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United States Government Accountability Office
Washington, DC 20548

The President
The President of the Senate
The Speaker of the House of Representatives

The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, is required to annually submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.[1] This is (1) our report on the accompanying U.S. government's accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008, and the 2009, 2008, 2007, and 2006 Statements of Social Insurance, and (2) our associated reports on internal control over financial reporting and on compliance with selected provisions of laws and regulations. As used in this report, accrual-based financial statements refer to all of the consolidated financial statements and notes, except for those related to the Statement of Social Insurance.[2]

The federal government is responsible for (1) preparing annual consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP); (2) establishing, maintaining, and evaluating internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act (FMFIA)[3] are met; and (3) complying with laws and regulations. Also, the 24 Chief Financial Officers (CFO) Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with the requirements of the Federal

[1]The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. 331(e). The federal government has elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well.
[2]The accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008 consist of the (1) Statements of Net Cost, (2) Statements of Operations and Changes in Net Position, (3) Reconciliations of Net Operating Cost and Unified Budget Deficit, (4) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (5) Balance Sheets, including the related notes to these financial statements. Most revenues are recorded on a modified cash basis. The 2009, 2008, 2007, and 2006 Statements of Social Insurance, including the related notes, are also included in the consolidated financial statements. The Statements of Social Insurance do not interrelate to the accrual-based consolidated financial statements.
[3]31 U.S.C. 3512 (c), (d) (commonly referred to as FMFIA). This act requires executive agency heads to evaluate and report annually to the President and the Congress on the adequacy of their internal control and accounting systems and on actions to correct significant problems.

Financial Management Improvement Act of 1996 (FFMIA).[4] Our objective was to audit the consolidated financial statements for the fiscal years ended September 30, 2009 and 2008 (as well as 2007 and 2006 with respect to the Statements of Social Insurance). Appendix I discusses the scope and methodology of our work.

Material weaknesses[5] discussed later in our report continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner. We found the following:

- Certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work[6] resulted in conditions that continued to prevent us from expressing an opinion on the accompanying accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008.[7]

- The Statements of Social Insurance for 2009, 2008, and 2007[8] are presented fairly, in all material respects, in conformity with GAAP; we disclaim an opinion on the 2006 Statement of Social Insurance.[9]

- Material weaknesses resulted in ineffective internal control over financial reporting (including safeguarding of assets).

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[4]31 U.S.C. 3512 note (Federal Financial Management Improvement Act).
[5]A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
[6]Three major impediments continued to prevent us from rendering an opinion on the accrual-based consolidated financial statements: (1) serious financial management problems at the Department of Defense (DOD) that have prevented DOD's financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition, the financial statements of the Department of Homeland Security and the National Aeronautics and Space Administration for fiscal years 2009 and 2008 were not auditable or not subjected to audit by agency auditors.
[7]We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2006 and on the accrual-based consolidated financial statements of the U.S. government for fiscal years 2007 and 2008.
[8]The valuation date is January 1 for all social insurance programs except the Black Lung program, which has a valuation date of September 30.
[9]We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance.

- Our work to test compliance with selected provisions of laws and regulations in fiscal year 2009 was limited by the material weaknesses and other scope limitations discussed in this report.

SIGNIFICANT MATTERS OF EMPHASIS

Before discussing our conclusions on the consolidated financial statements, the following key items deserve emphasis in order to put the information contained in the financial statements and the Management's Discussion and Analysis section of the *2009 Financial Report of the United States Government* (*2009 Financial Report*) into context.

The Federal Government's Actions to Stabilize Financial Markets and to Promote Economic Recovery

The economic recession and the federal government's unprecedented actions intended to stabilize the financial markets and to promote economic recovery have significantly affected the federal government's financial condition. The resulting substantial investments and increases in liabilities, net operating cost, the unified budget deficit, and debt held by the public, are reported in the accrual-based consolidated financial statements for fiscal year 2009. However, the ultimate cost of these actions and their impact on the federal government's financial condition will not be known for some time. Key actions that the federal government has taken to stabilize financial markets and to restore the availability of credit for Americans are discussed in the Management's Discussion and Analysis section of the *2009 Financial Report* and certain Notes to the consolidated financial statements.

Uncertainties Regarding Certain Asset and Liability Valuations

As of September 30, 2009, the federal government's actions to stabilize the financial markets and to promote economic recovery resulted in an increase in reported federal assets of over $500 billion (e.g., Troubled Asset Relief Program (TARP) equity investments,[10] investments in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), and mortgage-backed securities guaranteed by them),[11] which is net of about $80 billion in valuation losses. In addition, the federal government reported incurring additional significant liabilities (e.g., liquidity guarantees to Fannie Mae and Freddie Mac) and related net cost resulting from these actions. In valuing these assets and liabilities, management considered and selected assumptions and data that it believed provided a reasonable basis for the estimated values reported in the accrual-based consolidated financial statements. However, as discussed in

[10] TARP was established by the Department of the Treasury (Treasury) under authority provided in the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343). The Act requires the U.S. Comptroller General to audit TARP's financial statements as well as report every 60 days on a variety of areas associated with oversight of TARP. For the fiscal year 2009 audit and the 60-day reports, see GAO's Web site at www.gao.gov.

[11] The Housing and Economic Recovery Act of 2008 (Pub. L. No. 110-289) authorized Treasury to purchase, until December 31, 2009, any amount of Fannie Mae or Freddie Mac securities, whether debt or equity.

Note 1 to the consolidated financial statements, there are many factors affecting these assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions. As such, there will be differences between the estimated values as of September 30, 2009, and the actual results, and such differences may be material. These differences will also affect the ultimate cost of the federal government's actions.

Long-Term Fiscal Challenges

The federal government faces even larger fiscal challenges in the long term. As discussed in this *2009 Financial Report*, the federal government is on an unsustainable long-term fiscal path driven primarily by rising health care costs and known demographic trends. The Statement of Social Insurance, for example, shows that the present value of projected scheduled benefits exceeds earmarked revenues for social insurance programs (e.g., Social Security and Medicare) by about $46 trillion over the next 75-year period.[12] In addition, our most recent long-term simulations for all federal government programs show that absent policy changes, debt held by the public as a percentage of gross domestic product could exceed the historical high reached in the aftermath of World War II in a little over 10 years.[13] Absent a change in policy, under this scenario, the interest costs on the growing debt together with spending on major entitlement programs could absorb 92 cents of every dollar of federal revenue in 2019.[14] Clearly, this is not sustainable. The federal government faces increasing pressures yet a shrinking window of opportunity for making policy changes regarding these challenges.

Equity Interests in Certain Financial Organizations and Commercial Entities

As discussed in Note 1, the consolidated financial statements do not include the assets, liabilities, or results of operations of any financial organizations or commercial entities in which Treasury holds either a direct, indirect, or beneficial equity interest. Treasury and the Office of Management and Budget (OMB) have determined that none of these entities meet the criteria for a federal entity. The investments in such entities, however, are valued and reported on the Balance Sheet.

[12]On an open group basis (current and future participants).
[13]GAO, *The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update*, GAO-10-137SP (Washington, D.C.: October 2009). These simulations will be updated in a report forthcoming in early March 2010.
[14]GAO's Fall 2009 alternative simulation is based on the 2009 Trustees' assumptions for Social Security and Medicare. Discretionary spending other than the American Recovery and Reinvestment Act of 2009 (Recovery Act) provisions grows with gross domestic product (GDP) after 2009; and the Recovery Act provisions are included but assumed to be temporary. Expiring tax provisions are extended and the Alternative Minimum Tax exemption amount is indexed to inflation through 2019. After 2019, revenue as a share of GDP is brought to its 40-year historical average of 18.3 percent of GDP. Medicare spending is adjusted based on the assumption that physician payments are not reduced as specified under current law.

DISCLAIMER OF OPINION ON THE ACCRUAL-BASED CONSOLIDATED FINANCIAL STATEMENTS

Because of the federal government's inability to demonstrate the reliability of significant portions of the U.S. government's accompanying accrual-based consolidated financial statements for fiscal years 2009 and 2008, principally resulting from limitations related to certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work, we are unable to, and we do not, express an opinion on such accrual-based consolidated financial statements.

As a result of these limitations, readers are cautioned that amounts reported in the accrual-based consolidated financial statements and related notes may not be reliable. These material weaknesses and other scope limitations also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and other financial management information—including information used to manage the federal government day-to-day and budget information reported by federal entities—that is taken from the same data sources as the accrual-based consolidated financial statements.

We have not audited and do not express an opinion on the Management's Discussion and Analysis, or on Stewardship Information, Supplemental Information, or other information that is not part of the accrual-based consolidated financial statements and related notes included in the *2009 Financial Report*.

Other Limitations on the Scope of Our Work

For fiscal years 2009 and 2008, there were limitations on the scope of our work in addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements. Treasury and OMB depend on representations from certain federal entities to provide their representations to us regarding the U.S. government's consolidated financial statements. Treasury and OMB were unable to provide us with adequate representations regarding the U.S. government's accrual-based consolidated financial statements for fiscal years 2009 and 2008. In addition, the federal government was unable to provide us with adequate legal representations regarding the U.S. government's accrual-based consolidated financial statements for fiscal year 2009.

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual-based Consolidated Financial Statements

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the accompanying accrual-based consolidated financial statements, as briefly described below. The underlying material weaknesses in internal control, which generally have existed for years, contributed to our disclaimer of opinion on the accrual-based consolidated financial statements. Appendix II describes the material weaknesses in more detail and highlights the primary effects of these material weaknesses on the accompanying accrual-based consolidated financial statements and on the management of federal government operations. The material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements were the federal government's inability to

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by DOD, were properly reported in the accrual-based consolidated financial statements;
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;
- support significant portions of the total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain federal entities;
- adequately account for and reconcile intragovernmental activity and balances between federal entities;
- ensure that the federal government's accrual-based consolidated financial statements were (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in conformity with GAAP; and
- identify and either resolve or explain material differences between certain components of the budget deficit reported in Treasury's records, which are used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of Changes in Cash Balance from Unified Budget and Other Activities, and related amounts reported in federal entities' financial statements and underlying financial information and records.

Due to the material weaknesses and other limitations on the scope of our work discussed above, there may also be additional issues that could affect the accrual-based consolidated financial statements that were not identified.

UNQUALIFIED OPINIONS ON THE STATEMENTS OF SOCIAL INSURANCE FOR 2009, 2008, AND 2007

In our opinion, the Statements of Social Insurance for 2009, 2008, and 2007 present fairly, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with GAAP. We disclaim an opinion on the 2006 Statement of Social Insurance[15] and have not audited and do not express an opinion on the Statement of Social Insurance for 2005, and on other information related to such statements that is included in the accompanying *2009 Financial Report*.

As discussed in Note 26 to the consolidated financial statements, the Statement of Social Insurance presents the actuarial present value of the federal government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs.[16] In preparing the Statement of Social Insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the Statement of Social Insurance and the fact that such assumptions are inherently subject to substantial uncertainty (arising from the likelihood of future changes in general economic, regulatory, and market conditions, as well as other more specific future events, significant uncertainties, and contingencies), there will be differences between the estimates in the Statement of Social Insurance and the actual results, and those differences may be material. The Supplemental Information section of the *2009 Financial Report* includes unaudited information concerning how changes in various assumptions would change the present value of future estimated expenditures in excess of future estimated revenue. As discussed in that section, Medicare projections are very sensitive to changes in the health care cost growth assumption.

In addition to the inherent uncertainty that underlies the expenditure projections prepared for all parts of Medicare, the Supplementary Medical Insurance (SMI) Part D projections have an added uncertainty in that they were prepared using very little program experience upon which to base the estimates, and the SMI Part B projections assume significant reductions in physician payments, as required under current law, which may or may not occur. The Congress has overridden scheduled reductions in physician payments calculated for each of the last 7 years, including for 2009, and also for January and

[15]Beginning in fiscal year 2006, the Statement of Social Insurance became a principal financial statement and was audited as part of the applicable federal entities' financial statements. We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. For fiscal years 2009, 2008, and 2007, we designed our audits to provide an opinion on the 2009, 2008, and 2007 consolidated Statements of Social Insurance, respectively.

[16]The projection period used for the Social Security, Medicare, and Railroad Retirement social insurance programs is 75 years. For the Black Lung program, the projections are through 2040.

February of 2010.[17] It is not possible to anticipate what other actions the Congress might take, either in the near or long term, to alter the scheduled reductions in physician payments. If scheduled reductions continue to be overridden in the future, actual SMI Part B expenditures could be materially greater than the amounts presented in the 2009 Statement of Social Insurance.

The scheduled future benefits reported in the Statement of Social Insurance are based on benefit formulas in current law. However, consistent with the respective annual Trustees Reports, the Social Security and Medicare programs are not sustainable under current financing arrangements. Also, the law concerning these programs can be changed at any time by the Congress. In fact, payment of Social Security and Medicare Hospital Insurance (Part A) benefits are limited by law to the balances in the respective trust funds. Consequently, future scheduled benefits are limited to future revenues plus existing trust fund assets. As discussed in the Supplemental Information section of the *2009 Financial Report*, the Social Security and Medicare Part A trust funds are projected to be exhausted in 2037 and 2017, respectively, at which time they will be unable to pay the full amount of scheduled future benefits. For Social Security, projected future revenues would be sufficient to pay 76 percent of scheduled benefits in 2037, the year of trust fund exhaustion, and decreasing to 74 percent of scheduled benefits in 2083. Similarly, for Medicare Part A, projected future revenues would be sufficient to pay 81 percent of scheduled benefits in 2017, the year of trust fund exhaustion, and decreasing to 29 percent of scheduled benefits in 2083.

Management's Discussion and Analysis, Supplemental Information, and other information included in the accompanying *2009 Financial Report* contain information directly related to the Statements of Social Insurance. We did not audit and do not express an opinion on this information. However, we compared the information that directly related to the Statements of Social Insurance for consistency with the Statements of Social Insurance and discussed the methods of measurement and presentation of such information with Treasury officials. Based on this limited work, we found no material inconsistencies with the Statements of Social Insurance or GAAP.

MATERIAL WEAKNESSES RESULTED IN INEFFECTIVE INTERNAL CONTROL OVER FINANCIAL REPORTING

The material weaknesses discussed in this report resulted in ineffective internal control over financial reporting. Consequently, the federal government's internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the consolidated financial statements would be prevented or detected and

[17] The Medicare, Medicaid, and SCHIP Extension Act of 2007, Pub. L. No. 110-173, § 101(a)(1)(B), overrode the scheduled reductions for the first six months of calendar year 2008; the Medicare Improvements for Patients and Providers Act of 2008, Pub. L. No. 110-275, § 131(a)(1), overrode the scheduled reductions for the last six months of calendar year 2008 and all of 2009; and Pub. L. No. 111-118, div. B, § 1011(a), overrode the scheduled reductions for January and February of 2010, but left unchanged the scheduled reductions for the remainder of 2010 and subsequent years.

corrected on a timely basis. The federal government is responsible for establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness. Internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements.

In planning and performing our audit, we considered internal control over financial reporting. We did not consider all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We do not express an opinion on internal control over financial reporting because the purpose of our work was to determine our procedures for auditing the financial statements, not to express an opinion on internal control. Based on the scope of our work and the effects of the other limitations on the scope of our audit noted throughout this report, our internal control work would not necessarily identify all deficiencies in internal control including those that might be material weaknesses or significant deficiencies.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, which were discussed above, we found the following three other material weaknesses in internal control. These material weaknesses are discussed in more detail in appendix III, including the primary effects of the material weaknesses on the accompanying accrual-based consolidated financial statements and on the management of federal government operations. These other material weaknesses were the federal government's inability to

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments,
- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

We also found the following three significant deficiencies in internal control, which are discussed in more detail in appendix IV. These significant deficiencies involve the following areas:

- implementing effective internal controls at certain agencies for loans receivable, mortgage-backed securities, and loan guarantee liabilities, which for the most part, involve credit subsidy estimation and related financial reporting processes;

- verification procedures for data input for the TARP equity investment and direct loan valuations; and

- preparing the Statement of Social Insurance for certain programs.

Individual federal entity financial statement audit reports identify additional control deficiencies that were reported by the entity's auditors as either material weaknesses or significant deficiencies at the individual entity level. We do not consider these additional deficiencies to represent material weaknesses or significant deficiencies at the governmentwide level.

COMPLIANCE WITH LAWS AND REGULATIONS

Our work to test compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements was limited by the material weaknesses and other scope limitations discussed in this report. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations. Certain individual entity audit reports contain instances of noncompliance. None of these instances were deemed to be reportable noncompliance with regard to the accompanying consolidated financial statements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with laws and regulations.

CFO ACT AGENCY FINANCIAL MANAGEMENT SYSTEMS

The federal government's ability to efficiently and effectively manage and oversee its day-to-day operations and programs relies heavily on the ability of entity financial management systems[18] to produce complete, reliable, timely, and consistent financial information for use by executive branch agencies and the Congress. FFMIA was designed to lead to system improvements that would result in CFO Act agency managers routinely having access to reliable, useful, and timely financial-related information to measure performance and increase accountability throughout the year. FFMIA requires auditors, as part of the 24 CFO Act agencies' financial statement audits, to report whether those agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's Standard General Ledger (SGL) at the transaction level. For fiscal years 2009 and 2008, auditors for 10 and 14 of the 24 CFO Act agencies, respectively, reported that the agencies' financial management systems did not

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[18]The term financial management systems includes the financial systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions.

substantially comply with one or more of the three FFMIA requirements. Agency heads for the 24 CFO Act agencies also annually report on FFMIA compliance. A fewer number of agency heads (7 in 2009 and 9 in 2008) reported that their agencies' systems were not in substantial compliance with one or more of the three FFMIA requirements. Long-standing financial management systems weaknesses at several large CFO Act agencies along with the size and complexity of the federal government continue to present a formidable management challenge in providing accountability to the nation's taxpayers and have contributed significantly to our inability to determine the reliability of the accrual-based consolidated financial statements.

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We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.

Robert F. Dacey
Chief Accountant
U. S. Government Accountability Office

February 19, 2010

APPENDIX I

Objectives, Scope, and Methodology

The Government Management Reform Act of 1994 expanded the requirements of the Chief Financial Officers (CFO) Act of 1990 by making the inspectors general of 24 major federal agencies[19] responsible for annual audits of agencywide financial statements prepared by these agencies and GAO responsible for the audit of the U.S. government's consolidated financial statements. The Accountability of Tax Dollars (ATD) Act of 2002[20] requires most other executive branch entities to prepare and have audited annual financial statements. The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 35 entities[21] that are significant to the U.S. government's consolidated financial statements including many federal executive branch agencies and some government corporations. Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 entities to achieve our respective audit objectives. Our audit approach regarding the accrual-based consolidated financial statements focused primarily on determining the current status of the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements and the other material weaknesses affecting internal control that we had reported in our report on the consolidated financial statements for fiscal year 2008.[22] Our work included separately auditing the financial statements of the following significant federal entities and federal agency components:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2009 and 2008 financial statements.[23] In fiscal years 2009 and 2008, IRS collected about \$2.3 trillion and \$2.7 trillion, respectively, in tax payments and paid about \$438 billion and \$426 billion, respectively, in refunds to taxpayers.[24] For fiscal year 2009, we continued to report material weaknesses that resulted in ineffective internal control over financial reporting. Our tests of IRS's compliance in fiscal year 2009 with selected provisions of laws and regulations disclosed one area of noncompliance. We also found that IRS's financial management systems did not

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[19] 31 U.S.C. 901(b), 3521(e). The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. See 31 U.S.C. 3515(c) as amended.
[20] Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002); see 31 U.S.C. 3515.
[21] See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 entities.
[22] For our report on the U.S. government's consolidated financial statements for fiscal year 2008, see U.S. Department of the Treasury, *Fiscal Year 2008 Financial Report of the United States Government* (Washington, D.C.: December 2008), pp. 165-188, which can be found on GAO's Web site at www.gao.gov.
[23] GAO, *Financial Audit: IRS's Fiscal Years 2009 and 2008 Financial Statements*, GAO-10-176 (Washington, D.C.: Nov. 10, 2009).
[24] The Economic Stimulus Act of 2008, Pub. L. No. 110-185, §101, 122 Stat. 613, 613-17 (Feb.13, 2008) (*codified at* 26 U.S.C. § 6428), included provisions to help stimulate the economy through recovery rebates. In fiscal year 2008, the IRS disbursed about \$94 billion of recovery rebates to eligible taxpayers. In fiscal year 2009, the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009), increased the benefits for several existing refundable credits including the Earned Income Tax Credit (EITC) and the Child Tax Credit as well as authorized several new refundable tax credits.

substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996.

- We audited and expressed an unqualified opinion on the Schedules of Federal Debt managed by Treasury's Bureau of the Public Debt (BPD) for the fiscal years ended September 30, 2009 and 2008.[25] For these 2 fiscal years, the schedules reported (1) approximately $7.6 trillion (2009) and $5.8 trillion (2008) of federal debt held by the public;[26] (2) about $4.3 trillion (2009) and $4.2 trillion (2008) of intragovernmental debt holdings;[27] and (3) about $189 billion (2009) and $242 billion (2008) of interest on federal debt held by the public. We reported that as of September 30, 2009, BPD had effective internal control over financial reporting relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable BPD noncompliance in fiscal year 2009 with a significant provision of law related to the Schedule of Federal Debt (statutory debt limit) we tested.

- We audited and expressed unqualified opinions on the fiscal years 2009 and 2008 financial statements of the United States Securities and Exchange Commission (SEC).[28] However, we reported that as of September 30, 2009, SEC did not have effective internal control over financial reporting. We identified six significant deficiencies that collectively represented a material weakness in SEC's internal control over financial reporting. In addition, we reported that there was no reportable noncompliance in fiscal year 2009 with the selected provisions of laws and regulations we tested.

- We audited and expressed an unqualified opinion on the fiscal year 2009 financial statements of the Federal Housing Finance Agency (FHFA).[29] We reported that FHFA had effective internal control over financial reporting, and we found no reportable noncompliance in fiscal year 2009 with the selected provisions of laws and regulations we tested.

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[25]GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2009 and 2008 Schedules of Federal Debt*, GAO-10-88 (Washington, D.C.: Nov. 10, 2009).
[26]The public holding federal debt is comprised of individuals, corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks.
[27]Intragovernmental debt holdings represent federal debt issued by Treasury and held by certain federal government accounts such as the Social Security and Medicare trust funds.
[28]GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2009 and 2008*, GAO-10-250 (Washington, D.C.: Nov. 16, 2009).
[29]GAO, *Financial Audit: Federal Housing Finance Agency's Fiscal Year 2009 Financial Statements*, GAO-10-218 (Washington, D.C.: Nov. 16, 2009). FHFA was established by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008), as an independent agency empowered with supervisory and regulatory oversight of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the 12 federal home loan banks. While FHFA was in existence prior to the start of fiscal year 2009, this was its first full year of operations and the first year for which it prepared financial statements. Consequently, FHFA's financial statements do not present comparative information for the prior year.

- We audited and expressed an unqualified opinion on the fiscal year 2009 financial statements of the Office of Financial Stability (OFS) for the Troubled Asset Relief Program (TARP).[30] We reported that although internal controls could be improved, OFS had effective internal control over financial reporting as of September 30, 2009. We also reported that we found no reportable noncompliance for the period ended September 30, 2009, with the selected provisions of laws and regulations we tested.

- We audited and expressed unqualified opinions on the December 31, 2008 and 2007, financial statements of two funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund.[31] We reported that as of December 31, 2008, FDIC had effective internal control over financial reporting, and we found no reportable noncompliance for calendar year 2008 with the selected provisions of laws and regulations we tested.

In addition, we considered the CFO Act agencies' and certain other federal entities' fiscal years 2009 and 2008 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. Financial statements and audit reports for these entities provide information about the operations of each of these entities. The entity audit reports also contain details regarding any audit findings and related recommendations for the respective entity. We did not audit, and we do not express an opinion on, any of these individual federal entity financial statements.

We considered the Department of Defense's (DOD) assertion that DOD management had prepared and submitted pursuant to the provisions of the National Defense Authorization Act for Fiscal Year 2002.[32] In accordance with section 1008 of this act, DOD reported that certain major deficiencies related to noncompliant systems and noncompliant processes continued to impact the department's ability to prepare reliable financial statements. In addition, DOD refers to its ongoing efforts to address related material weaknesses reported by the DOD Inspector General. In the DOD Inspector General's fiscal year 2009 report on internal control over financial reporting, the Inspector General cited material weaknesses in several areas including (1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; (4) intragovernmental eliminations; and (5) material amounts of unsupported accounting entries needed to prepare DOD's annual consolidated financial statements.

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[30]GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, GAO-10-301 (Washington, D.C.: Dec. 9, 2009). The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, div. A, 122 Stat. 3765 (Oct. 3, 2008), *codified in part, as amended,* at 12 U.S.C. §§ 5201-5261, authorized the Secretary of the Treasury to implement TARP and established OFS within Treasury to do so. Fiscal year 2009 was the first year that OFS prepared and issued audited financial statements for TARP.
[31]GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2008 and 2007 Financial Statements*, GAO-09-535 (Washington, D.C.: May 28, 2009).
[32]Pub. L. No. 107-107, §1008, 115 Stat. 1012, 1204 (Dec. 28, 2001).

Because of the significance of the amounts included in the Statement of Social Insurance related to the Social Security Administration (SSA) and the Department of Health and Human Services (HHS), our audit approach regarding the Statement of Social Insurance focused primarily on these two agencies. For each federal entity preparing a Statement of Social Insurance,[33] we considered the entity's fiscal year 2009, 2008, and 2007 financial statements and the related auditor's reports prepared by the inspectors general or contracted independent public accountants. We believe our audit, including internal control and substantive audit procedures, reperformance procedures, and review of the other auditors' Statement of Social Insurance-related audit work, provides a reasonable basis for our opinions on the 2009, 2008, and 2007 Statements of Social Insurance.

We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and compliance with selected provisions of laws and regulations. We considered the limitations on the scope of our work regarding the accrual-based consolidated financial statements in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

[33]These entities consist of SSA, HHS, the Railroad Retirement Board, and the Department of Labor.

APPENDIX II

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual-based Consolidated Financial Statements

The continuing material weaknesses discussed below contributed to our disclaimer of opinion on the federal government's accrual-based consolidated financial statements. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying accrual-based consolidated financial statements, as described below.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that property, plant, and equipment (PP&E) and inventories and related property were properly reported in the accrual-based consolidated financial statements. Most of the PP&E and inventories and related property are the responsibility of the Department of Defense (DOD). As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other entities, most notably the National Aeronautics and Space Administration, reported continued deficiencies in internal control procedures and processes related to PP&E.

Deficiencies in internal control over such assets could affect the federal government's ability to fully know the assets it owns, including their location and condition, and its ability to effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets and reliably report asset balances; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including any related to treaties and other international agreements entered into to further the federal government's interests, were complete and properly reported.

Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, deficiencies in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as adversely affect the federal government's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, if disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.

Cost of Government Operations and Disbursement Activity

The previously discussed material weaknesses in reporting assets and liabilities, material weaknesses in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal entities affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably those related to DOD.

With respect to disbursements, DOD and certain other federal entities reported continued material weaknesses and significant deficiencies in reconciling disbursement activity. For fiscal years 2009 and 2008, there was unreconciled disbursement activity, including unreconciled differences between federal entities' and the Department of Treasury's (Treasury) records of disbursements and unsupported federal entity adjustments, totaling billions of dollars, which could also affect the balance sheet.

Unreliable cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required or authorized. If disbursements are improperly recorded, this could result in misstatements in the financial statements and in certain data provided by federal entities for inclusion in *The Budget of the United States Government* (President's Budget) concerning obligations and outlays.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

Federal entities are unable to adequately account for and reconcile intragovernmental activity and balances. The Office of Management and Budget (OMB) and Treasury require the chief financial officers (CFO) of 35 federal entities to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these entities are required to report to Treasury, the entity's inspector general, and GAO on the extent and results of intragovernmental activity and balance-reconciliation efforts as of the end of the fiscal year.

A substantial number of the entities did not adequately perform the required reconciliations for fiscal years 2009 and 2008. For these fiscal years, based on trading partner information provided to Treasury in entities' closing packages, Treasury produced a "Material Difference Report" for each entity showing amounts for certain intragovernmental activity and balances that significantly differed from those of the entity's corresponding trading partners as of the end of the fiscal year. Based on our analysis of the "Material Difference Reports" for fiscal year 2009, we noted that a significant number of CFOs were unable to adequately explain the differences with their trading partners or did not provide adequate documentation to support responses on the CFO Representations. For both fiscal years 2009 and 2008, amounts reported by federal entity trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, a significant number of CFOs cited differing accounting methodologies, accounting errors, and timing differences for their material differences with their trading partners. Some CFOs simply indicated that they were unable to explain the differences with their trading partners with no indication as to when the differences would be resolved. As a result of these circumstances, the federal government's ability to determine the impact of these differences on the amounts reported in the accrual-based consolidated financial statements is significantly impaired.

Treasury continues to take steps to help resolve material differences in intragovernmental activity and balances. For example, beginning in the third quarter of 2009, Treasury required entities to perform additional reconciliations related to certain intragovernmental appropriations and transfer activity. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal entities to fully implement guidance regarding business rules for intragovernmental transactions issued by OMB and Treasury as well as continued strong leadership by OMB and Treasury.[34]

Preparation of Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2009, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited entity financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). During our fiscal year 2009 audit, we found the following:[35]

- Treasury's process for compiling the consolidated financial statements demonstrated that amounts in the Statement of Social Insurance were consistent with the underlying

[34]In 2006, OMB issued Memorandum No. M-07-03, *Business Rules for Intragovernmental Transactions* (Nov. 13, 2006), and Treasury issued the Treasury Financial Manual Bulletin No. 2007-03, *Intragovernmental Business Rules* (Nov. 15, 2006). This guidance added criteria for resolving intragovernmental disputes and major differences between trading partners for certain intragovernmental transactions.

[35]Most of the issues we identified in fiscal year 2009 existed in fiscal year 2008, and many have existed for a number of years. In April 2009, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Financial Audit: Material Weaknesses in Internal Control Continue to Impact Preparation of the Consolidated Financial Statements on the U.S. Government*, GAO-09-387 (Washington, D.C.: Apr. 21, 2009). We also reported that as of December 9, 2008, the date of our report on our audit of the fiscal year 2008 consolidated financial statements, 16 of the 56 open recommendations from the previous years' audits had been closed.

federal entities' audited financial statements and that the Balance Sheet and the Statement of Net Cost were also consistent with federal entities' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process did not ensure that the information in the remaining three principal financial statements was fully consistent with the underlying information in federal entities' audited financial statements and other financial data.

- For fiscal year 2009, auditors for many of the CFO Act agencies continued to report control deficiencies regarding entities' financial reporting processes which, in turn, could affect the preparation of the consolidated financial statements. For example, auditors for several entities reported that a significant number of adjustments were required to prepare the entities' financial statements. These and other auditors are also required to separately audit financial information sent by the federal entities to Treasury through a closing package. In connection with preparing the consolidated financial statements, several auditors reported significant deficiencies regarding the preparation of the closing package. Further, Treasury had to record material adjustments to correct errors found in federal entities' audited closing package information.

- To make the fiscal years 2009 and 2008 consolidated financial statements balance, Treasury recorded net increases of $17.4 billion and $29.8 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Unmatched transactions and balances."[36] An additional net $8 billion and $11 billion of unmatched transactions were recorded in the Statement of Net Cost for fiscal years 2009 and 2008, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.

- The federal government could not demonstrate that it had fully identified and reported all items needed to reconcile the operating results, which for fiscal year 2009 showed a net operating cost of $1,253.7 billion, to the budget results, which for the same period showed a unified budget deficit of $1,417.1 billion.

- The federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the accrual-based consolidated financial statements. Treasury's elimination of certain intragovernmental activity and balances continues to be impaired by the federal entities' problems in handling their intragovernmental transactions. As a result, Treasury recorded the net differences in intragovernmental elimination entries as "Unmatched transactions and balances," in order to force the Statements of Operations and Changes in Net Position into balance. As previously discussed, amounts reported for federal entity trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, there are hundreds of billions of dollars of unreconciled differences between the General Fund of the U.S. Government and federal entity

[36]Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to net operating cost, it reported this amount as a component of net operating cost in the accompanying consolidated financial statements.

trading partners related to appropriation and other intragovernmental transactions. The ability to reconcile such transactions is hampered because only some of the General Fund of the U.S. Government is reported in the Department of the Treasury's financial statements.

- Over the past several years, significant actions have been taken to assist in ensuring that financial information is reported or disclosed in the consolidated financial statements in conformity with GAAP. However, Treasury's reporting of certain financial information required by GAAP continues to be impaired. Due to certain material weaknesses noted in this report—for example, commitments and contingencies related to treaties and other international agreements—Treasury is precluded from determining if additional disclosure is required by GAAP in the consolidated financial statements, and we are precluded from determining whether the omitted information is material. Further, Treasury's ability to report information in accordance with GAAP will also remain impaired until federal entities, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal entities within those branches have provided Treasury such information. However, as we have reported in past years, there continue to be undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence that the excluded financial information was immaterial.

- Other internal control deficiencies existed in Treasury's process for preparing the consolidated financial statements, involving inadequate or ineffective (1) policies and procedures related to certain areas; (2) reviews of the financial statements and supporting documentation provided to GAO; and (3) processes for monitoring the preparation of the consolidated financial statements.

- As in previous years, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2009 financial reporting challenges it faced, such as control deficiencies in Treasury's process for preparing the consolidated financial statements noted above. The extension of the date of the issuance of the fiscal year *2009 Financial Report* from mid December 2009 to mid February 2010 generally alleviated excessive workloads that personnel at Treasury's Financial Management Service have historically experienced in meeting the December 15th reporting deadline.[37] However, the need for additional personnel with specialized financial reporting experience to help ensure reliable financial reporting continues to exist. In addition, the federal government does not perform interim compilations at

[37] In light of concurrent financial management and audit activities affected by the implementation of emergency economic stabilization and economic recovery programs, OMB issued Memorandum M-10-04, *Fiscal Year 2009 Audited Financial Statement Reporting Deadline* on October 13, 2009. This memorandum allowed federal entities to request an extension on the issuance of their fiscal year 2009 audited financial statements and certain entities requested and were granted extensions. As a result, the preparation of the consolidated financial statements was also extended.

the governmentwide level. Under the typical reporting deadline, this has lead to almost all of the compilation effort being performed during a condensed time period at the end of the year.

During fiscal year 2009, Treasury, in coordination with OMB, continued implementing corrective action plans and made progress in addressing certain internal control deficiencies we have previously reported. Until the internal control deficiencies have been fully addressed, the federal government's ability to ensure that the consolidated financial statements are consistent with the underlying audited federal entities' financial statements, properly balanced, and in conformity with U.S. GAAP will be impaired. Resolving some of these internal control deficiencies will be a difficult challenge and will require a strong commitment from Treasury and OMB as they continue to execute and implement their corrective action plans.

Components of the Budget Deficit

Both the Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget and Other Activities report a unified budget deficit for fiscal years 2009 and 2008 of $1,417.1 billion and $454.8 billion, respectively.[38] The budget deficit is calculated by subtracting actual budget outlays (outlays) from actual budget receipts (receipts).

For several years, we have been reporting material unreconciled differences between the total net outlays reported in selected federal entities' Statements of Budgetary Resources (SBR) and Treasury's central accounting records used to compute the budget deficit[39] reported in the consolidated financial statements. Unreconciled net outlays of $28 billion and $31 billion existed for fiscal years 2009 and 2008, respectively. OMB and Treasury continue to work towards establishing effective processes and procedures for identifying, resolving, and explaining material differences in this and other components of the deficit between Treasury's central accounting records and information reported in entity financial statements and underlying entity financial information and records. Both entities have recognized the importance of establishing such processes and procedures and that it will take a coordinated effort between them. Until these types of differences are timely reconciled by the federal government, their effect on the U.S. government's consolidated financial statements will continue to be unknown.

In fiscal year 2009, we again noted that several entities' auditors reported internal control deficiencies (1) affecting the entities' SBRs, and (2) related to monitoring, accounting, and reporting of budgetary transactions. These control deficiencies could affect the reporting and calculation of the net outlay amounts in the entities' SBRs. In addition,

[38]The budget deficit, receipts, and outlays amounts are reported in Treasury's *Monthly Treasury Statement* and the President's Budget.
[39]See GAO, *Financial Audit: Material Weaknesses in Internal Control Continue to Impact Preparation of the Consolidated Financial Statements on the U.S. Government*, GAO-09-387 (Washington, D.C.: Apr. 21, 2009). Also, see GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

such deficiencies may also affect the entities' ability to report reliable budgetary information to Treasury and OMB and may affect the unified budget deficit reported in the accrual-based consolidated financial statements. The unified budget deficit is also reported by Treasury in its *Combined Statement of Receipts, Outlays, and Balances*,[40] and in other federal government publications.

[40]Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on entity reporting.

APPENDIX III

Other Material Weaknesses

Material weaknesses in internal control discussed in this report resulted in ineffective controls over financial reporting. In addition to the material weaknesses discussed in appendix II that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, we found the following three other material weaknesses in internal control.

Improper Payments

The federal government continues to make progress under the requirements of the Improper Payments Information Act of 2002 (IPIA)[41] in identifying and reporting on the nature and extent of improper payments,[42] including increasing the number of programs that reported estimates of improper payments. Federal entities reported estimates of improper payment amounts that totaled $98.7 billion for fiscal year 2009, which represented about 5 percent of $1.9 trillion of reported outlays for the related programs. The $98.7 billion estimate is a significant increase of $26.2 billion from the prior year estimate of $72.5 billion.[43] Entities reported that the improper payment increases were mostly attributable to changes in estimation methodologies or increased program outlays for four major programs: (1) Department of Health and Human Services' (HHS) Medicare Fee-For-Service program, (2) HHS' Medicare Advantage program, (3) Department of Labor's Unemployment Insurance program, and (4) Department of Transportation's Federal Aid Highway program. In addition, the Department of Homeland Security reported improper payment estimates totaling about $641 million in fiscal year 2009 for 5 programs that did not report in fiscal year 2008.

While progress has been made, the federal government still faces challenges in determining the full extent to which improper payments occur and to reasonably assure that appropriate actions are taken to reduce improper payments. For example, four federal entities did not report estimated improper payment amounts for fiscal year 2009 for 11 risk-susceptible programs that had total outlays of at least $89 billion. Of these 11 programs, 5 programs had reported improper payment estimated amounts in fiscal year

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[41]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002). The IPIA requires federal executive branch entities to review all programs and activities, identify those that may be susceptible to significant improper payments, estimate and report the annual amount of improper payments for those programs, and implement actions to reduce improper payments.

[42]IPIA defines an improper payment as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts.

[43]In their fiscal year 2009 Performance and Accountability Reports (PAR) and Annual Financial Reports (AFR), select federal entities updated their fiscal year 2008 improper payment estimates to reflect changes since issuance of their fiscal year 2008 PARs and AFRs. These updates increased the governmentwide improper payment estimate for fiscal year 2008 from $72.1 billion to $72.5 billion.

2008. Some entities cited insufficient documentation, incorrect computations, and changes in eligibility requirements as causes of improper payments. Entity auditors also reported a variety of control deficiencies and challenges, such as financial systems limitations and contract monitoring issues, that could allow improper payments to occur. Corrective actions needed to reduce improper payments will be unique across specific entities and programs. Furthermore, until the federal government has implemented effective processes to determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken across entities and programs to effectively reduce improper payments, the federal government will not have reasonable assurance that the use of taxpayer funds is adequately safeguarded.

On November 20, 2009, the President issued Executive Order 13520, *Reducing Improper Payments*, which further heightened awareness of the need to reduce improper payments and eliminate waste, fraud, and abuse in federal programs. The order focuses on transparency, holding entities accountable, and creating incentives to reduce improper payments. We view this as a positive step toward improving transparency over and reducing improper payments, however, it is too soon to determine whether the activities called for in the executive order will achieve its goal of reducing improper payments while continuing to ensure that federal programs serve and provide access to intended beneficiaries.

Information Security

Although progress has been made, serious and widespread information security control deficiencies continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. We have reported information security as a high-risk area across government since February 1997. During fiscal year 2009, federal entities had reported control deficiencies related to preventing, limiting, or detecting unauthorized access to computing resources. Specifically, contol deficiencies were identified related to (1) security management; (2) access to computer resources (data, equipment, and facilities) being reasonable and restricted to authorized individuals; (3) changes to information system resources being authorized and systems being configured and operating as intended; (4) segregation of incompatible duties; and (5) contingency planning for protecting information resources, minimizing the risk of unplanned interruptions, and providing for recovery of critical operations.

Such information security control deficiencies unnecessarily increase the risk that the reliability and availability of data that are recorded in or transmitted by federal financial management systems could be compromised. A primary reason for these deficiencies is that federal entities generally have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control deficiencies, resolving information security problems, and managing information security risks on an ongoing basis. The administration has taken important actions to improve information security, such as issuing extensive guidance on information security and requiring entities to perform specific actions to protect certain personally identifiable information. However, until entities identify and resolve information security control deficiencies and manage information security risks on an on-going basis, federal data and systems, including financial information, will remain at risk.

Tax Collection Activities

During fiscal year 2009, material weaknesses and systems deficiencies continued to affect the federal government's ability to effectively manage its tax collection activities. Due to errors and delays in recording taxpayer information, payments, and other activities, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden by causing frustration to taxpayers who either have already paid taxes owed or who owe significantly lower amounts. In addition, these deficiencies indicate that internal controls over the financial reporting process were not effective to (1) ensure that reported amounts of taxes receivable and tax assessments were accurate on an ongoing basis and could be relied upon by management as a tool to aid in making and supporting resource allocation decisions and (2) support timely and reliable financial statements, accompanying notes, and required supplemental and other accompanying information without extensive supplemental procedures and adjustments.

APPENDIX IV

Significant Deficiencies

In addition to the material weaknesses discussed in appendices II and III, we found three significant deficiencies in internal control as described below.

Loans Receivable, Mortgage-Backed Securities, and Loan Guarantee Liabilities

Internal control deficiencies were identified at federal agencies accounting for the majority of the reported balances for loans receivable, mortgage-backed securities, and loan guarantee liabilities. The deficiencies, for the most part, involved credit subsidy estimation and related financial reporting processes. The issues and the complexities associated with estimating the costs of lending and other loan-related financing activities significantly increase the risk that misstatements in agency and governmentwide financial statements could occur and go undetected. Further, these control deficiencies can adversely affect the federal government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.

Verification Procedures for Data Input for the Troubled Asset Relief Program (TARP) Equity Investment and Direct Loan Valuations

There were deficiencies in verification procedures for certain assumptions and related data that were input into the economic and financial credit subsidy models used for the valuation of TARP direct loans, equity investments, and asset guarantees. Effective verification of data inputs used in the subsidy models is key to providing reasonable assurance that the asset valuations and related subsidy cost are reliably reported in the financial statements.

Preparation of the Statement of Social Insurance

Deficiencies were identified in certain controls over spreadsheets used by the Department of Health and Human Services (HHS) to prepare its Statement of Social Insurance, including the lack of robust controls over spreadsheet changes and inputs that may result in output that varies from management's intentions. HHS, which administers the Medicare programs, contributes the majority of the amounts reported on the consolidated Statement of Social Insurance. Such control deficiencies could result in misstatements to the consolidated Statement of Social Insurance.

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