



OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 24, 2007

INFORMATION MEMORANDUM FOR SECRETARY PAULSON

FROM:

Dennis S. Schindel
Acting Inspector General

SUBJECT:

Management and Performance Challenges Facing the
Department of the Treasury (OIG-CA-08-005)

The Reports Consolidation Act of 2000 requires that we provide you with our perspective on the most serious management and performance challenges facing the Department of the Treasury, for inclusion in the Department's annual performance and accountability report. We believe it is important to note that management and performance challenges do not necessarily represent a deficiency in management or performance. Instead, most of them represent inherent risks associated with Treasury's mission, organizational structure, or the environment in which it operates. As a result, the Department can take steps to mitigate these challenges but not entirely eliminate them; as such, they require constant management attention.

This year, we continue to report the same five challenges we reported last year: (1) Corporate Management, (2) Management of Capital Investments, (3) Information Security, (4) Linking Resources to Results, and (5) Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement. In addition to these five management and performance challenges, we want to bring to your attention two additional areas that are of increasing concern to our office. These areas are: the potential impact of worsening real estate and credit markets on Treasury's regulators, and the effect of stagnant or reduced budgets on the Department's control environment. While we have not specifically declared these areas as management and performance challenges, we continue to monitor their impact on the Department's programs and operations.

Challenge 1 – Corporate Management

Starting in 2004, we identified corporate management as an overarching management challenge. In short, Treasury needs to provide effective corporate leadership in order to improve performance as a whole. Inherent in this is the need for clear lines of accountability between corporate, bureau, and program office management; enterprise solutions for core business activities; consistent application of accounting principles; and effective oversight of capital investments and information security. With nine bureaus and a number of program offices, Treasury is a highly decentralized organization. We believe the Department has made progress in building up a sustainable corporate control structure. The challenge now is

to maintain emphasis on corporate governance and institutionalize these efforts to ensure that capital investments are properly managed, information about government operations and citizens is adequately secured, and financial resources used by Treasury can be linked to operational results. These matters are discussed in more detail in the following challenges.

Challenge 2 – Management of Capital Investments

Managing large capital investments, particularly information technology (IT) investments, is a difficult challenge facing any organization whether in the public or private sector. In prior years we have reported on a number of capital investment projects that either failed or had serious problems. In light of this, with hundreds of millions of procurement dollars at risk, Treasury needs to be vigilant in this area as it proceeds with its telecommunications transition to TNet, implementation of Homeland Security Presidential Directive – 12, *Policy for a Common Identification Standard for Federal Employees and Contractor*, the anticipated renovation of the Treasury Annex, and other large capital investments.

During the last year, the Secretary and Deputy Secretary continued to emphasize that effective management of major IT investments is the responsibility of all Treasury executives. Additionally, the Department significantly increased the number of IT investments that are monitored through the Office of Management and Budget (OMB) quarterly high-risk reporting process. The Department also plans to reinstitute a governance board consisting of senior management officials to provide executive decision-making on, and oversight of, IT investment planning and management and to ensure compliance with the related statutory and regulatory requirements.

Challenge 3 – Information Security

Despite notable accomplishments, the Department needs to improve its information security program and practices to achieve compliance with the Federal Information Security Management Act of 2002 (FISMA) and OMB requirements. Our 2007 FISMA evaluation found that the Department made progress in addressing previously reported deficiencies in the areas of certification and accreditation, information security training, plans of actions and milestones, system inventory, and incident response. However, our evaluation disclosed a significant deficiency in configuration management. Specifically, we noted that Treasury did not have adequate configuration management to provide the security necessary to protect against common and dangerous threats.

During 2006, OMB issued Memorandum 06-16, *Protection of Sensitive Agency Information* (M-06-16), requiring agencies to perform specific actions to protect certain personally identifiable information. Last year, we reported that our evaluation of Treasury's compliance with M-06-16 disclosed that Treasury still faced significant challenges to meet these requirements. We will be performing follow-up work to determine if Treasury has progressed in resolving these issues. However, as a significant action, the Department recently established the Personally Identifiable Information Risk Management Group

(PIIRMG) consisting of senior management officials. The purpose of this group is to help manage and contain breaches of personally identifiable information. Our office, along with the Treasury Inspector General for Tax Administration, participates in the PIIRMG in an advisory role.

Challenge 4 – Linking Resources to Results

Because the Department has not fully developed and incorporated managerial cost accounting (MCA) into its business activities, the Department cannot adequately link financial resources to operating results. This inhibits comprehensive program performance reporting and meaningful cost benefit analyses of the Department's programs and operations.

We have noted progress in this area, but more needs to be accomplished to implement an effective MCA program Treasury-wide. In 2006, we reported that the Department developed a high-level MCA implementation plan, but specific action items were not completed and certain target dates were missed. This year, Treasury established a Chief Financial Officer (CFO) Council workgroup to address MCA requirements. This workgroup is comprised of representatives from all of the Treasury offices and bureaus and is led by the Deputy CFO. We are also participating with the workgroup in an advisory capacity. The workgroup (1) developed a charter that was approved by the Treasury CFO Council, (2) surveyed current bureau MCA practices, (3) summarized bureau cost allocation methodologies for major expenses, and (4) defined organizational MCA needs. The Department expects to have a viable MCA program in place in Fiscal Year 2008. At that time, we plan to assess Treasury's progress in relation to this challenge.

Challenge 5 – Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement

Treasury faces unique challenges in carrying out its responsibilities under the Bank Secrecy Act (BSA) and USA Patriot Act to prevent and detect money laundering and terrorist financing. While the Financial Crimes Enforcement Network (FinCEN) is the Treasury bureau responsible for administering BSA, a large number of federal and State entities participate in efforts to ensure compliance with BSA. These entities include the five federal banking regulators, the Internal Revenue Service (IRS), the Securities and Exchange Commission, the Department of Justice, and state regulators. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by Treasury's Office of Foreign Assets Control (OFAC).

The dynamics and challenges for Treasury of coordinating the efforts of multiple entities, many external to Treasury, are difficult. In this regard, FinCEN and OFAC have entered into memoranda of understanding (MOU) with many federal and State regulators in an attempt to build a consistent and effective process. Long-term data, however, is not yet available to make an overall determination of the effectiveness of the MOUs.

Recently, federal regulators and the Department of Justice have participated with FinCEN in assessing fines, often in the tens of millions of dollars, against financial institutions which have not been maintaining effective BSA compliance programs. While this is a sign that regulators are more willing to aggressively enforce BSA requirements, it is also a sign that not all financial institutions, despite years of warnings, have implemented effective or adequate programs. At the same time, the financial services industry has often complained about regulatory burden. To this end, Treasury has taken steps to clarify program and reporting requirements, and must continually monitor and balance the needs of law enforcement with these concerns.

In Fiscal Year 2006, the number of BSA reports filed increased to 17.6 million, from 15.6 million in Fiscal Year 2005. Although these reports are critical to law enforcement, past audits have shown that many contain incomplete or erroneous data. Also, the Patriot Act increased the types of financial institutions required to file these reports. The regulation of certain industries, such as casinos, insurance companies, jewelers, and money service businesses, is the responsibility of IRS as a default regulator. IRS has often struggled to conduct examinations of many of these entities and recently postponed examinations of jewelers, which were supposed to start in January 2006, until at least Fiscal Year 2008.

Given the criticality of this management challenge to the Department's mission, we will continue to devote a significant portion of our audit resources to this challenge. Last year we reported that we planned to review the effectiveness of (1) FinCEN's Office of Compliance, and (2) the MOUs that have been established. Due to resource constraints and other required work, we have yet to initiate these reviews but hope to do so during Fiscal Year 2008.

In addition to these five management challenges, we want to bring to your attention two areas that are of increasing concern. As mentioned at the beginning of this memorandum, while we have not declared these areas as management challenges, we continue to monitor their impact on the Department's programs and operations.

- Recently, conditions in the real estate market have worsened. At the same time, credit markets are being impacted by problems associated with subprime loans. Together, these events are putting pressure on financial institutions, including those supervised by the Office of the Comptroller of the Currency and the Office of Thrift Supervision (OTS). For example, in September the OTS-supervised NetBank failed, representing the largest financial institution failure since 2001. Accordingly, Treasury needs to ensure it has the capability to monitor and take prompt action to address potential problems at other institutions should economic conditions worsen.
- Many Federal agencies, including Treasury, are facing an increasingly difficult budget environment. In these situations agencies tend to rely on attrition and hiring freezes to address budget shortfalls. While in the short term this strategy may work, longer term it often leads to a less than optimal mix of positions and skills, ultimately impacting an agency's ability to meet its mission for many years. Additionally, agencies tend to cut

Page 5

certain operations that are viewed as non-mission related, particularly those involved in review and monitoring functions, including contractor oversight – fundamental elements of a strong control environment. Over time, such actions could lead to the deterioration of the control environment and compromise both the effectiveness and integrity of programs and operations.

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

cc: Peter B. McCarthy, Assistant Secretary for Management
and Chief Financial Officer