DEPARTMENT OF THE TREASURY
WASHINGTON

January 30, 2002

INSPECTOR GENERAL

MEMORANDUM FOR SECRETARY O'NEILL

FROM: Jeffrey Rush, Jr.
Inspector General

SUBJECT: Management and Performance Challenges Facing the Department of the Treasury

The Reports Consolidation Act of 2000 requires that we provide you with our perspective on the most serious management and performance challenges currently facing the Department of the Treasury for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2001*. Last year, we identified nine challenges that were either management and performance related or mission specific. A copy of last year's report is attached. Some progress was made, but more remains to be done.

This year, in light of the President's Management Agenda, we have shifted our assessment away from mission specific areas. We have identified the serious challenges that are currently impeding the Department's ability to carryout its program responsibilities and ensure the integrity of its operations. We also considered the terrorist attacks of September 11, which have served to underscore the need to improve the management and security of Treasury assets that contribute to homeland security. In this regard, we believe there are five overarching challenges requiring management's increased attention:

Challenge 1 - Prompt Corrective Action

Treasury management has not been willing to promptly correct material weaknesses and other serious deficiencies in programs and operations. Although the number of material weaknesses has been reduced in the past few years, one material weakness was first reported in 1991 and remains uncorrected. Thirteen other material weaknesses reported in the 1990's remain uncorrected. Audit resolution must become a priority for Department managers.

Challenge 2 - Linking Resources to Results

Treasury management has not integrated managerial cost accounting into its business activities. Thus, Treasury managers are unable to link resources to results. Treasury managers often report their accomplishments relying on antidetal performance evidence and out-of-date financial information.

Challenge 3 - Financial Management Systems

Treasury management continues to operate financial management systems that are not capable of producing timely, accurate, and reliable information. Treasury has been working to produce more timely reports with its "3-day close" initiative. Most bureaus have reduced the number of days to report their monthly result; however, the data is generally inaccurate and unreliable because management has not developed appropriate estimation processes and has not developed a framework to review the data and analyze variances.

Challenge 4 - Information Security

Treasury management has not corrected long-standing information security problems and vulnerabilities. Although the Computer Security Act of 1987 required agencies to protect information technology assets, several bureaus are still in the process of developing information system security plans. Our recent review disclosed that 82 percent of the Department's information systems are not accredited, and have been allowed to operate without a reasonable assurance of secure operations or adequate safeguards.

Challenge 5 - Duplicated, Wasteful Practices

Treasury management has not adapted enterprise solutions to its core business activities. Thus, rather than realize the economy, efficiency, and effectiveness of consolidation and sharing, Treasury bureaus and offices operate as autonomous agencies. Treasury management should consider the cost of bureau-wide personnel, payroll, travel, and procurement activities and look for opportunities to eliminate duplicative systems and business processes.

We would be pleased to discuss our views on these management and performance challenges in more detail.

Attachment

cc: Ed Kingman, Consultant

DEPARTMENT OF THE TREASURY
WASHINGTON

INSPECTOR GENERAL

February 28, 2001

MEMORANDUM FOR SECRETARY O'NEILL

FROM: Jeffrey Rush, Jr.
Inspector General

SUBJECT: Management and Performance Challenges Facing the Department of the Treasury

SUMMARY

The Reports Consolidation Act of 2000 requires that we provide you with our perspective on the most serious management and performance challenges currently facing the Department of the Treasury for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2000*. This new legislation codified into law what had become, since 1997, an annual request of my office from the Senate and House leadership for similar information.

In our December 2000 response to the Congress, we identified nine serious challenges. The following eight challenges were identified in our prior year response: (1) Information Security, (2) Treasury's Information Technology Investment Management, (3) Money Laundering/Bank Secrecy, (4) Narcotics Interdiction and Trade Enforcement, (5) Revenue Protection, (6) Violent Crime, (7) Implementation of the Government Performance and Results Act, and (8) Financial Management at Treasury/Compliance with the Federal Financial Management Improvement Act. While Treasury has made substantial progress to address these challenges, we were not able to remove any from our December 2000 list because each continues to present a serious risk. In addition, we identified the following new challenge for 2000: Safety and Soundness of the Banking Industry.

It should be noted that Treasury made sufficient progress in addressing certain other previously reported serious challenges to warrant their removal from our list. These challenges include (1) Year 2000 compliance, (2) Treasury's debt collection initiatives, and (3) Electronic Funds Transfer/ Electronic Benefits Transfer.

The Treasury Inspector General for Tax Administration will separately address challenges related to the Internal Revenue Service (IRS).

DISCUSSION

Our reasons for identifying these nine challenges as the most serious facing Treasury are as follows:

1. Information Security

Protecting information and data from unauthorized access is critical to ensure, among other things, the integrity of Treasury's law enforcement and financial operations. Information technology (IT) enables Treasury to achieve its business goals but creates a number of internal control challenges. As information becomes more accessible through electronic means, threats to security increase. This has given rise to various initiatives to improve the Government's infrastructure.

Treasury has achieved some of its security goals such as establishing an Information System Architecture Framework and Public Key Infrastructure draft standards. However, more needs to be done.

Our audits have found significant, long-standing weaknesses in the U.S. Customs Service's (Customs) ability to maintain continuity of operations as well as overall security and access control. As a result, we issued a "7-Day" letter to the Secretary of the Treasury on May 26, 2000, who in turn notified Congress as required by the Inspector General Act. In that letter, we recommended that Customs take immediate steps to develop an alternative site for continuity of operations and install firewall and detection software to reduce the risk of unauthorized Internet access. Our audits have also identified Electronic Data Processing general control weaknesses at other Treasury bureaus, most notably the Financial Management Service (FMS). We also found that Treasury needed to devote additional resources to its implementation of Presidential Decision Directive (PDD) 63 which requires the development of a reliable, interconnected, and secure information system infrastructure. Treasury's efforts to implement PDD 63 have revealed the lack of resources being devoted to the effort. Furthermore, we noted the need for Treasury to identify and prioritize its critical assets.

2. Treasury's Information Technology Investment Management

The Clinger Cohen Act of 1996 (CCA) sets the groundwork for effective management of IT investments. With nearly $2 billion annually invested in IT by Treasury, CCA requires improved capital planning, investment controls, project management, systems development, and performance measurement. Treasury's weaknesses in effectively managing major IT investments have been well documented over the past several years for such systems as the IRS Tax System Modernization and the Customs Automated Commercial Environment (ACE) initiative. We recently issued a report detailing Treasury's implementation of CCA. In that report, we noted that the Treasury Investment Review Board (IRB) and Departmental practices needed improvement if they were to be able to provide executive direction and effective management over IT investments. Treasury implemented some CCA requirements and a number of our recommendations. Two examples of this are the restructuring of the IRB and expanded IRB oversight of 14 capital investment projects.

3. Money Laundering/Bank Secrecy

It is estimated that criminals launder hundreds of billions of dollars globally each year. It was recently reported that Citibank, the nations largest bank, failed to follow Federal guidelines to prevent money laundering and allowed as much as $800 million in suspicious Russian funds to flow through 136 accounts. In an audit we performed on the Office of the Comptroller of the Currency's (OCC) Bank Secrecy Act (BSA) examinations, we identified the need for OCC to strengthen examination procedures in several areas. We found that OCC examiners did not always perform complete BSA examinations including (1) following up on indicators of suspicious activity and (2) performing sufficient reviews of high-risk accounts. OCC agreed to take a number of actions, which should improve BSA examinations. Our work on Customs' strategic money laundering initiatives has revealed opportunities for expanding its intelligence capabilities. In response to another recent audit, Customs' Report of Transportation of Currency or Monetary Instruments was revised to require the reporting of additional types of monetary instruments.

4. Narcotics Interdiction and Trade Enforcement

Despite years of concerted Federal effort, drug smuggling continues unabated. As an indicator of the magnitude of the illicit drug trade and challenges faced by Customs to stop it, the Office of National Drug Control Policy reported that over 1,120 tons of cocaine entered the United States during Fiscal Year (FY) 1999. For the same period, Customs reported that it had seized 172 tons of cocaine. Our prior audits have disclosed that Customs needs better narcotics examination criteria, better targeting systems, and more consistency in the performance and reporting of narcotics examinations.

In FY 2001, Customs expects to process 25 million entry summaries valued at $1.3 trillion, 503 million persons, and 149 million conveyances. However, the automated system Customs uses to process merchandise is outdated and unable to keep up with trade demands. The system also has significant control weaknesses. Customs recognizes that its ability to process the growing volume of imports, while improving compliance with trade laws, depends heavily on its modernization of the trade compliance process and supporting automated systems. The success of this effort is contingent on how well and how soon Customs is able to implement ACE.

5. Revenue Protection

Based on our work, we believe that stronger internal controls and system improvements would increase revenues collected by Customs and the Bureau of Alcohol, Tobacco and Firearms (ATF). For example, Customs recognizes its revenue collection rate is less than 100 percent and reported a revenue gap (the estimated net amount owed the government for non-compliant consumption entries) of $252 million for FY 1999. We believe Customs could significantly reduce uncollected revenue through its planned large-scale systems improvements discussed previously. Our recent audits of ATF have also identified control weaknesses over the tax-free status of tobacco and spirits exports.

6. Violent Crime

Despite a decline in the overall crime rate, violent crime remains a serious problem in the United States and remains the nation's number one public safety concern. Our recent audits of a major ATF program aimed at reducing violent crime, the Youth Crime Gun Interdiction Initiative (YCGII), found a number of opportunities for improvement. YCGII has the primary goals of tracing every recovered crime gun in participating cities through ATF's National Tracing Center and analyzing the resulting crime gun information to determine the community-wide patterns relating to recovered firearms. We found that ATF needed to do a better job of implementing the YCGII program and accounting for resources. Also, ATF needed to develop performance indicators that better measure YCGII's impact on reducing violent crime committed by youth. ATF agreed with our audit recommendations and is taking corrective actions.

7. Implementation of the Government Performance and Results Act

Integrating the Government Performance and Results Act's (GPRA) reporting requirements with traditional budget formulation and execution activities and the financial reporting requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994 continues to serve as a worthwhile challenge for all Federal government agencies, including Treasury. Critical to this challenge are the collection, integration, and management of reliable performance data. To validate Treasury's data, we recently audited the accuracy and reliability of certain key performance measures. Through these audits we identified data errors and made recommendations for improving data reliability. While Treasury has improved the quality of the data stored in its automated and manual systems, we anticipate continued difficulty in the collection and management of reliable performance data.

Additionally, improved managerial cost accounting is necessary for the Department to effectively report and evaluate program performance. Accurate cost information is needed to identify the full costs of programs, activities, and outputs. The linkage of costs with performance measures is essential for informative reporting and meaningful cost/benefit analysis. The Department has initiated actions to improve managerial cost accounting; however, at most bureaus these efforts are still in the early stages.

Treasury has improved its strategic planning process and reassessed its strategic goals this past year. As a result of our assessment of Treasury's FY 1999 Performance Report and FY 2001 Performance Plan, Treasury modified the way it tracks performance goals and measures.

8. Financial Management at Treasury/Compliance with the Federal Financial Management Improvement Act

Treasury continues to face significant challenges to meet the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). FFMIA requires Federal agencies to implement and maintain financial management systems that comply substantially with Federal Financial Management System Requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. As reported in connection with our audit of Treasury's FY 2000 financial statements, Treasury is not in substantial compliance with the requirements of FFMIA.

Treasury, as well as individual component entities that were audited, received unqualified opinions on their FY 2000 financial statements. This is a notable accomplishment, however in certain cases it was achieved only through extensive efforts after year-end to overcome material weaknesses in internal controls to develop auditable financial information. Also, financial systems were not adequately integrated to support fiscal management of program delivery as well as budget execution functions and internal and external financial reporting requirements. These conditions precluded Treasury and a number of its bureaus the ability to generate timely and accurate information for routine operating and decision-making purposes, as well as for annual financial reporting.

9. Safety and Soundness of the Banking Industry

Clearly, a safe and sound banking system is a pre-condition for stability within our financial system. Through OCC and the Office of Thrift Supervision (OTS), Treasury regulates and supervises banks and thrifts with combined assets of over $4.2 trillion that account for over 58 percent of total industry assets. In addition, OCC-regulated national banks account for approximately $14.4 trillion of the off-balance-sheet assets, also known as financial derivatives. For nearly a decade the banking industry has experienced record profits, and bank failures continue to be minimal with less than 10 per year since 1995. However, recent signs of a slowing economy have become more evident given higher commodity prices and the spike in corporate bankruptcies. For the second quarter of Calendar Year 2000, the banking industry's earnings not only declined but also were the lowest since 1997.

Aside from fundamental economic factors, added regulatory and supervisory challenges arise out of the recently enacted Gramm-Leach-Bliley Financial Services Modernization Act (GLBA). This legislation lifted decade old restrictions on affiliations among banks, securities firms, and insurance companies. With it, additional supervisory challenges may also arise in other areas such as money laundering, the Community Reinvestment Act, financial privacy, predatory lending, and the expanded sharing of regulatory responsibility under the new law's functional regulation provisions. For example, we recently reported that the business of banking is evolving to include selling insurance, and this activity is expected to expand with the passage of GLBA. While insurance activities have traditionally been under the functional regulation of states, we believe that OCC needs to determine the reliance it can place on state supervision, and better define its supervisory role over national bank insurance activities.

Should you or your staff have questions, you may contact me at (202) 622-1090, or a member of your staff may contact Dennis Schindel, Assistant Inspector General for Audit, at (202) 927-5400.