

TESTIMONY OF
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before the
House Committee on Government
Reform's Subcommittee on Government
Management Information and Technology

on the
Status of Financial Management
at the Department of Agriculture

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Thank you, Mr. Chairman and members of the Committee. I am pleased to be here to provide testimony about the Department of Agriculture's financial management. With me today is Robert Young, Deputy Assistant Inspector General for Audit.

In order to be effective, management must have reliable financial information. This is essential. Reliable financial data cannot be viewed as being in the "nice to have" category, but as a necessity. The need for this information resounds throughout all activities, from the more obvious stewardship over assets, fiduciary responsibilities, and budgeting, to operational matters such as performance measurement. For the Department to fulfill its mission and otherwise serve the public, it must know how much money has been received, spent, and is needed. It must know where its assets are and when they need to be repaired or replaced. It must know the costs of its operations to make informed decisions and identify where efficiencies and economies need to be implemented.

Financial information in USDA is, on the whole, not reliable. Our annual financial statement audits, which we have performed since 1991, have disclosed only a limited correlation between the accounting numbers the Department reports and the resources or events those numbers are to represent. Our initial audit opinions on the Department were adverse -- meaning the Department did not conform with prescribed accounting principles. We have issued disclaimers of opinions for the past 6 years. In other words, the books and records of the Department have been so poorly maintained we have been unable to compile and analyze sufficient evidence to enable us to reach an opinion. What we are saying is that,

due to the significance of the deficiencies in the Department's accounting systems, the resulting limitations on the scope of our audits were so material that we could not possibly do enough work to determine the reliability of the amounts in the USDA financial statements, such as its \$118 billion in assets. And, given the extent of internal control weaknesses, amounts presented on USDA's statements are highly questionable. More critically, this also means that the managers of the programs and operations may be relying on this highly questionable information. Thus, their ability to do their jobs effectively and efficiently would be significantly impaired.

I will discuss the primary problems preventing USDA from getting an improved opinion on their financial statements.

Department's Accounting Systems

The Department has six primary accounting systems used to account for program costs of over \$60 billion. Key to this activity are the financial management systems maintained at the National Finance Center, or NFC. NFC's, and one of the Department's most critical systems is the Central Accounting System, or CAS. The problems with CAS have been well chronicled—it is poorly documented, provides for only summary, and not detailed, data and does not meet Governmentwide accounting requirements. An example of the impact of this systemic weakness on the Department's financial statements is the Forest Service's \$195 million in accounts receivable. In the absence of a subsidiary ledger, individual cash collections or write-offs cannot be matched to the specific receivable. As a result, this material account becomes unauditible. CAS does not have an adequate audit trail and so-called reconciliations and adjustments are processed extensively and without justification. These

actions, to artificially bring accounts into balance, have an ugly nickname and even uglier connotation -- plugs. If you have to plug it's analogous to a golfer's shank. There's little worse, you don't want to acknowledge it, and you have to live with the consequences.

Simply stated, CAS does not work and cannot be fixed. Only one clear course of action was apparent to enable the Department to emerge from the murky pool of bad data that seeps from CAS--jettison the system. The Department embarked on fulfilling this goal in 1993 through an initiative referred to as the Financial Information System Vision and Strategy, or FISVIS. The purpose of this significant undertaking was to replace CAS with a new system that came to be called the Foundation Financial Information System (FFIS), establish a common coding structure, interface or integrate data from other financial, and mixed systems, and modernize or replace existing administrative, financial and mixed systems. The primary goal was to improve financial management in USDA by providing timely, accurate, and cost effective information to policy, management, and operating personnel. At the core of FFIS is a commercial off-the-shelf system, which is compliant with Government accounting and system requirements, to replace CAS. A critical decision at the outset of the implementation of FFIS has stymied implementation and significantly driven up costs. Specifically, the Department, in concert with the user agencies, opted to retain many of the legacy "feeder" systems and interface them with the new core package. The interfaced "feeder" system transactions require complex analytical processes (called mapping) to generate FFIS general ledger entries. Because the "feeder" systems are old and poorly documented, problems have been encountered when "mapping" these transactions to FFIS. Retaining the "feeder" systems has had the effect of reintroducing the same bad blood after a transfusion.

The “feeder” systems are poorly documented, operationally complex, deficient in appropriate control mechanisms, and costly to maintain. The “feeder” for purchases, for example, costs over \$6 million per year to operate and maintain. We have recommended that the “feeder” systems be reassessed and consolidated, integrated, and/or reengineered as appropriate. A review performed by the Department shared this view and recommended that 11 of the “feeder” systems be eliminated or integrated into either FFIS or a new administrative system.

The task of converting data from CAS to FFIS is critical to the success of FFIS. Our reviews identified problem areas related to the conversion of personal property data, data clean-up, and write-off of unreconciled amounts. For example, from just the three Forest Service regions converted into FFIS, over \$500 million in unvalidated accounting data was disclosed. These three regions represent only about one third of the Forest Service’s financial activity.

Fund Balance with Treasury

Another accounting problem at NFC is so severe and sensitive that it warrants special note. What I am referring to is the Department’s “Fund Balance with Treasury” account or, simply put, cash-in-bank. NFC’s account, which totals over \$5.5 billion, has not reconciled with Treasury records since at least 1992, when we first reported on it. NFC’s annual “fix” of this problem was to plug its accounts to reconcile with Treasury. The unreconciled differences as of September 30, 1999, was \$5 billion (the

absolute value). This problem is of paramount importance for several reasons--the amount of money involved, the inherent vulnerability of cash to theft or misappropriation, and the fact that both CAS and the new FFIS are similarly impacted. The causes of the variances are numerous and oftentimes difficult to track down. For example, “schedules” of remittances or disbursements may not be traceable to Treasury data because feeder systems assign incorrect numbers to the schedules. In addition, posting models erroneously record cash transactions. Further, timing differences frequently occur. For example, the Forest Service lockbox financial institution may promptly remit proceeds to the Treasury, but the Forest Service may not forward the supporting documentation to NFC for several months. In an attempt to resolve these problems, the Department brought in a “Big 5” CPA firm to reconcile the cash at NFC. Although the Department has made significant headway, and the posting model problems in CAS are being rectified, all issues have not been resolved and new out-of-balance conditions loom daily. Of particular concern is that the posting models in FFIS have not been corrected, and FFIS, unlike its much-maligned predecessor CAS, does not have a process that adequately identifies variances.

Personal Property

Our fiscal year 1999 financial statement audit identified another issue which would impact the Department’s opinion unless rectified. Specifically, because of significant weaknesses, we were unable to substantiate whether the financial statements were free from material misstatements for personal property valued at over \$888 million. The problem stems from one of NFC’s “feeder” systems, called PROP. Although system weaknesses exist, the primary cause of the misstatements is attributable to lack of required actions, such as annual inventories, by accountable officials. In addition, system reports

have not been used by the agencies. For example, our review of properties valued at over \$1 million identified, among other questionable items, a \$97 million vehicle and an \$11 million microscope. USDA's inflated accounting for assets appears to make NASA's \$600 toilet seats look cheap in comparison.

Credit Reform

Another longstanding, highly complex and very material encumbrance to the Department's efforts to secure a clean opinion has been its implementation of the credit reform legislation. USDA has a portfolio of loans totaling over \$70 billion that is subject to credit reform (it is the largest direct lender in the Federal Government). Affected programs include: the Rural Housing Service's Single Family and Multifamily Housing programs; the Farm Services Agency's Farmer Program Ownership and Operating Loan programs; the Rural Business Service's Business and Industry loan program; and the Rural Utilities Service Electric and Telephone Loan programs. The Federal Credit Reform Act of 1990 rectified an inherent disparity in that accounting data, loans disbursed, loan payments received, loan write-offs, etc., were recorded on a cash basis. This distorted the costs of the programs and precluded meaningful comparative analyses. The law required that the cost of extending or guaranteeing credit be recognized in the period that it was incurred. This cost, called the subsidy cost, must now be accounted for as the present value of the disbursements over the life of the loan less the estimated payments to be made back to the Government. A significant amount of historical data needs to be analyzed to compute these estimates, such as interest rate fluctuations and loan default rates. The initial predictions, or estimates, are to be reestimated at the end of the year to reflect any changes in the assumptions made and future loan performance.

The Department's loan accounting systems were not equipped to provide the extensive detail necessary to fulfill credit reform requirements. Further, due to systemic deficiencies, much of the data generated by these systems was incorrect. Congress recognized the potential lack of historical data in the accounting for loans and therefore reduced requirements for all loans made prior to fiscal year 1992. Due to the long term duration of USDA's loans (up to 50 years), however, the characteristics of these older loans (made before 1992) must be analyzed to predict future performance.

OMB has issued guidance for deriving cash flow inputs to subsidy models for budget formulation and reestimates of all credit programs. The guidance requires current and complete documentation and justification for the estimation methods and assumptions used in determining the cash flow figures in the subsidy model. In the absence of reliable historical data, USDA agencies have relied almost exclusively on the judgment of program managers to estimate, for example, the likely performance of loans in the 11th year of a 33-year note. No statistically valid studies or analyses are on hand, however, to support these critical assumptions. Although the systems were changed in 1992 to begin to capture the needed data, too many unknowns continue to exist regarding prior year activity which undermine the support for the estimates used.

The Department has launched an aggressive corrective action plan to overcome the noncompliances with credit reform requirements that we first reported in 1994. Whereas initial actions by the individual agencies were inadequate at best, under the leadership of the Chief Financial Officer, a task force including representatives of OIG was formed to redirect the sideways movement. A series of cash flow

models have been devised to capture and analyze the necessary elements to yield meaningful subsidy estimates and reestimates. Legislative requirements impacting cash flow have been identified with emphasis on those having a material effect, and calculation methodologies have been developed. GAO is also participating in this venture. Substantial work remains, however, in that some of the key models, such as RHS' for Single Family Housing and those for all of FSA's programs, require a significant amount of further review and refinement. Further, field testing needs to be performed to verify the key assumptions used.

In addition, our current audit work has disclosed weaknesses in the accounting for credit reform by the Commodity Credit Corporation (CCC). Our reviews have disclosed that accounting postings were frequently in error and the calculation and recording of subsidy estimates and reestimates were incorrect. CCC is hindered in this effort due to an absence of written procedures and its organizational structure related to foreign credits and guarantees does not currently foster or facilitate reliable accounting.

Real Property

Another longstanding and major encumbrance to a clean opinion is the Forest Service's accounting for real property. As of the September 30, 1999, the Forest Service reported about \$2.6 billion in real property assets. About 60 percent of this dollar value is attributable to what is referred to as "pooled assets" – primarily roads. The remainder represents individual assets such as buildings. The Forest Service is unable to support the valuation of its pooled assets, which is estimated to be \$1.5 billion. Reliable records are not available which document the cost of the roads or the timeframe they were put

into service, a critical factor needed to estimate depreciation and the value of their remaining useful life. The Forest Service, in concert with OIG, is working to develop a strategy whereby this data can be reasonably estimated. During fiscal year 1998, the Forest Service completed an agency-wide inventory and valuation of its individual real property assets (non-pooled assets). This was an extraordinary undertaking and a major step towards achieving accountability. Our reviews disclosed problems in the inventory process, however, in that adequate documentation was not always maintained and the agency's real property system, called INFRA, was not fully populated with the assets not previously accounted for, nor were abandoned items removed. Further, a significant problem persists in the valuation of the individual real property assets. Our audit tests statistically projected that these assets were overstated by about \$135 million and understated by almost \$80 million. The most prevalent problem identified was the same one that has impaired the Forest Service's accounting for these assets since our audits were first initiated – the lack of adequate supporting documentation to verify capitalized costs and in-service dates. To remedy this material weakness, the Forest Service is about to embark on another inventory with emphasis on compiling the requisite support.

Corrective Actions Needed

Now, let me address what the Department needs to do to strengthen its financial management and obtain an upgraded audit opinion. First, FFIS must be fully functional and not beset by significant weaknesses. As of October 1, 1999, the Food Safety and Inspection Service and the remainder of the Forest Service were implemented (two of the nine Forest Service regions came on line the prior year, along with the Risk Management Agency). The plans call for the Animal and Plant Health Inspection

Service, Rural Development, the Natural Resources Conservation Service, and the Farm Service Agency to be implemented on October 1, 2000. Thus, after a slow start, the implementation is aggressively unfolding. Regarding resolution of the problems we identified in FFIS, the Department provided a very positive response to our report which describes, in part, analyses to be undertaken to eliminate the problem-causing feeder systems. The direction is therefore clear; the uncertainty stems from the speed and effectiveness with which these significant issues can be overcome.

The next area of concern is the cash issue. Significant progress has been made to reduce the unreconciled items but, as noted, new variances continue to occur. The Department intends to implement an automated tool to identify cash variances arising out of FFIS by December 31, 2000. Due to the sensitivity of this account, the materiality level that could cause a qualification or disclaimer of audit opinion is much lower than the level for accounts such as buildings which are less vulnerable to loss, misappropriation or abuse. This issue remains a concern, though it is being addressed.

In terms of personal property, we believe if our recommendations are implemented this problem area can be overcome. A broad based commitment by the Department's accountable officials is needed however, and years have elapsed since this commitment has been manifested.

Credit reform remains a huge obstacle to an improved audit opinion because of the breadth and complexity of the issue. Although some of the cash flow models are progressing to the point that data verification procedures can be performed, most have not. While the Department's plans call for the problems to be resolved this fiscal year, much remains to be accomplished. The intensive

commitment by all affected agencies is needed to assure the impact on the financial statements will be eliminated as soon as possible.

Forest Service real property is another very difficult matter that cannot be eliminated by flicking a switch. Considerable resources will be needed to compile data; with the shortcomings already known, a viable model must be derived that can generate reliable data in the absence of much of the underlying support.

One final issue is the Statement of Net Cost, which became a reporting requirement in fiscal year 1998.

Although our audits have been focused elsewhere due to the extent of the Department's problems, we have concerns over the adequacy of the cost accounting system in place to generate reliable costing data. For example, the Forest Service's \$3.5 billion in reported costs included \$1.3 billion that was allocated based upon budgetary estimates, and not actual costs as required.

All that having been said, I would like to say something on behalf of current top financial management in the Department. These people have brought a new philosophy, level of commitment, and focus to this critical function. They have had to deal with financial management weaknesses similar in magnitude to potholes the size of the Grand Canyon. Nonetheless, they are making a bona fide, concerted effort to make financial management viable in the Department. Despite the extraordinary encumbrances, they are making headway and deserve a significant amount of credit for their efforts and accomplishments to date.