

GAO

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Financial Management and Intergovernmental Relations,
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FINANCIAL MANAGEMENT

Extending the Financial Statements Audit Requirement of the CFO Act to Additional Federal Agencies

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to assist the Subcommittee in its consideration of H.R. 4685, a bill to amend title 31 of the United States Code to expand the number of federal agencies that are required to prepare audited financial statements. As currently proposed, the Chief Financial Officers (CFO) Act audit requirement¹ would be expanded to executive branch agencies that have budget authority of \$25 million or more and are not already required to have financial statements audits.² Agencies subject to CFO Act audit requirements are also subject to the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).³ FFMIA builds on the CFO Act by emphasizing the need for agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions on an ongoing basis.

Our remarks today are based on work we did at the request of Representative Patrick J. Toomey, who has introduced H.R. 4685, on the views of 26 surveyed executive branch agencies not covered by the CFO Act on having audited financial statements⁴ and on our past and ongoing audit work at various CFO Act agencies.

We agree with the thrust of the proposed amendment in H.R. 4685 to expand the number of federal agencies that are required to prepare audited financial statements. Our longstanding position has been that the preparation and audit of financial statements increase accountability and transparency and are an important tool in the development of reliable, timely, and useful financial information for day-to-day management and oversight. Preparing audited financial statements also leads to improvements in internal control and financial management systems. The views expressed by the 26 selected agencies in our survey are generally

¹The CFO Act of 1990, as expanded by the Government Management Reform Act of 1994, requires 24 major executive branch departments and agencies to prepare annual financial statements and have them audited (31 U.S.C. 3515).

²The requirement would not apply to executive agencies already required by statute to have audited financial statements or to corporations, agencies, or instrumentalities subject to chapter 91 of title 31 of the United States Code.

³31 U.S.C. 3512 note (2000).

⁴U.S. General Accounting Office, *Survey Results of Selected Non-CFO Act Agencies' Views on Having Audited Financial Statements*, [GAO-02-281R](#) (Washington, D.C.: Dec. 14, 2001).

consistent with our views on the bill and generally support the position that agencies should have audited financial statements. For the existing CFO Act agencies, the preparation and audit of financial statements have been the primary catalyst for increasing the reliability of financial data, improving financial operations, and enhancing accountability.

Summary of Survey Results

The 26 non-CFO Act agencies we surveyed are generally independent agencies that have commissions or boards appointed by the President.⁵ The objectives of the survey were to determine the

- benefits achieved or anticipated by the surveyed agencies from preparing financial statements and having them audited;
- degree of effort or anticipated effort for the surveyed agencies to prepare financial statements and have them audited;
- factors, including budget authority, that should be considered in determining whether agencies should prepare financial statements and have them audited; and
- surveyed agencies' views about whether, in general, agencies should have their financial statements audited.

As shown in table 1, 12 of the 26 surveyed agencies have had financial statements audits within the past 5 years, and 14 have not. (See app. I for information about the 26 surveyed agencies, including baseline and financial information.)

⁵We selected the 26 agencies by identifying 28 executive branch entities that (1) were not subject to the CFO Act, as amended, (2) had budget authority for fiscal year 1999 of at least \$10 million, and (3) with one exception, were not required by law to have their financial statements audited. As agreed with the study's requester, we did not include two of the entities—the Central Intelligence Agency Retirement Fund and the Executive Office of the President—in the scope of our survey, leaving 26 agencies for our survey.

Table 1: Surveyed Agencies

Have had financial statements audits	Have not had financial statements audits
Defense Nuclear Facilities Safety Board ^a	Commodity Futures Trading Commission
Farm Credit System Insurance Corporation	Consumer Product Safety Commission
Federal Communications Commission	Equal Employment Opportunity Commission ^d
Federal Housing Finance Board	Federal Election Commission
Federal Mediation and Conciliation Service	Federal Labor Relations Authority
Federal Trade Commission	Institute of Museum and Library Services
International Trade Commission ^b	Merit Systems Protection Board
Office of Navajo and Hopi Indian Relocation	National Archives and Records Administration ^e
Railroad Retirement Board	National Endowment for the Arts
U.S. Court of Appeals for Veterans Claims ^c	National Endowment for the Humanities
U.S. Holocaust Memorial Museum	National Labor Relations Board
U.S. Institute of Peace	National Transportation Safety Board ^d
	Securities and Exchange Commission
	Selective Service System

^aThe Defense Nuclear Facilities Safety Board has balance-sheet-only audits every 3 to 5 years, most recently for fiscal year 1997. It did not prepare fiscal year 2000 financial statements.

^bThe International Trade Commission discontinued audits of its financial statements, effective for fiscal year 1999. It did not prepare fiscal year 2000 financial statements.

^cThe U.S. Court of Appeals for Veterans Claims' first audit was of its fiscal year 2000 financial statements.

^dThe Equal Employment Opportunity Commission and the National Transportation Safety Board have indicated that they plan to have financial statements audits within the next 5 years.

^eThe National Archives and Records Administration has annual financial statements audits of three trust and revolving funds.

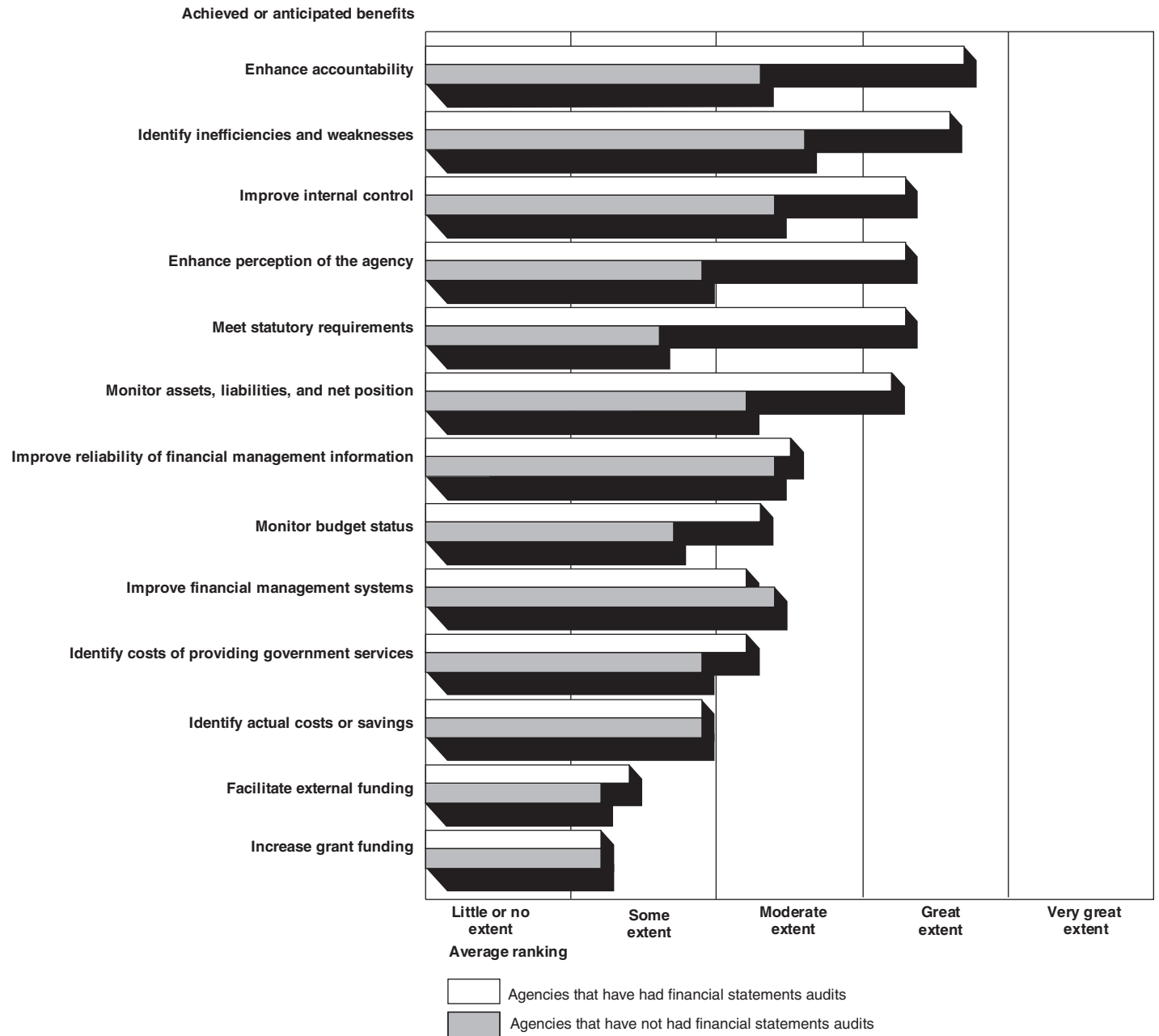
Overall, the surveyed agencies reported that they either achieved significant benefits or would anticipate achieving such benefits from having audited financial statements. The level of effort to prepare financial statements and prepare for an audit of the statements varied significantly with the size and other characteristics of the agencies. In determining whether agencies should prepare financial statements and have them audited, respondents identified a number of factors that should be considered, including budget authority, key financial statement amounts, and the type of agency operations. For example, the surveyed agencies reported that the fiduciary responsibilities of the agency and the risks associated with the agency's operations were the most important factors to

consider. Twenty-one of the 26 surveyed agencies responded that federal agencies, in general, should have audited financial statements.

Achieved or Anticipated Benefits of Having Audited Financial Statements

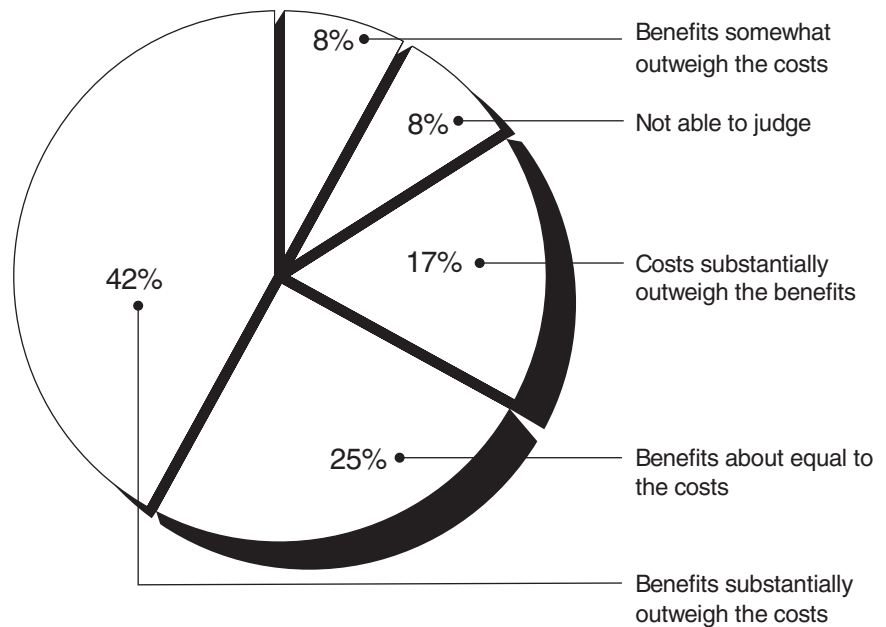
The 12 surveyed agencies that have had their financial statements audited generally reported significant benefits from those audits. As shown in figure 1, the most significant benefits cited were enhancing accountability and identifying inefficiencies and weaknesses. Other significant benefits included improving internal control, enhancing the public's perception of the agency, meeting statutory requirements, and monitoring assets and liabilities. The 14 surveyed agencies that have not had audited financial statements reported that they would anticipate benefits from such audits, but to a much lesser extent than the achieved benefits reported by the 12 surveyed agencies that have had their financial statements audited.

Figure 1: Average Ranking by Surveyed Agencies of Extent of Benefits Achieved or Anticipated from Financial Statements Audits



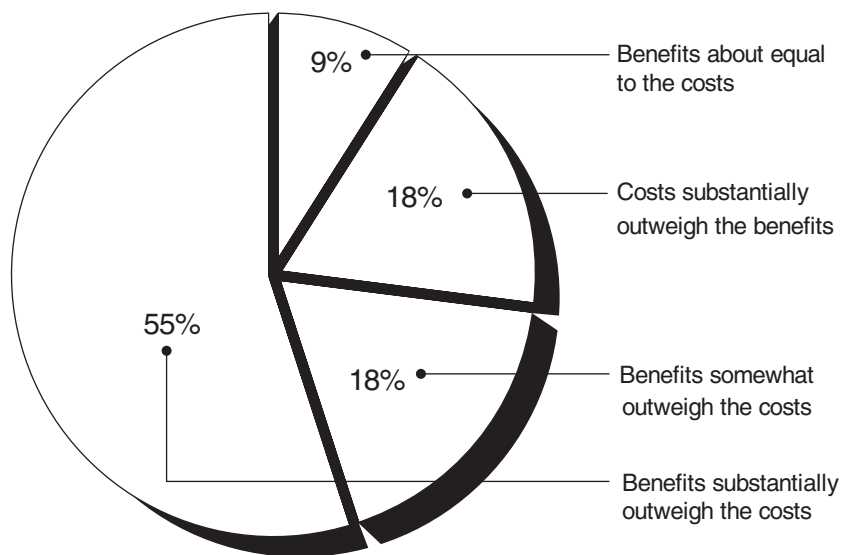
We asked the 12 audited agencies whether the benefits of their first audit and subsequent audits outweighed the costs and whether their audits were more or less beneficial than expected. As shown in figures 2 and 3, half of the 12 agencies responded that the benefits achieved outweighed the costs of the first audit, and about three-fourths of the agencies responded that the benefits achieved outweighed the costs of subsequent audits.

Figure 2: Benefits Achieved Versus Costs for First Audit for Surveyed Agencies That Have Had Financial Statements Audits



Note: None of the surveyed agencies that have had financial statements audits responded that the costs somewhat outweigh the benefits.

Figure 3: Benefits Achieved Versus Costs for Subsequent Audits for Surveyed Agencies That Have Had Financial Statements Audits



Note: None of the surveyed agencies that have had financial statements audits responded that the costs somewhat outweigh the benefits or that they were not able to judge. One of these 12 surveyed agencies is not included in this chart because fiscal year 2000 was the agency's first financial statements audit.

Ten of the 12 agencies (83 percent) responded that their audits were more beneficial than or about as beneficial as they had expected.

Degree of Effort or Anticipated Effort to Prepare Financial Statements and Have Them Audited

For the 12 surveyed agencies that have had their financial statements audited, the reported level of effort to prepare financial statements and to prepare for an audit varied significantly with the size and other characteristics of the agencies. For example, the reported number of staff days to prepare for the first audit ranged from 50 to 750 days, and, as shown in table 2, the estimated fiscal year 2000 audit costs ranged from \$11,000 to \$350,000.

Table 2: Reported Audit and Related Costs for Surveyed Agencies That Had Fiscal Year 2000 Financial Statements Audits

Range of budget authority ^a	Number of agencies that had fiscal year 2000 financial statements audits ^b	Estimated costs of financial statements audits performed by contractor or Office of Inspector General			Other estimated costs related to financial statements audits		
		Low	High	Average	Low	High	Average
Less than \$25 million	4	\$11,000	\$54,512	\$29,525	\$0	\$9,300	\$2,325
\$25 million to \$150 million	4	\$26,000	\$100,000	\$54,000	\$0	\$15,000	\$5,750
Greater than \$6 billion	2	\$220,000	\$350,000 ^c	\$285,000	\$2,000	\$1,218,000 ^c	\$610,000

^aBudget authority data were obtained from the Fiscal Year 2002 President's Budget. None of the surveyed agencies that have had financial statements audits had fiscal year 2000 budget authority between \$150 million and \$6 billion.

^bTwo of the 12 surveyed agencies that have had financial statements audits, the International Trade Commission and the Defense Nuclear Facilities Safety Board, did not have financial statements audits for fiscal year 2000.

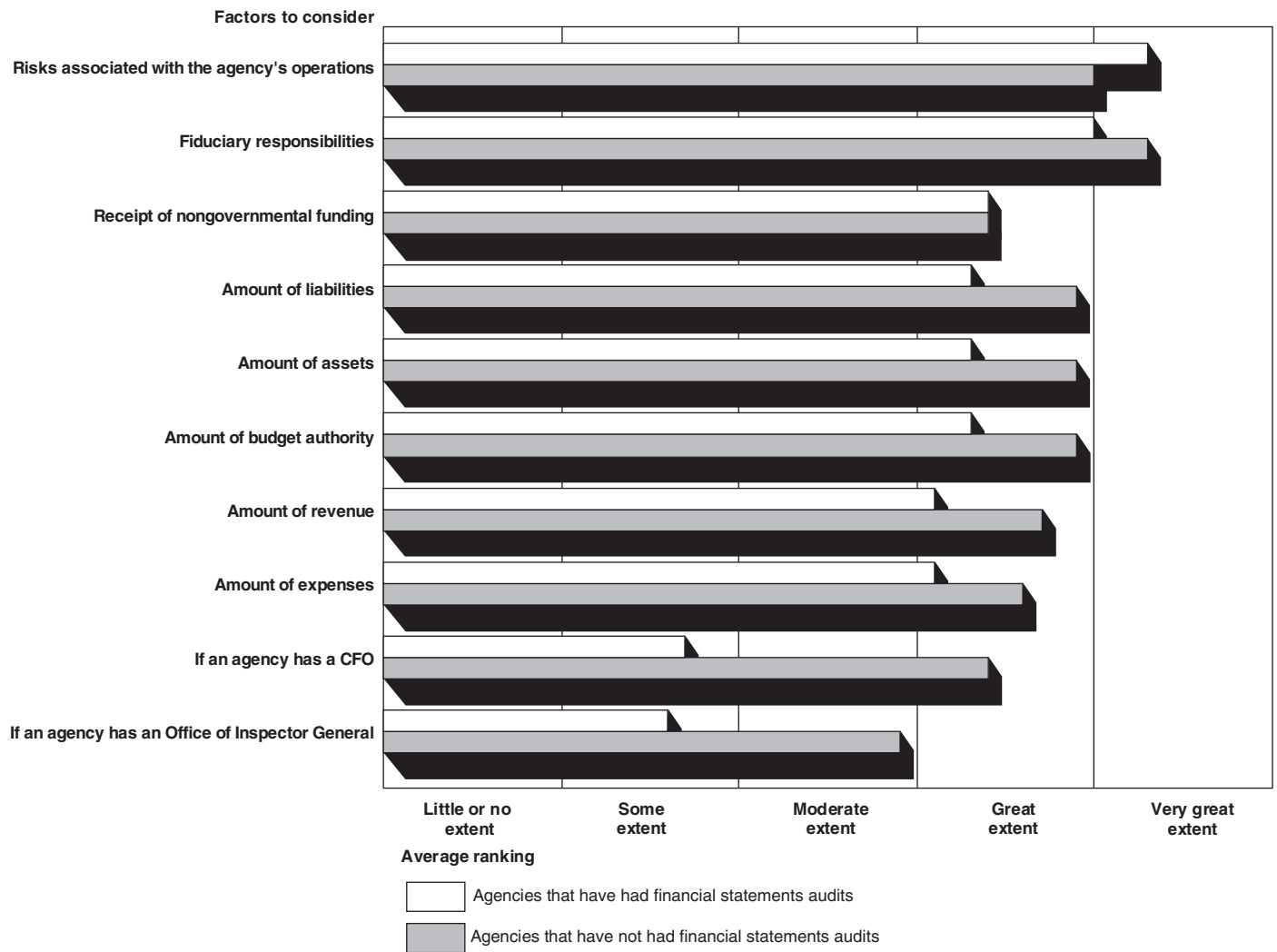
^cThe surveyed agency that reported financial statements audit costs of \$350,000 also reported related costs of \$1,218,000 for consultants to assist the agency in preparing for the financial statements audit.

Frequently reported steps that these agencies had taken to prepare for their first and subsequent audits are (1) improving or replacing financial management systems, (2) hiring additional financial management personnel, (3) training financial management personnel, and (4) performing significant manual procedures (for first audits).

Factors to Consider in Determining Whether Agencies Should Have Financial Statements Audits

As figure 4 shows, the 26 surveyed agencies responded that the most important factors that should be considered in determining whether agencies should have audited financial statements are (1) whether the agency has fiduciary responsibilities and (2) risks associated with the agency's operations. The surveyed agencies said that the amounts of an agency's assets and liabilities are of equal importance to the amount of budget authority an agency has. Other important factors include whether the agency receives nongovernmental funding and the amounts of an agency's revenues and expenses.

Figure 4: Ranking of Importance by Surveyed Agencies of Factors to Consider in Determining Need for Financial Statements Audits



Of the 14 surveyed agencies that have not had their financial statements audited, 13 reported that the absence of a statutory requirement to do so was a reason they have not had such audits. Other reasons cited by 6 of the 14 agencies include an insufficient number of financial management personnel and insufficient funding.

Surveyed Agencies' General Views about Whether Agencies Should Have Financial Statements Audits

Twenty-one of the 26 surveyed agencies, including all 12 that have had their financial statements audited, reported that, in general, agencies should have their financial statements audited. The remaining 5 surveyed agencies, whose budget authority ranged from about \$250,000 to about \$325 million, expressed the opposite view.

Other Considerations

Using a fixed-dollar threshold to determine which agencies should be subject to the audit requirement has the benefit of simplicity. Over time, however, entities could move above and below the threshold depending on annual changes in their budget authority. Also, through inflation, the number of entities that meet the dollar threshold would likely increase. One way to deal with this issue and still incorporate a dollar threshold is to provide the Office of Management and Budget (OMB), through the proposed legislation, the authority to add agencies that fall below or exclude agencies that meet the threshold based in part on the other factors identified in our survey. OMB could then be required to report to the Congress on the reasons for a change to any agency's status with respect to the financial statements audit requirement.

The proposed legislation does not specifically provide for a phase-in period for an agency to implement the audit requirement, but it does provide that OMB may waive this requirement for the first 2 fiscal years beginning after the date of enactment. We support this waiver provision and would support making a similar waiver available to OMB for agencies that do not initially meet, but at a subsequent date do meet, the dollar audit threshold.

Conclusions

In closing, I would like to reiterate our support for the thrust of H.R. 4685 to expand financial statements audit requirements beyond the current 24 CFO Act agencies. The importance of having financial statements audits goes far beyond obtaining an unqualified opinion. The preparation and audit of financial statements contribute to reliable, timely, and useful financial information, and such information is important in helping management ensure accountability, measure and control costs, and make timely and fully informed decisions. Preparing audited financial statements also leads to improvements in internal control and financial management systems. Hence, we view much of the effort involved in preparing financial statements and having them audited as an integral part of effective financial management.

Mr. Chairman, this concludes my statement. We welcome any questions that you or other members of the Subcommittee may have.

Contact

If you have any questions about this testimony, please contact me at (202) 512-3406. I can be reached by e-mail at engelg@gao.gov. Other key contributors to this testimony were Kent Bowden, Casey Keplinger, LaShawnda Wilson, and Esther Tepper.

Information on the 26 Surveyed Agencies

The following tables provide financial and other baseline information about the 26 surveyed agencies. The tables generally contain information provided by the agencies, which we did not independently verify.

Table 3: Fiscal Year 2000 Financial Data as Reported to Treasury by Surveyed Agencies That Have Had Financial Statements Audits

Agency	Budget Authority ^a	Percent	Total Assets	Percent	Total Liabilities	Percent	Total Revenue	Percent	Total Expenses	Percent
Railroad Retirement Board	\$9,183	56	\$22,703.1	57	\$3,977.6	29	\$9,330.2	54	\$8,678.5	47
Federal Communications Commission	6,795	42	15,360.8	38	9,306.0	68	7,580.9	44	9,408.3	51
Federal Trade Commission	126	1	227.3	1	218.4	2	126.8	1	143.7	1
Farm Credit System Insurance Corporation	83	1	1,601.7	4	167.9	1	101.4	1	12.7	0
International Trade Commission	44	0	6.7	0	5.4	0	46.0	0	46.3	0
Federal Mediation and Conciliation Service	39	0	10.2	0	6.9	0	41.2	0	40.6	0
U.S. Holocaust Memorial Museum	33	0	0.9	0	0.2	0	2.6	0	2.7	0
Federal Housing Finance Board ^b	19	0	6.6	0	3.8	0	19.1	0	18.9	0
Defense Nuclear Facilities Safety Board	17	0	10.2	0	2.8	0	0.0	0	17.4	0
U.S. Institute of Peace	13	0	0.8	0	0.7	0	0.0	0	12.9	0
U.S. Court of Appeals for Veterans Claims	11	0	10.4	0	2.5	0	11.5	0	11.4	0
Office of Navajo and Hopi Indian Relocation	8	0	11.0	0	2.0	0	14.1	0	14.1	0
Total	\$16,371	100	\$39,949.7	100	\$13,694.2	100	\$17,273.8	100	\$18,407.5	100

^aFiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.

^bThe amounts reported for Federal Housing Finance Board are from their audited financial statements and not from data reported to Treasury.

Note: All dollar amounts are in millions. The individual percentages do not total to 100 percent due to rounding. The percentages less than one are portrayed as zero in this chart.

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Table 4: Fiscal Year 2000 Financial Data as Reported to Treasury by Surveyed Agencies That Have Not Had Financial Statements Audits

Agency	Budget Authority ^a	Percent	Total Assets	Percent	Total Liabilities	Percent	Total Revenue	Percent	Total Expenses	Percent
Securities and Exchange Commission	\$382	20	\$2,790.0	71	\$123.3	15	\$3,638.7	74	\$363.9	20
National Archives and Records Administration	323	17	252.8	6	345.4	42	280.6	6	311.5	17
Equal Employment Opportunity Commission	282	15	42.1	1	17.7	2	65.9	1	67.6	4
National Labor Relations Board	205	11	47.7	1	49.8	6	8.8	0	213.4	11
Institute of Museum and Library Services	190	10	225.5	6	0.3	0	187.0	4	187.2	10
National Endowment for the Humanities	118	6	99.8	3	1.7	0	116.3	2	116.0	6
National Endowment for the Arts	102	5	106.4	3	2.8	0	111.1	2	108.5	6
National Transportation Safety Board	82	4	34.0	1	4.7	1	_____b	_____b	_____b	_____b
Commodity Futures Trading Commission	63	3	261.2	7	251.6	30	312.6	6	310.9	17
Consumer Product Safety Commission	52	3	19.1	0	14.9	2	57.0	1	58.1	3
Federal Election Commission	38	2	11.5	0	3.4	0	41.1	1	41.5	2
Merit System Protection Board	29	2	7.3	0	4.2	1	31.1	1	31.1	2
Federal Labor Relations Authority	24	1	4.0	0	4.2	1	23.9	0	24.2	1
Selective Service System	24	1	15.5	0	3.8	0	21.2	0	22.5	1
Total	\$1,914	100	\$3,916.9	100	\$827.8	100	\$4,895.3	100	\$1,856.4	100

^aFiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.

^bNational Transportation Safety Board did not report data for revenue and expenses to Treasury.

Note: All dollar amounts are in millions. The individual percentages do not total to 100 percent due to rounding. The percentages less than one are portrayed as zero in this chart.

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Table 5: Baseline Information as Reported by Surveyed Agencies That Have Had Financial Statements Audits

Agency	Agency Functions												
	Fiscal year 2000 budget authority (in millions)	Fiscal year 2000 total full time equivalents	Number of offices	CFO or equivalent?	Statutory Office of Inspector General?	Audit in accordance with GAGAS or GAAS?	Buy/lease real estate	Provide insurance	Make loans or loan guarantees	Assess fines and penalties	Maintain services for a fee	Other fiduciary/custodial functions	
Railroad Retirement Board	\$9,183	1,154	60	Yes	Yes	GAGAS		X		X	X	X	
Federal Communications Commission	6,795	1,950	4	Yes	Yes	GAGAS	X		X	X	X	X	
Federal Trade Commission	126	1,007	9	Yes	Yes	GAGAS				X	X	X	
Farm Credit System Insurance Corporation	83	10	1	Yes	No	GAGAS		X		X			
International Trade Commission	44	354	1	Yes	Yes	GAGAS ^a	X			X	X		
Federal Mediation and Conciliation Service	39	288	71	Yes	No	GAGAS			X	X	X		
U.S. Holocaust Memorial Museum	33	458	5	Yes	No	GAAS					X	X	
Federal Housing Finance Board	19	107	1	Yes	Yes	GAGAS				X			
Defense Nuclear Facilities Safety Board	17	96	7	Yes	No	GAAS ^b							
U.S. Institute of Peace	13	65	1	No	No	GAAS			X				
U.S. Court of Appeals for Veterans Claims	11	88	1	Yes	No	GAGAS			X		X	X	
Office of Navajo and Hopi Indian Relocation	8	60	3	Yes	No	GAAS							
Total	\$16,371	5,637	164										
Average	\$1,364	470	14										

^aInternational Trade Commission discontinued audits of its financial statements, effective for fiscal year 1999. It did not prepare fiscal year 2000 financial statements.

^bDefense Nuclear Facilities Safety Board has balance sheet only audits every 3 to 5 years, most recently for fiscal year 1997. It did not prepare fiscal year 2000 financial statements.

Notes: Fiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.

GAGAS (generally accepted government auditing standards) are public sector auditing standards; GAAS (generally accepted auditing standards) are private sector auditing standards.

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Table 6: Baseline Information as Reported by Surveyed Agencies That Have Not Had Financial Statements Audits

Agency											Agency Functions				
	Fiscal year 2000 budget authority (in millions)	Fiscal year 2000 total full time equivalents	Number of offices	CFO or equivalent?	Statutory Office of Inspector General?	Fiscal year 2000 financial statements prepared?	Buy/lease real estate	Provide insurance	Make loans or loan guarantees	Assess fines and penalties	Maintain services for a fee	Maintain retail operations	Other fiduciary/custodial functions		
Securities and Exchange Commission	\$382	3,037	14	No	Yes	No	X				X	X			
National Archives and Records Administration	323	2,362	28	Yes	Yes	No	X			X		X	X		
Equal Employment Opportunity Commission	282	2,924	52	Yes	Yes	No					X			X	
National Labor Relations Board	205	1,976	52	Yes	Yes	No								X	
Institute of Museum and Library Services	190	45	1	Yes	No ^a	No				X					
National Endowment for the Humanities	118	170	1	Yes	Yes	No				X		X			
National Endowment for the Arts	102	155	1	Yes	Yes	No				X				X	
National Transportation Safety Board	82	425	11	Yes	No ^a	No					X				
Commodity Futures Trading Commission	63	546	6	Yes	Yes	No	X				X	X			
Consumer Product Safety Commission	52	480	43	Yes	Yes	No					X	X			
Federal Election Commission	38	357	2	Yes	Yes	No					X				
Merit Systems Protection Board	29	234	11	Yes	No ^b	No									
Federal Labor Relations Authority	24	198	8	Yes	Yes	No					X				
Selective Service System	24	165	5	Yes	No ^a	No									
Total	\$1,914	13,074	235												
Average	\$137	934	17												

^aInstitute of Museum and Library Services, National Transportation Safety Board, and Selective Service System use the services of another agency's Office of Inspector General.

^bMerit Systems Protection Board's General Counsel acts as its Inspector General for investigating fraud, waste, and abuse. The agency also uses the services of another agency's Office of Inspector General.

Note: Fiscal year 2000 budget authority data were obtained from the Fiscal Year 2002 President's Budget.