

TESTIMONY OF
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before the
House Committee on Government
Reform's Subcommittee on Government
Efficiency, Financial Management and
Intergovernment Relations

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 James Ebbitt, Assistant Inspector General for Audit.

In order for Government managers to administer their responsibilities they must have reliable financial information at their fingertips just as corporate leaders must have. One can readily imagine how long any company could stay in business if it did not know its level of cash, how much it owed or was owed, or what its asset posture was. Yet this is the environment in which USDA has operated. In the absence of shareholders demanding accountability, the deep-seated financial weaknesses in the Department have persisted throughout the years. Financial data do not represent meaningless numbers on some obscure statements examined by only a few. It represents the information needed to direct activities. Accurate and timely financial information serves as the steering mechanism by which programs can be managed in an effective, efficient, and economical manner. Without this capability, the course cannot be navigated; the vessel may be propelled in circles or drift aimlessly.

We issued a disclaimer of opinion on the Department's fiscal year 2000 financial statements. A disclaimer, in this case, means the information needed to conduct the audit was not provided to us so that we could perform sufficient work to determine the reliability of the \$124 billion in assets and other amounts in the USDA financial statements. In addition, the extent of internal control weaknesses in the Department's financial systems and operations means that the amounts presented are highly questionable. Also, the timeliness of the availability of data is as important as the accuracy of the data. Reliable information is needed in "real time" to manage effectively,

not 6 months after the end of the fiscal year. Whereas corporate America closes its books daily, the Forest Service provided us with draft financial statements in November but then continued to modify them until February. Financial information so mercurial is of no utility at all. Similarly, the Commodity Credit Corporation (CCC) was unable to provide us with auditable statements until April 27 of this year. The Comptroller General recently testified before this Subcommittee on this crucial issue – audit opinions are not the “be all and end all;” viable systems which produce timely and reliable financial data are. However, I do need to emphasize that although the past has been bleak, the future is bright, or at least brightening.

The most positive news we have is that the Central Accounting System, or CAS, is in its penultimate year of phase-out. Fiscal year 2001 will still be negatively impacted, however, in that a potentially material percentage of the Department’s administrative payments will yet be processed by 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. CAS does not have an adequate audit trail and so-called reconciliations are not always performed and adjustments are processed extensively, without justification and in error. This system is so inherently flawed that it cooks its own books.

Starting with the next fiscal year, October 1, 2001, the culmination of a strategy launched in 1993 will be achieved with the implementation of a new system. The new system, entitled the Foundation Financial Information System (FFIS) will be operational for all agencies’ administrative payment activities. FFIS establishes a common coding structure, interfaces or

integrates data from other financial and mixed systems, and modernizes or replaces several existing administrative, financial and mixed systems. The implementation of FFIS has not been without problems, however. A critical decision at the outset of the implementation of FFIS has hindered 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.

We have recommended that the “feeder” systems be reassessed and consolidated, integrated, and/or reengineered as appropriate. The Department completed its own study more than a year ago of selected OCFO/NFC feeder systems to identify candidates for consolidation and/or update. This study noted that for the eight OCFO/NFC feeder systems analyzed, five could be eliminated if FFIS functionality was used. The OCFO is working with the business process owners to address the problems with the legacy feeder systems, with the objective to provide an improved integration of the financial management architecture in the Department. Because no final decision has been made, however, the legacy of the legacy systems stays with us.

The task of converting data from CAS to FFIS is critical to the success of FFIS. We have found, however, that data integrity problems with ending CAS balances continue to impact current FFIS financial statements. Material dollar amounts contained in CAS have been identified as potentially invalid by some agencies. For example, we noted where one agency converted its

financial operations to the FFIS effective October 1, 1999. Prior to conversion, the agency performed a massive review to identify activity recorded in CAS that was not supported. This activity was converted to FFIS using “alternate” fund codes. During fiscal year 2000, the agency planned to research this activity and either transfer supported amounts to the correct fund code or adjust erroneous balances, as appropriate. As of September 30, 2000, about \$874 million in unsupported prior year activity (absolute value) remained in these alternate fund codes, and were reported in the agency’s financial statements. As additional agencies convert to FFIS, it is imperative that they clean up the data converted to the alternate fund codes in a timely manner.

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, 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 difference as of September 30, 1999 was about \$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, but the primary problem stems from posting models erroneously recording 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 and FFIS 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. The positive news is that the out-of-balance condition was reduced to about \$550 million at yearend. The Department wrote off about \$160 million with the approval of Treasury and the Office of Management and Budget (the remainder was still being researched).

Antideficiency Act Violations

Two USDA agencies, the Forest Service and CCC, committed Antideficiency Act violations in fiscal year 2000. The Forest Service obligated \$274 million in excess of available funds to fight fires. The violation occurred primarily due to incurring obligations without inputting the data to the system. CCC represented to us that it had disbursed \$50,000 more than had been appropriated for the livestock Indemnity Program. These violations of law are examples of the negative impact the absence of reliable accounting systems and/or operational weaknesses can have.

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 nearly \$97 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 in which 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 estimated impact on future loan performance.

The Department's loan accounting systems were not equipped to provide the extensive detail necessary to fulfill credit reform requirements. 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.

The Department has launched an aggressive corrective action plan to overcome the noncompliance 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. Significant achievements in the area of credit reform include the development of two new cash flow models for Rural Development's non-housing direct loans and guaranteed loans.

Despite the actions already taken by the Department, significant issues remain which require resolution. These include:

- The Department needs to establish a methodology for performing timely reestimates for all of its credit reform programs for budgetary and financial statement reporting.
- The accounting treatment of loans made prior to 1992 must be reviewed using the same systemic process as loans made after 1992.
- The Department has not implemented a process as required by Federal Accounting Standards Advisory Board (FASAB) accounting standards to adjust its estimated loan loss allowances in consideration of future and forecasted economic events, and fully comply with all technical guidance.

In summary, the Department has made significant strides in resolving longstanding credit reform problems. If actions planned are taken in an efficient and effective manner, we believe this problem, which impacts both the Departmental and Governmentwide financial statements, can be corrected.

Commodity Credit Corporation (CCC)

Significant problems continue to be encountered in our audits of CCC. This entity represents an example of a case where the implementation of a new accounting system does not, by itself, result in accurate and timely financial data. CCC instituted a new system called CORE over two years ago. However, since loan subsidy systems and credit reform financing systems have still not been fully automated and integrated to CORE, numerous manual interventions are necessary and these have proven to be fraught with error. Numerous sizeable adjustments have been needed long after the fiscal yearend. Although by law, audited financial statements are due by March 1 of each year, we received CCC's statements so late and they were in such poor shape, that we still cannot issue the audit report. The Department has made progress in several areas, but CCC is not one of them.

Cost Accounting

One of the required financial statements is the Statement of Net Cost. The purpose of the statement is self-explanatory – to provide users with the full cost of Federal programs. One of the fundamental accounting tenets, as promulgated by the Federal Accounting Standards Advisory Board, mandates cost accounting. USDA, however, has no cost accounting system and, due to other priorities, has no plans to institute one. This will directly impact upon the reliability of the Statement of Net Cost and thus the audit opinion.

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, 2000, the Forest Service reported about \$4.7 billion in real property assets. About 55 percent of this dollar value, or \$2.6 billion, is attributable to what is referred to as "pooled assets" – primarily roads. The remainder represents individual assets such as buildings. An extraordinary breakthrough occurred in this area in fiscal year 2000; for the first time, the agency was able to reasonably estimate the value of its pooled assets. Due to the absence of historical cost data, a strategy was needed to estimate costs. Forest Service and OIG partnered to develop such a strategy. The Forest Service compiled the inventory data and the best cost information available, and then computed a reasonable balance. A significant problem persists, however, in the valuation of the individual real property assets. Audit tests disclosed that the values of about 24 percent of the assets examined were overstated, 5 percent were understated, and 7 percent did not have adequate documentation to support any valuation. The cumulative error rates were too high to allow us to project the total variances, but, nonetheless, we were unable to obtain assurance of the balance of the line item as presented on the statements.

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.

Second, we must address the issue of cash. Significant progress has been made to reduce the unreconciled items but, as noted, new variances continue to occur. Due to the sensitivity of this account, the materiality level that could result in 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, although it is being addressed.

Third, credit reform remains an obstacle to an improved audit opinion because of the breadth and complexity of the issue. Although some of the cash flow models have progressed to the point where data verification procedures can be performed, others have not. While the Department's plans call for the problems to be resolved by the next fiscal year, much remains to be accomplished. An intensive commitment from all affected agencies is needed to assure the impact on the financial statements will be eliminated as soon as possible.

Fourth, Forest Service real property is another very difficult matter. Considerable resources will be needed to compile valuation data, and controls must be put in place to verify that the amounts are supportable.

Lastly, the Forest Service and CCC must strengthen their financial processes to ensure they are capable of producing timely and reliable data.

Despite the extraordinary encumbrances, the Department is making headway and deserves a significant amount of credit for its efforts and accomplishments to date.