMB. We plan to evaluate the effectiveness of any corrective actions taken by Treasury and OMB during our fiscal year 2004 audit. The source report for recommendations contained in this appendix is [GAO-04-45, Process for Preparing the CFS Needs Improvement](#), October 2003.

Comments from the Office of Management and Budget



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

THE CONTROLLER

Mr. Jeffrey C. Steinhoff
Managing Director, Financial Management Assurance
Government Accountability Office
Washington, DC 20548

Dear Mr. Steinhoff:

Thank you for the opportunity to comment on the draft of your report "Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Further Improvement" before it is finalized and issued. We understand that the Department of the Treasury (Treasury) will be providing more detailed comments under a separate cover.

We appreciate your recommendations to improve the process for preparing the *Financial Report of the United States Government* and have worked closely with the Government Accountability Office and Treasury to implement the new Closing Package. We generally concur with the findings in your report and will work with Treasury and other Executive departments and agencies to address these findings.

If you have any questions, please contact David M. Zavada, Chief, Financial Standards and Grants Branch, Office of Federal Financial Management at (202) 395-3993.

Sincerely,

A handwritten signature in black ink, appearing to read "LMS", written over a horizontal line.

Linda M. Springer
Controller

Comments from the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

July 23, 2004

Mr. Jeffrey C. Steinhoff
Managing Director, Financial Management and Assurance
Government Accountability Office
Washington, DC 20548

RE: GAO FY 2003 Financial Audit Management Letter
Process for Preparing the Consolidated Financial Statements of the US Government Needs Further Improvement (GAO-04-866)

Dear Mr. Steinhoff:

We received GAO's draft financial audit letter (management letter) on the FY 2003 Financial Report of the U.S. Government (*Process for Preparing the Consolidated Financial Statements of the US Government Needs Further Improvement, GAO-04-866*) and are pleased to provide our comments. This response also addresses at greater length some FY 2002 management letter concerns which are still listed as open in Appendix II of this report.

We appreciate your recommendations for improving the preparation of this government-wide report. GAO's audit report clearly pointed out issues regarding certain federal financial reporting procedures and internal controls and offered valuable advice and recommendations for improvements. Many of the concerns GAO raised are in critical areas where federal financial reporting can be improved. We have already been addressing many of these recommendations through procedural changes and revised policies and guidance to the agencies whose financial information comprises the report. While we generally agree with GAO's concerns on most major issues, in some cases, we disagree on either the finding or the approach to addressing the problem. We discuss these specific items below.

1. **Unreconciled transactions affecting the change in net position.** We agree with GAO that net position is a problem and that the eliminations are not performed through balanced accounting entries. We do have some concerns with your emphasis on the elimination process. Mathematically the plug is the same no matter how the eliminations are performed. The focus on the elimination process clouds the problem. The fundamental issue here is that agency net position balances do not add forward from one year to the next. Our process does not introduce out of balance conditions, they are inherent in the agency balances. We do agree that increasing the granularity of the eliminations will help us focus on where the problem exists. That is why our new process will do two things. First, eliminations will be performed using reciprocal categories insofar as they exist. Second, we have devised a net position tracking methodology that will identify both the nature and the

See comment 1.

Appendix IV
Comments from the Department of the
Treasury

See comment 1.

source of the plug (i.e. by financial area and by agency).

- 2. Reconciliation of net operating cost with budget surplus/deficit and Statements of changes in cash balance from budget.** The GAO recommendation is to report the amount of net unreconciled differences as a separate reconciling activity in the reconciliation statement. We disagree. While we agree that this difference needs to be taken in to account we believe that showing the amount on the reconciliation schedule implies that we know that is where it belongs. This is an unidentified difference which by definition is unknown. Therefore we will continue to place it in results of operations until we have more information about where it belongs.

See comment 2.

You have stated that we failed to ensure completeness in the preparation of the reconciliation statement and you have expressed a preference for a lower level of detail in the line items. While we agree that we can always improve the report, we take exception to your finding that the amounts identified as changes in the balance sheet items are incorrect. As the attached reconciliation shows, the prior period items account for the majority of the differences you identified. In addition, your preference for more detail flow information in the statements is not something we plan to do, in part because the report is already overly detailed and lengthy, and in part because the primary value of the reconciliation occurs in the display of the actuarial costs.

See comment 1.

- 3. Statements of Changes in Cash Balance from Unified Budget and Other Activities**
You have recommended that we reconcile receipts and outlays used by agencies in their statements of budgetary resources to our statements. The FASAB Board realized that this information was not reliable or appropriate for our purposes. SFFAS 24 states:

9. SFFAS 7, paragraphs 77-82, require certain information about budgetary resources and about the relationship between budget obligations and proprietary net costs of operations. Such information is reported in the Statement of Budgetary Resources and Statement of Financing, respectively. This information is not required in the consolidated financial report of the Government as a whole and accordingly such statements are not required.

See comment 3.

It is important to note that the "information" is not required therefore agency budgetary data is not used nor was ever contemplated to be used in our reports. We maintain the source of original entry for budgetary information in the STAR system and consider the use of other data not only less accurate but also a waste of taxpayer resources to both obtain and then correct the balances when we already have the information at our finger tips. There are no material differences between outlays reported by us and those included in the President's Budget. The standard does not require either receipts or outlays. SFFAS 24 requires only the unified budget surplus or deficit as follows:

**Appendix IV
Comments from the Department of the
Treasury**

10. The financial report of the Government as a whole should provide a financial statement reconciling net operating revenue (or cost) and the annual unified budget surplus (or deficit). The financial statement should highlight:

See comment 3.

GAO recommended that amounts used in preparing the consolidated statements be reconciled to agency statements. The unified government surplus is not reported in any agency statement.

See comment 1.

As to the findings for cash and loans, we agree that the illustrative financial statement for Statement of Changes in Cash Balance provided in SFFAS No. 24 does show total cash and the gross amounts for receipts and disbursements of cash related to direct loans and loan guarantees. However, we also see that presentation of this amount of detail is not authoritative, as seen in the following cite from SFFAS 24 for cash:

39. Several respondents urged the board to tie the change in cash on the new statement of changes in cash balance to balance sheet line item and accompanying note disclosure, and/or to include beginning and ending cash balances on the statement. The Board decided that such information would improve the statement and has included it in the illustration on the standard, but does not believe that it is necessary to require it as part of the standard.

At this time, we will not provide the amount of detail called for on the illustrative statement but will focus on resolving matters required by the standard.

See comment 4.

The example cited about the difference between the Department of the Treasury's financial statement operating cash and the FR's operating cash is not an appropriate example. The Department of the Treasury includes time deposits and other cash items in what it presents as operating cash. The FR separately presents these items, as disclosed in footnote 2.

See comment 5.

See comment 6.

See comment 7.

See comment 8.

4. Management representation letters. We disagree with several of the statements in this section. First, we already are using the auditor's opinion where discrepancies exist between management and their auditor. Second, we believe that the appropriate level of the officials who are being asked to sign the letters is something determined by their auditors. These letters are written by the agencies to their auditors not to us. Third, audit standards do not require the materiality disclosures that GAO is recommending. In fact, materiality is a matter negotiated between each auditor and their clients and we believe it is inappropriate for us to take such a position. You obviously have concerns with regard to materiality levels used by agencies. We believe this should be taken up by GAO with those auditors along with any other audit quality issues you may have.

See comment 1.

5. Allocation process. The draft report recommends that OPM costs be allocated by FTEs to the agencies listed in the Statement of Net Cost in accordance with Treasury's methodology. A new law mandating fully funded pension cost recognition at the USPS occurred in mid-year, which necessitated that we adjust our OPM pension costs allocation methodology to reflect the change. To not have amended our methodology to reflect the change in the law would have resulted in an inaccurate allocation of OPM pension costs to the USPS and to the other agencies listed in the Statement of Net Cost.

The draft report also recommended that reviews of the accuracy of the allocated OPM costs by Treasury management be a requirement. In fact, management played a large role in the adjustment of the OPM pension allocation methodology in FY 2003.

6. Criminal debt. As previously discussed with GAO, we will need to explore this with both Justice and the court system.

In conclusion, we are appreciative of GAO's recommendations. We agree with most of the recommendations and have been at work implementing them since we received the draft report. We would like to meet with you to discuss both our progress on correcting the deficiencies and those areas where we disagree. We look forward to working together to improve Federal financial reporting.

Sincerely,



Donald V. Hammond
Fiscal Assistant Secretary
Department of the Treasury

GAO Comments

1. See “Agency Comments and Our Evaluation” section.
2. Treasury provided a detailed reconciliation that purports to show that prior period adjustments accounted for the majority of the differences we identified. The spreadsheet provided an expanded version of the information we had already taken into account in our review of the fiscal year 2003 reconciliation statement. Therefore, our view is unchanged.
3. As we stated last year as part of our fiscal year 2002 audit, we were not calling for Treasury to use federal agencies’ financial statements to prepare the Statement of Changes in Cash Balance. Instead, we recommended that Treasury collect certain information already reported in federal agencies’ audited financial statements and develop procedures that ensure consistency of the significant line items on the Statement of Changes in Cash Balance with the agency-reported information. As we stated in our fiscal year 2002 report, Treasury has expressed the belief that the information it maintains in its system is materially reliable. However, federal agencies also believe their amounts are materially reliable and are supported by unqualified audit opinions on their financial statements.
4. Our example is appropriate. As stated in this report, we found that the total operating cash amount reported in the Statement of Changes in Cash Balance did not link to the underlying agencies’ operating cash reported in their financial statements. Our analysis showed that Treasury reported operating cash in its own financial statements of \$51 billion but reported only \$35 billion of operating cash in the Statement of Changes in Cash Balance in the CFS. Treasury attributes the difference to time deposits and other cash items which are included in Treasury’s department wide financial statements as components of operating cash, but are reported in the CFS separately from operating cash. In that Treasury is the preparer of the CFS, we see this inconsistency as a relevant example.
5. As part of our audit of the fiscal year 2002 CFS, we found that 2 of the 30 federal agencies’ management representation letters we had reviewed had discrepancies between what the auditor found and what the agency represented in its management representation letter. Treasury needs to be aware of these types of discrepancies and their resolution in order to determine the effects, if any, on the

representations made in the management representation letter for the CFS.

6. As part of our audit of the fiscal year 2002 CFS, we found that 8 of the 30 federal agencies' management representation letters we had reviewed were not signed by the appropriate level of management. Treasury has a responsibility to determine that the agency management representation letters are signed by the highest-level agency officials that are responsible for and knowledgeable about the matters included in the agency management representation letter because Treasury is relying on federal agencies' representations in the management representations letter for the CFS.
7. As part of our audit of the fiscal year 2002 CFS, we found that 25 of the 30 federal agencies' management representation letters we had reviewed did not disclose the materiality thresholds used by management in determining items to be included in the letter. Treasury stated that the audit standards do not require these amounts to be included in the management representation letter. While we agree that the standards do not require the materiality amounts to be included, we require Treasury and OMB to include a materiality threshold in the management representation letter for the CFS. Therefore, without assessing the materiality thresholds used by federal agencies in their management representation letters, we are unsure as to how Treasury and OMB can ensure that the representations made to GAO at the governmentwide level are within the materiality thresholds they state in the management representation letter for the CFS.
8. Materiality is one of several tools the auditor uses to determine that the nature, timing, and extent of procedures are appropriate. Materiality is a matter of the auditors' professional judgment, influenced by the needs of the reasonable person relying on the financial statements, and is not negotiated between the auditors and their clients. The management representation letter findings we reported as part of our fiscal year 2002 audit have also been communicated to agency auditors and we will continue to work with them to resolve these issues.

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