



U.S. GOVERNMENT ACCOUNTABILITY OFFICE

441 G St. N.W.  
Washington, DC 20548

## Independent Auditor's Report

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

In our audits of the U.S. government's consolidated financial statements as of and for the fiscal years ended September 30, 2013, and 2012, we found the following:

- Certain material weaknesses<sup>1</sup> in internal control over financial reporting and other limitations on the scope of our work resulted in conditions that continued to prevent us from expressing an opinion on the accompanying accrual-based consolidated financial statements<sup>2</sup> as of and for the fiscal years ended September 30, 2013, and 2012.<sup>3</sup>
- Significant uncertainties (discussed in Note 24 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2013, 2012, 2011, and 2010 Statements of Social Insurance, prevented us from expressing an opinion on those statements as well as on the 2013 and 2012 Statements of Changes in Social Insurance Amounts. The Statement of Social Insurance for 2009 is presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.<sup>4</sup>
- Material weaknesses resulted in ineffective internal control over financial reporting for fiscal year 2013.

---

<sup>1</sup>A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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 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.

<sup>2</sup>The accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2013, and 2012, 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 2013, 2012, 2011, 2010, and 2009 Statements of Social Insurance and the 2013 and 2012 Statements of Changes in Social Insurance Amounts, including the related notes, are also included in the consolidated financial statements.

<sup>3</sup>We previously reported that certain material weaknesses and, for some years, other limitations on the scope of our work prevented us from expressing an opinion on the accrual-based consolidated financial statements of the U.S. government for fiscal years 1997 through 2012.

<sup>4</sup>Statements of Social Insurance are presented for the current year and each of the 4 preceding years in accordance with U.S. generally accepted accounting principles. Also, both the Statements of Social Insurance and the Statements of Changes in Social Insurance Amounts do not interrelate with the accrual-based consolidated financial statements. In addition, the valuation date is January 1 for all social insurance programs except the Black Lung program, which has a valuation date of September 30.

- Our tests of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements for fiscal year 2013 were limited by the material weaknesses and other scope limitations discussed in this audit report.

The following sections discuss in more detail (1) our report on the accompanying consolidated financial statements, which includes (a) two emphasis of matters—equity investments related to the federal government’s actions to stabilize financial markets and to promote economic recovery, and long-term fiscal challenges, (b) required supplementary information (RSI), required supplementary stewardship information (RSSI), and other information included with the consolidated financial statements in the *Fiscal Year 2013 Financial Report of the United States Government (2013 Financial Report)*, and (c) information on Chief Financial Officers (CFO) Act agency financial management systems; (2) our report on internal control over financial reporting; (3) our report on compliance with laws, regulations, contracts, and grant agreements; and (4) the Department of the Treasury’s (Treasury) and the Office of Management and Budget’s (OMB) comments on a draft of this audit report. Appendix I discusses the objectives, scope, and methodology of our work.

### **Report on the Consolidated Financial Statements**

The Secretary of the Treasury, in coordination with the Director of OMB, is required to annually submit audited financial statements for the U.S. government to the President and Congress. GAO is required to audit these statements.<sup>5</sup> As noted above, the consolidated financial statements are comprised of the accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2013, and 2012; the 2013, 2012, 2011, 2010, and 2009 Statements of Social Insurance; the 2013 and 2012 Statements of Changes in Social Insurance Amounts; and the related notes to the financial statements.

We performed sufficient audit work to provide this report on the consolidated financial statements. We considered the limitations on the scope of our work regarding the accrual-based consolidated financial statements; the 2013, 2012, 2011, and 2010 Statements of Social Insurance; and the 2013 and 2012 Statements of Changes in Social Insurance Amounts in forming our conclusions. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion on the 2009 Statement of Social Insurance. Our work was performed in accordance with U.S. generally accepted government auditing standards.

### **Management’s Responsibility**

Management of the federal government is responsible for (1) the preparation and fair presentation of annual consolidated financial statements of the U.S. government in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI and RSSI in accordance with U.S. generally accepted accounting principles; and (3) preparing and presenting other information included in documents containing the consolidated financial statements and auditor’s report, and ensuring the consistency of that information with the consolidated financial statements, RSI, and RSSI. This includes maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

---

<sup>5</sup>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). Treasury and OMB have elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well.

### Auditor's Responsibility

Our responsibility is to express opinions on these consolidated financial statements based on conducting the audit in accordance with U.S. generally accepted government auditing standards. We are also responsible for applying certain limited procedures to the RSI, RSSI, and other information included with the consolidated financial statements. Because of the matters discussed below, we were unable to obtain sufficient appropriate evidence to provide a basis for audit opinions on the consolidated financial statements, except for the 2009 Statement of Social Insurance.

For the 2009 Statement of Social Insurance, our responsibility is to express an opinion on this statement based on our audit. U.S. generally accepted government auditing standards require that we plan and perform the audit to obtain reasonable assurance about whether this financial statement is free from material misstatement.

### Basis for Disclaimers of Opinion on the Consolidated Financial Statements, Except for the 2009 Statement of Social Insurance

#### Accrual-Based Consolidated Financial Statements as of and for the Fiscal Years Ended September 30, 2013, and 2012

The federal government is not able to demonstrate the reliability of significant portions of the accompanying accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2013, and 2012, principally resulting from limitations related to certain material weaknesses in internal control over financial reporting and other limitations affecting the reliability of these financial statements and the scope of our work as discussed below. 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.

The federal government did not maintain adequate systems or have sufficient appropriate evidence to support certain material information reported in the accompanying accrual-based consolidated financial statements. The underlying material weaknesses in internal control, which have existed for years, contributed to our disclaimer of opinion on the accrual-based consolidated financial statements. Specifically, these weaknesses concerned the federal government's inability to

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the Department of Defense (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 reported 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 accordance with U.S. generally accepted accounting principles; and
- ensure the consistency of (1) information used by Treasury to compute the budget deficit reported in the consolidated financial statements, (2) Treasury's records of cash transactions, and (3) information reported in federal entity financial statements and underlying financial information and records.

These material weaknesses 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. Due to these material weaknesses and to other limitations on the scope of our work discussed below, additional issues may exist that could affect the accrual-based consolidated financial statements that were not identified. Appendix II describes these 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.

Statements of Social Insurance for 2013, 2012, 2011, and 2010 and the Statements of Changes in Social Insurance Amounts for 2013 and 2012

Significant uncertainties (discussed in Note 24 to the consolidated financial statements), that primarily relate to the achievement of projected reductions in Medicare cost growth, affect the 2013, 2012, 2011, and 2010 Statements of Social Insurance. As a result of these significant uncertainties, readers are cautioned that amounts reported in the 2013, 2012, 2011, and 2010 Statements of Social Insurance, the 2013 and 2012 Statements of Changes in Social Insurance Amounts, and the related notes to such financial statements may not fairly present, in all material respects, the financial condition and changes in the financial condition of the federal government's social insurance programs for those years, in accordance with U.S. generally accepted accounting principles.

These significant uncertainties include the following.

- Medicare projections in the 2013, 2012, 2011, and 2010 Statements of Social Insurance were based on benefit formulas in current law and included a significant decrease in projected Medicare costs from the 2009 Statement of Social Insurance related to (1) reductions in Medicare payment rates for physician services (totaling almost 25 percent in January 2014, as estimated in the 2013 Medicare Trustees Report) and (2) productivity improvements for most other categories of Medicare providers, based on full implementation of the provisions of the Patient Protection and Affordable Care Act, as amended (PPACA).<sup>6</sup> However, there are significant uncertainties concerning the achievement of these projected decreases in Medicare costs.
- Management has noted that actual future costs for Medicare are likely to exceed those shown by the current-law projections presented in the 2013, 2012, 2011, and 2010 Statements of Social Insurance due, for example, to the likelihood of modifications to the scheduled reductions in

---

<sup>6</sup>PPACA, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

Medicare payment rates for physician services.<sup>7</sup> The extent to which actual future costs exceed the projected current-law amounts due to changes to the scheduled reductions in Medicare payment rates for physician services and productivity adjustments depends on both the specific changes that might be legislated and whether such legislation would include further provisions to help offset such costs.

- Management has developed an illustrative alternative projection intended to provide additional context regarding the long-term sustainability of the Medicare program and to illustrate the uncertainties in the Statement of Social Insurance projections. The present value of future estimated expenditures in excess of future estimated revenue for Medicare, included in the illustrative alternative projection, exceeds the \$27.3 trillion estimate in the 2013 Statement of Social Insurance by \$8.9 trillion.

Projections of Medicare costs are sensitive to assumptions about future decisions by policymakers and about the behavioral responses of consumers, employers, and health care providers as policy, incentives, and the health care sector change over time. Such secondary impacts are not fully reflected in the Statement of Social Insurance projections but could be expected to influence the excess cost growth rate used in the projections.<sup>8</sup> Key drivers of uncertainty about the excess cost growth rate include the future development and deployment of medical technology, the evolution of personal income, and the cost and availability of insurance, as well as federal policy changes, such as the implementation of PPACA.

Readers are cautioned that the uncertainties discussed previously also affect the projected Medicare and Medicaid costs reported in the Fiscal Projections for the U.S. Government and Social Insurance information included in the unaudited Required Supplementary Information section of the 2013 *Financial Report* and summarized in Management's Discussion and Analysis. The Required Supplementary Information section of the 2013 *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.

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.<sup>9</sup> In preparing the Statements 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

---

<sup>7</sup>Statutes have been enacted with provisions that prevented scheduled reductions in Medicare payment rates for physician services from taking effect from 2003 through March 2014, including the most recent provision enacted in the Pathway for SGR Reform Act of 2013, which replaced the almost 25 percent scheduled reductions in Medicare payment rates with an increase of 0.5 percent for the period of January 1, 2014, through March 31, 2014. Pub. L. No. 113-67, div. B, tit. I, § 1101, 127 Stat. 1165, 1196 (Dec. 26, 2013), which is classified at 42 U.S.C. § 1395w-4(d)(15). Some of these statutes also included provisions that reduced the federal government's spending on other categories of health care, which had the effect of helping to offset the increased costs related to the physician payment updates.

<sup>8</sup>The excess cost growth rate is the increase in health care spending per person relative to the growth of gross domestic product per person after removing the effects of demographic changes on health care spending.

<sup>9</sup>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 September 30, 2040.

of 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. In addition to the inherent uncertainty that underlies the expenditure projections prepared for all parts of Medicare, the Supplementary Medical Insurance Part D projections have an added uncertainty in that they were prepared using very little program experience upon which to base the estimates.

The scheduled future benefits presented 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 projected to be sustainable under current financing arrangements. Also, the law concerning these programs can be changed at any time. Payment of Social Security and Medicare Hospital Insurance (Part A) benefits is 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 unaudited Required Supplementary Information section of the *2013 Financial Report*, the Social Security and Medicare Hospital Insurance (Part A) trust funds are, based on achievement of the cost reductions discussed above, projected to be exhausted in 2033 and 2026, respectively, at which time they would be unable to pay the full amount of scheduled future benefits. For Social Security, as of January 1, 2013, future revenues were projected to be sufficient to pay 77 percent of scheduled benefits in 2033, the year of projected trust funds (combined) exhaustion, and decreasing to 72 percent of scheduled benefits in 2087.<sup>10</sup> For Medicare Hospital Insurance (Part A), as of January 1, 2013, future revenues were projected to be sufficient to pay 87 percent of scheduled benefits in 2026, the year of projected trust fund exhaustion, and then decreasing to 73 percent of scheduled benefits in 2087.

#### Other Limitations on the Scope of Our Work

For fiscal years 2013 and 2012, there were other limitations on the scope of our work, in addition to the material weaknesses and significant uncertainties noted above, that contributed to our disclaimers of opinion on the consolidated financial statements. Such limitations primarily relate to our ability to obtain adequate representations from management. 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 2013 and 2012 primarily because of insufficient representations provided to them by certain federal entities, including DOD.

#### Disclaimers of Opinion on the Consolidated Financial Statements, Except for the 2009 Statement of Social Insurance

##### Accrual-Based Consolidated Financial Statements as of and for the Fiscal Years Ended September 30, 2013, and 2012

Because of the significance of the related matters described in the Basis for Disclaimer of Opinion paragraphs above, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the accrual-based consolidated financial statements. Accordingly, we do not

---

<sup>10</sup>The combined Social Security trust funds consist of the Federal Old-Age and Survivors Insurance (OASI) trust fund and the Federal Disability Insurance (DI) trust fund. The OASI and DI trust funds' assets are projected to be exhausted in 2035 and 2016, respectively.

express an opinion on the accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2013, and 2012.

Statements of Social Insurance for 2013, 2012, 2011, and 2010 and the Statements of Changes in Social Insurance Amounts for 2013 and 2012

Because of the significance of the related matters described in the Basis for Disclaimer of Opinion paragraphs above, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the Statements of Social Insurance for 2013, 2012, 2011, and 2010 as well as on the Statements of Changes in Social Insurance Amounts for 2013 and 2012. Accordingly, we do not express an opinion on the 2013, 2012, 2011, or 2010 Statements of Social Insurance or on the 2013 and 2012 Statements of Changes in Social Insurance Amounts.

Opinion on the Statement of Social Insurance for 2009

In our opinion, the Statement of Social Insurance for 2009 presents fairly, in all material respects, the financial condition of the federal government's social insurance programs for 2009, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matters

The following key items deserve emphasis in order to put the information contained in the consolidated financial statements and the Management's Discussion and Analysis section of the *2013 Financial Report* into context. However, our disclaimers of opinion and our opinion noted above are not modified with respect to these matters.

Equity Investments Related to the Federal Government's Actions to Stabilize Financial Markets and to Promote Economic Recovery

The last economic recession and the federal government's actions to stabilize financial markets and promote economic recovery, among other factors, significantly affected the federal government's financial condition, including the addition of significant assets and liabilities. While the federal government has significantly reduced the assets and liabilities related to such actions, the accrual-based consolidated financial statements, as of September 30, 2013, and 2012, continue to include significant equity investments in certain entities. For example, as of September 30, 2013, reported investments in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) totaled about \$140 billion (reported net of about \$54 billion in valuation reserves).

In valuing these equity investments, 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 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 the 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, 2013, and the actual results, and such differences may be material. Also, as discussed in Note 1 to the consolidated financial statements, the financial statements do not include the assets, liabilities, or results of operations of such entities in which Treasury holds either a direct, indirect, or beneficial equity interest. Treasury and OMB have determined that none of the entities meet the criteria for a federal entity.

### Long-Term Fiscal Challenges

Increased attention to risks that could affect the federal government's financial condition is made more important because of the nation's longer-term fiscal challenges. The comprehensive long-term fiscal projections presented in the unaudited Required Supplementary Information section of the *2013 Financial Report* show that—absent policy changes—the federal government continues to face an unsustainable long-term fiscal path. The oldest members of the baby-boom generation are already eligible for Social Security retirement benefits and for Medicare benefits. Under these projections, spending for the major health and retirement programs will increase in coming decades as more members of the baby-boom generation become eligible for benefits and the health care cost for each enrollee increases. Over the long term, the imbalance between spending and revenue that is built into current law and policy will lead to continued growth of debt held by the public as a share of gross domestic product (GDP). This situation—in which debt grows faster than GDP—means the current federal fiscal path is unsustainable.

These projections, with regard to Social Security and Medicare, are based on the same assumptions underlying the information presented in the Statement of Social Insurance and assume that the provisions in law designed to slow the growth of Medicare costs are sustained and remain effective throughout the projection period. If, however, the Medicare cost containment measures are not sustained over the long term—a concern expressed by the Trustees of the Medicare trust funds, the Centers for Medicare & Medicaid Services' (CMS) Chief Actuary, the Congressional Budget Office, and others—spending on federal health care programs will grow much more rapidly.

GAO also prepares long-term federal fiscal simulations which continue to show debt rising as a share of GDP.<sup>11</sup> Under GAO's Alternative simulation,<sup>12</sup> which uses the CMS Office of the Actuary's alternative health care cost projections, future spending in excess of receipts would be greater and debt held by the public as a share of GDP would grow more quickly than the projections in the *2013 Financial Report*.

---

<sup>11</sup>GAO, *The Federal Government's Long-Term Fiscal Outlook: Spring 2013 Update*, GAO-13-481SP (Washington, D.C.: Apr. 11, 2013).

<sup>12</sup>GAO's Spring 2013 Alternative simulation incorporates the CMS Office of the Actuary's alternative projections for health care cost growth, which assume physician payments are not reduced as specified under current law and certain cost controls are not maintained over the long term. Also, in this simulation, expiring tax provisions, such as the research and experimentation tax credit, are extended to 2023. In the Alternative simulation, discretionary spending follows the original discretionary spending caps set by the Budget Control Act of 2011, but not the lower caps triggered by the automatic enforcement procedures. Over the long term, discretionary spending and revenue are held at their historical average share of GDP.

The Bipartisan Budget Act of 2013 (budget agreement),<sup>13</sup> which amended the Balanced Budget and Emergency Deficit Control Act (BBEDCA),<sup>14</sup> established new (higher) limits on defense and nondefense discretionary appropriations for fiscal years 2014 and 2015, extended sequestration for direct spending programs by 2 years through fiscal year 2023, and made other changes to direct spending and revenue.

## Other Matters

### Required Supplementary Information and Required Supplementary Stewardship Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that RSI<sup>15</sup> and RSSI<sup>16</sup> be presented in the *2013 Financial Report* to supplement the financial statements. Although not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the RSI and RSSI in accordance with U.S. generally accepted government auditing standards because of the material weaknesses and other scope limitations discussed in this audit report. We did not audit and do not express an opinion or provide any assurance on the RSI or RSSI.

### Other Information

Other information included in the *2013 Financial Report* contains a wide range of information, some of which is not directly related to the consolidated financial statements.<sup>17</sup> This information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements, RSI, or RSSI. We read the other information included with the consolidated financial statements in order to identify material inconsistencies, if any, with the consolidated financial statements. We did not audit and do not express an opinion or provide any assurance on the other information in the *2013 Financial Report*.

Readers are cautioned that the material weaknesses, significant uncertainties, and other scope limitations discussed in this audit report may affect the reliability of certain information contained in the RSI, RSSI, and other information that is taken from the same data sources as the accrual-based

---

<sup>13</sup>Pub. L. No. 113-67, div. A, tit. I, § 101,127 Stat. 1165, 1166-69 (Dec. 26, 2013). The Continuing Appropriations Act, 2014, Pub. L. No. 113-76, 128 Stat. 5 (Jan. 17, 2014), enacted discretionary appropriations for fiscal year 2014 consistent with the limits established in the budget agreement and the Balanced Budget and Emergency Deficit Control Act (BBEDCA), as amended.

<sup>14</sup>The Budget Control Act of 2011, Pub. L. No. 112-25, 125 Stat. 240 (Aug. 2, 2011), which amended BBEDCA, imposed discretionary spending limits for fiscal years 2012 through 2021 to reduce projected spending by about \$1 trillion. The Budget Control Act also established the Joint Select Committee on Deficit Reduction, which was tasked with proposing legislation to reduce the deficit by an additional \$1.2 trillion through fiscal year 2021. The Joint Committee did not report a proposal, and Congress and the President did not enact legislation. This triggered the sequestration process in section 251A of BBEDCA, which is classified, as amended, at 2 U.S.C. § 901a. Section 251A required OMB to calculate, and the President to order, a sequestration of discretionary and direct spending on March 1, 2013. Section 251A also provides for an annual reduction of the discretionary spending limits and a sequestration of direct spending from fiscal years 2014 through 2021. The budget agreement enacted further changes amending section 251A of BBEDCA.

<sup>15</sup>RSI is comprised of Management's Discussion and Analysis and information in the Required Supplementary Information section of the *2013 Financial Report*.

<sup>16</sup>RSSI is comprised of information on stewardship investments in the Required Supplementary Stewardship Information section of the *2013 Financial Report*.

<sup>17</sup>Other information is comprised of information in the *2013 Financial Report* other than the consolidated financial statements, RSI, RSSI, the auditor's report, and the Statement of the Comptroller General of the United States.

consolidated financial statements; the 2013, 2012, 2011, and 2010 Statements of Social Insurance; and the 2013 and 2012 Statements of Changes in Social Insurance Amounts.

### 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 to produce complete, reliable, timely, and consistent financial information for use by executive branch agencies and Congress.<sup>18</sup> The Federal Financial Management Improvement Act of 1996 (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 with which to measure performance and increase accountability throughout the year.

The 24 CFO Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with the requirements of FFMIA. 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 *U.S. Standard General Ledger* at the transaction level.

For both fiscal years 2013 and 2012, auditors for 11 of the 24 CFO Act agencies reported that the agencies' financial management systems did not substantially comply with one or more of the three FFMIA requirements. Agency management at the 24 CFO Act agencies also annually report on FFMIA compliance. For both fiscal years 2013 and 2012, agency management at 9 of the CFO Act agencies reported that their agencies' financial management systems were not in substantial compliance with one or more of the three FFMIA requirements. Based on agency financial reports, the differences in the assessments of substantial compliance between the auditors and agency management reflected differences in views between management and the auditors on the impact reported deficiencies had on agencies' financial management systems.

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 the material weaknesses and other limitations that have resulted in our disclaimers of opinion on the accrual-based consolidated financial statements.

## **Report on Internal Control over Financial Reporting**

### Management's Responsibility

Management of the federal government is responsible for (1) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement,

---

<sup>18</sup>The Federal Financial Management Improvement Act of 1996, which is reprinted in 31 U.S.C. § 3512 note, defines "financial management systems" to include 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.

whether due to fraud or error, and (2) evaluating the effectiveness of internal control over financial reporting, based on criteria established under the Federal Managers' Financial Integrity Act (FMFIA).<sup>19</sup>

### Auditor's Responsibility

The purpose of an audit of financial statements is to express an opinion on the financial statements. An audit of financial statements includes considering internal control over financial reporting to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of 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 performance information and ensuring efficient operations.

Our responsibility is to report any material weaknesses or significant deficiencies in internal control over financial reporting for fiscal year 2013 that come to our attention as a result of our audit. Based on the scope of our work and the effects of the other limitations on the scope of our audit noted throughout this audit report, our internal control work was not designed to, and would not necessarily, identify all deficiencies in internal control, including those that might be material weaknesses or significant deficiencies.<sup>20</sup> Therefore, additional material weaknesses or significant deficiencies may exist that were not identified. Our work was performed in accordance with U.S. generally accepted government auditing standards.

### Definitions and Inherent Limitations of Internal Control over Financial Reporting

An entity's 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 financial statements in accordance with U.S. generally accepted accounting principles, 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 applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error.

### Material Weaknesses Resulted in Ineffective Internal Control over Financial Reporting

The material weaknesses discussed in this audit report resulted in ineffective internal control over financial reporting. Consequently, the federal government's internal control did not provide reasonable assurance that a material misstatement of the consolidated financial statements would be prevented, or detected and corrected, on a timely basis.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, which were discussed previously, we found the following three

---

<sup>19</sup>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 Congress on the adequacy of their internal control and accounting systems and on actions to correct significant problems.

<sup>20</sup>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.

other material weaknesses in internal control. 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 them,
- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

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.

We also found two significant deficiencies in the federal government's internal control related to implementing effective internal controls at certain federal entities for the following areas:

- loans receivable and loan guarantee liabilities and
- federal grants management.

Due to improvements during fiscal year 2013, we determined that control deficiencies related to loans receivable and loan guarantee liabilities, which were reported as a material weakness in fiscal year 2012, constitute a significant deficiency in fiscal year 2013. These significant deficiencies are discussed in more detail in appendix IV.

Further, individual federal entity financial statement audit reports identified additional control deficiencies that were reported by the entities' 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 with respect to the U.S. government's consolidated financial statements.

#### Intended Purpose of Report on Internal Control over Financial Reporting

The purpose of this report on internal control over financial reporting is solely to describe the scope of our consideration of internal control over financial reporting, and the results of our procedures, and not to provide an opinion on the effectiveness of internal control over financial reporting. This report on internal control over financial reporting is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering internal control. Accordingly, this report on internal control over financial reporting is not suitable for any other purpose.

#### **Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements**

##### Management's Responsibility

Management of the federal government is responsible for the federal government's compliance with laws, regulations, contracts, and grant agreements.

### Auditor's Responsibility

An audit of federal financial statements includes testing compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements that have a direct effect on the determination of material amounts and disclosures in the consolidated financial statements, and performing certain other limited procedures. Accordingly, we did not test the federal government's compliance with all laws, regulations, contracts, and grant agreements. Due to the limitations discussed below and the scope of our procedures, noncompliance may occur and not be detected by these tests.

Our objective was not to provide an opinion on the federal government's compliance with laws, regulations, contracts, and grant agreements. Accordingly, we do not express such an opinion. Our work was performed in accordance with U.S. generally accepted government auditing standards.

### Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

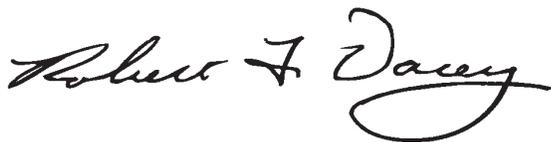
Our work to test compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements was limited by the material weaknesses and other scope limitations discussed in this audit report. U.S. generally accepted government auditing standards and OMB guidance require auditors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

### Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report on compliance with laws, regulations, contracts, and grant agreements is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report on compliance with laws, regulations, contracts, and grant agreements is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

### **Agency Comments**

We provided a draft of this audit 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, 2014

## Appendix I

### Objectives, Scope, and Methodology

Our objectives were to audit the consolidated financial statements consisting of the (1) accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2013, and 2012; (2) 2013, 2012, 2011, 2010, and 2009 Statements of Social Insurance; and (3) 2013 and 2012 Statements of Changes in Social Insurance Amounts. Our objectives also included reporting on internal control over financial reporting and on compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements.

The Chief Financial Officers Act of 1990 (CFO Act), as expanded by the Government Management Reform Act of 1994 (GMRA), requires the inspectors general of the 24 CFO Act agencies to be responsible for annual audits of agency-wide financial statements prepared by these agencies.<sup>21</sup> GMRA requires GAO to be responsible for the audit of the U.S. government's consolidated financial statements,<sup>22</sup> and the Accountability of Tax Dollars Act of 2002 (ATDA) requires most other executive branch entities to prepare and have audited annual financial statements.<sup>23</sup> The Office of Management and Budget and the Department of the Treasury (Treasury) have identified 35 federal entities that are significant to the U.S. government's consolidated financial statements, consisting of the 24 CFO Act agencies, several other federal executive branch agencies, and some government corporations (35 significant entities).<sup>24</sup> We consider these 35 entities to be significant component entities for purposes of our audit of the consolidated financial statements. Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 significant component entities to achieve our respective audit objectives. Our audit approach regarding the accrual-based consolidated financial statements primarily focused 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 2012.<sup>25</sup> We also separately audited the financial statements of certain component entities, and parts of a significant component entity, including the following.

- We audited and expressed an unmodified opinion on the Internal Revenue Service's (IRS) financial statements as of and for the fiscal years ended September 30, 2013, and 2012.<sup>26</sup> In fiscal years 2013 and 2012, IRS collected about \$2.9 trillion and \$2.5 trillion, respectively, in tax payments and paid about \$364 billion and \$373 billion, respectively, in refunds to taxpayers. For fiscal year 2013, we continued to report a material weakness in internal control over unpaid tax assessments that resulted in ineffective internal control over financial reporting. In addition, we continued to report a significant deficiency in IRS's internal control over financial reporting systems, which includes both recurring and newly identified issues that are collectively important enough to merit the attention of those charged with governance. We also reported that we found no reportable noncompliance for

---

<sup>21</sup>31 U.S.C. § 3521(e). GMRA 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).

<sup>22</sup>GMRA, Pub. L. No. 103-356, § 405(c), 108 Stat. 3410, 3416-17 (Oct. 13, 1994), *codified at* 31 U.S.C. § 331(e)(2).

<sup>23</sup>ATDA, Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002), *codified at* 31 U.S.C. § 3515.

<sup>24</sup>See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 entities.

<sup>25</sup>GAO, *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*, GAO-13-271R (Washington, D.C.: Jan. 17, 2013).

<sup>26</sup>GAO, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements*, GAO-14-169 (Washington, D.C.: Dec. 12, 2013).

fiscal year 2013 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

- We audited and expressed an unmodified opinion on the Schedules of Federal Debt Managed by Treasury's Bureau of the Fiscal Service (Fiscal Service) for the fiscal years ended September 30, 2013, and 2012.<sup>27</sup> For these 2 fiscal years, the schedules reported (1) approximately \$12.0 trillion (2013) and \$11.3 trillion (2012) of federal debt held by the public;<sup>28</sup> (2) about \$4.8 trillion (2013) and \$4.8 trillion (2012) of intragovernmental debt holdings;<sup>29</sup> and (3) about \$247 billion (2013) and \$245 billion (2012) of interest on federal debt held by the public. We also reported that although internal controls could be improved, Fiscal Service maintained, in all material respects, effective internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2013. In addition, we reported that we found no reportable noncompliance for fiscal year 2013 with provisions of applicable laws, regulations, contracts, and grant agreements we tested related to the Schedule of Federal Debt.
- We audited and expressed unmodified opinions on the U.S. Securities and Exchange Commission's (SEC) and its Investor Protection Fund's (IPF) financial statements as of and for the fiscal years ended September 30, 2013, and 2012.<sup>30</sup> We also reported that although internal controls could be improved, SEC maintained, in all material respects, effective internal control over financial reporting for both the entity as a whole and the IPF as of September 30, 2013. In addition, we reported that we found no reportable noncompliance for either SEC or IPF for fiscal year 2013 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.
- We audited and expressed an unmodified opinion on the Federal Housing Finance Agency's (FHFA) financial statements as of and for the fiscal years ended September 30, 2013, and 2012.<sup>31</sup> We also reported that FHFA maintained, in all material respects, effective internal control over financial reporting as of September 30, 2013. In addition, we reported that we found no reportable noncompliance for fiscal year 2013 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.
- We audited and expressed an unmodified opinion on the Office of Financial Stability's (OFS) financial statements for the Troubled Asset Relief Program (TARP) as of and for the fiscal years ended September 30, 2013, and 2012.<sup>32</sup> We also reported that OFS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2013. In addition, we reported that we found no reportable noncompliance for fiscal year 2013 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

---

<sup>27</sup>GAO, *Financial Audit: Bureau of the Fiscal Service's Fiscal Years 2013 and 2012 Schedules of Federal Debt*, GAO-14-173 (Washington, D.C.: Dec. 12, 2013).

<sup>28</sup>Debt held by the public on the Schedules of Federal Debt represents federal debt issued by Treasury and held by investors outside of the federal government, including individuals, corporations, state or local governments, the Federal Reserve, and foreign governments.

<sup>29</sup>Intragovernmental debt holdings represent federal debt owed by Treasury to federal government accounts, primarily federal trust funds such as Social Security and Medicare.

<sup>30</sup>GAO, *Financial Audit: Securities and Exchange Commission's Fiscal Years 2013 and 2012 Financial Statements*, GAO-14-213R (Washington, D.C.: Dec. 16, 2013, reissued Dec. 23, 2013).

<sup>31</sup>GAO, *Financial Audit: Federal Housing Finance Agency's Fiscal Years 2013 and 2012 Financial Statements*, GAO-14-171R (Washington, D.C.: Dec. 16, 2013).

<sup>32</sup>GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2013 and 2012 Financial Statements*, GAO-14-172R (Washington, D.C.: Dec. 11, 2013).

- We audited and expressed an unmodified opinion on the Bureau of Consumer Financial Protection's (CFPB) financial statements as of and for the fiscal years ended September 30, 2013, and 2012.<sup>33</sup> We also reported that although internal controls could be improved, CFPB maintained, in all material respects, effective internal control over financial reporting as of September 30, 2013. In addition, we reported that we found no reportable noncompliance for fiscal year 2013 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

In addition, we considered the CFO Act agencies' and certain other federal entities' fiscal years 2013 and 2012 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 the entities. The entity audit reports also contain details regarding any identified material weaknesses or significant deficiencies 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 in the *DOD Agency Financial Report for Fiscal Year 2013* regarding its noncompliant financial management systems and lack of reasonable assurance that internal controls over financial reporting were effective. In addition, in the DOD Inspector General's fiscal year 2013 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.

Because of the significance of the amounts presented in the Statements of Social Insurance and Statements of Changes in Social Insurance Amounts related to the Social Security Administration (SSA) and the Department of Health and Human Services (HHS), our audit approach regarding these statements focused primarily on these two agencies. For each federal entity preparing a Statement of Social Insurance and Statement of Changes in Social Insurance Amounts,<sup>34</sup> we considered the entity's 2013, 2012, 2011, 2010, and 2009 Statements of Social Insurance and the 2013 and 2012 Statements of Changes in Social Insurance Amounts, as well as 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 opinion on the 2009 Statement of Social Insurance.

We performed sufficient audit work to provide our reports on (1) the consolidated financial statements, (2) internal control over financial reporting, and (3) compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements. We considered the limitations on the scope of our work regarding the accrual-based consolidated financial statements; the 2013, 2012, 2011, and 2010 Statements of Social Insurance; and the 2013 and 2012 Statements of Changes in Social Insurance Amounts in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

---

<sup>33</sup>GAO, *Financial Audit: Bureau of Consumer Financial Protection's Fiscal Years 2013 and 2012 Financial Statements*, GAO-14-170R (Washington, D.C.: Dec. 16, 2013).

<sup>34</sup>These entities are 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 appropriate 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. Certain other entities' auditors 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, to the extent 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

Reported net costs were affected by the previously discussed material weaknesses in reporting assets and liabilities; material weaknesses in financial statement preparation, as discussed below; and the lack of adequate reconciliations of disbursement activity at certain federal entities. As a result, the federal

government was unable to support significant portions of the reported total net cost of operations, most notably those related to DOD.

With respect to disbursements, auditors of DOD and certain other federal entities reported continued material weaknesses and significant deficiencies in reconciling disbursement activity. For fiscal years 2013 and 2012, unreconciled disbursement activity, including unreconciled differences between federal entities' and the Department of the Treasury's (Treasury) records of disbursements and unsupported federal entity adjustments, totaled 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

Significant progress was made in fiscal year 2013; however, the federal government continues to be unable to adequately account for and reconcile intragovernmental activity and balances between federal entities. Federal entities are responsible for properly accounting for and reporting their intragovernmental activity and balances in their entity financial statements. When preparing the consolidated financial statements, intragovernmental activity and balances between federal entities should be in agreement and must be subtracted out, or eliminated, from the financial statements. If the two federal entities engaged in an intragovernmental transaction do not both record the same intragovernmental transaction in the same year and for the same amount, the intragovernmental transactions will not be in agreement, resulting in errors in the consolidated financial statements. The Office of Management and Budget (OMB) and Treasury require the chief financial officers (CFO) of the 35 significant component 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, their respective inspectors general, and GAO on the extent and results of intragovernmental activity and balance-reconciliation efforts as of the end of the fiscal year.

In fiscal year 2013, Treasury continued to actively work with federal entities to resolve intragovernmental differences. For example, Treasury expanded its quarterly scorecard process to include all 35 significant component entities,<sup>35</sup> highlighting differences requiring the entities' attention and encouraging the use of the dispute resolution process.<sup>36</sup> As a result of these and other actions, a significant number of intragovernmental differences were identified and resolved. While such progress was made, we continued to note that amounts reported by federal entity trading partners were not in agreement by significant amounts. Reasons for the differences cited by several CFOs included differing accounting methodologies, accounting errors, and timing differences. In addition, the auditor for DOD reported that DOD, which contributes significantly to the unreconciled amounts, could not accurately identify most of its intragovernmental transactions by customer and was unable to reconcile most intragovernmental transactions with trading partners, which resulted in adjustments that cannot be fully supported.

---

<sup>35</sup>For each quarter, Treasury produces a scorecard for each significant entity that reports various aspects of the entity's intragovernmental differences with its trading partners, including the composition of the differences by trading partner and category. Entities are expected to resolve, with the respective trading partners, the differences identified in their scorecards.

<sup>36</sup>When an entity and respective trading partner cannot resolve an intragovernmental difference, the entities must request Treasury to resolve the dispute. Treasury will review the dispute and issue a decision on how to resolve the difference, which the entities must follow.

Further, there are unreconciled transactions between the General Fund of the U.S. Government (General Fund)<sup>37</sup> and federal entity trading partners related to appropriations and other intragovernmental transactions, which amount to hundreds of billions of dollars. The ability to reconcile such transactions is hampered because only some of the General Fund is reported in Treasury's department-level financial statements. 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. In fiscal year 2013, Treasury continued to establish processes to account for and report General Fund activity and balances. As part of the quarterly scorecard process, Treasury provides entities information to assist them in complying with the proper use of the General Fund as a trading partner. In fiscal year 2014, Treasury plans to implement a process for federal entities to confirm and reconcile all of their activity and balances with the General Fund.

Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong and sustained commitment by federal entities to timely resolve differences with their trading partners, as well as continued strong leadership by Treasury and OMB.

### Preparation of Consolidated Financial Statements

Treasury, in coordination with OMB, implemented corrective actions during fiscal year 2013 to address certain internal control deficiencies detailed in our previously issued report; however, 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 accordance with U.S. generally accepted accounting principles (U.S. GAAP).<sup>38</sup> During our fiscal year 2013 audit, we found the following.

- Treasury's process for compiling the consolidated financial statements generally demonstrated that amounts in the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts were consistent with the underlying federal entities' financial statements and that the Balance Sheet, Statement of Net Cost, and Statement of Operations and Changes in Net Position were also consistent with the 35 significant component entities' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process did not ensure that the information in the remaining two principal financial statements (Reconciliation of Net Operating Cost and Unified Budget Deficit, and Statement of Changes in Cash Balance from Unified Budget and Other Activities) was fully consistent with the underlying information in the 35 significant component entities' audited financial statements and other financial data.
- For fiscal year 2013, auditors reported internal control deficiencies at several entities regarding entities' financial reporting processes that could affect information included in the respective entities' closing packages.<sup>39</sup> Further, Treasury had to record significant adjustments to correct errors found in federal entities' audited closing package information. To ensure consistency of underlying entity information and financial data with the U.S. government's consolidated financial

---

<sup>37</sup>The General Fund is a central reporting entity that tracks core activities fundamental to funding the federal government (e.g., issued budget authority, operating cash, and debt financing activities).

<sup>38</sup>Most of the issues we identified in fiscal year 2013 existed in fiscal year 2012, and many have existed for a number of years. Most recently, in June 2013, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action. See GAO, *Management Report: Improvements Needed in Controls over the Preparation of the U.S. Consolidated Financial Statements*, GAO-13-540 (Washington, D.C.: June 28, 2013).

<sup>39</sup>The closing package methodology links federal entities' audited consolidated department-level financial statements to certain of the U.S. government's consolidated financial statements.

statements, entity auditors are required to separately audit and report on the financial information that the 35 significant component entities send to Treasury through closing packages.

- Treasury is unable to properly balance the accrual-based consolidated financial statements. To make the fiscal years 2013 and 2012 consolidated financial statements balance, Treasury recorded a net decrease of \$9.0 billion and a net increase of \$20.2 billion, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which were identified as “Unmatched transactions and balances.”<sup>40</sup> Treasury recorded an additional net \$5.9 billion and \$1.8 billion of unmatched transactions in the Statement of Net Cost for fiscal years 2013 and 2012, respectively. The material weakness in the federal government’s ability to account for and reconcile intragovernmental activity and balances, discussed above, significantly contributes to the unmatched transactions and balances and consequently impairs Treasury’s ability to fully eliminate such intragovernmental activity and balances.
- The federal government has not established and implemented effective processes and procedures for identifying and reporting all items needed to (1) prepare the Statement of Changes in Cash Balance from Unified Budget and Other Activities and (2) reconcile the operating results to the budget results. Typical reconciling items would include both accrual-based costs that are not yet recognized in the unified budget deficit and budget costs that are not yet recognized in the net operating cost.
- Over the past several years, Treasury has taken significant actions to assist in ensuring that financial information is reported or disclosed in the consolidated financial statements in accordance with U.S. GAAP. However, Treasury’s reporting of certain financial information required by U.S. GAAP continues to be impaired. Due to certain control deficiencies noted in this audit report—for example, commitments and contingencies related to treaties and other international agreements—Treasury is precluded from determining if additional disclosure is required by U.S. 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 U.S. 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. While progress was made in fiscal year 2013, undetermined amounts of assets, liabilities, costs, and revenues are not included, and the federal government did not provide evidence that the excluded financial information was immaterial.
- Other internal control deficiencies existed in the process for preparing the consolidated financial statements, involving (1) inadequate design and ineffective implementation of policies and procedures related to certain areas, such as analysis of federal entity-provided data and journal vouchers,<sup>41</sup> and (2) inadequate processes for monitoring and assessing internal controls over the preparation of the consolidated financial statements. As a result, we identified errors in draft consolidated financial statements that were subsequently corrected.

---

<sup>40</sup>Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relates to net operating cost, it reported this amount as a component of net operating cost in the accompanying consolidated financial statements.

<sup>41</sup>Treasury prepares journal vouchers to adjust the consolidated financial statements, for example, to correct errors in or omissions of federal entity-provided data.

- While progress was made in fiscal year 2013, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2013 financial reporting challenges it faced, such as control deficiencies in its process for preparing the consolidated financial statements noted above. Treasury has taken various steps to begin to address these issues, including (1) obtaining and utilizing certain interim financial information from federal entities in preparing initial financial statement drafts, (2) beginning to implement an automated tool to streamline the compilation process, (3) supplementing staff during the financial report preparation process, and (4) reassigning staff from other parts of Treasury and hiring new staff. However, there were not enough personnel in Treasury's Bureau of the Fiscal Service with specialized financial reporting experience that were involved in the preparation of the consolidated financial statements to help ensure reliable financial reporting. In addition, the federal government does not perform interim compilations at the government-wide level, which leads to almost all of the compilation effort being performed during a condensed time period at the end of the year.
- Treasury's and OMB's corrective action plans are not adequate to reasonably ensure that internal control deficiencies involving the process for preparing the consolidated financial statements are efficiently and effectively addressed. For example, these plans do not contain sufficiently detailed actions that must be performed to resolve each of the deficiencies, interim milestones so that interim actions and progress can be monitored and progress assessed, and outcome measures to assist in assessing the effectiveness of the corrective actions. Also, the corrective actions do not fully consider the interrelationships between deficiencies.

Until these 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 accordance with U.S. GAAP will be impaired. Resolving these internal control deficiencies remains a difficult challenge and will require a strong and sustained commitment from Treasury and OMB as they continue to execute and implement corrective actions.

### 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 2013 and 2012 of about \$0.7 trillion and \$1.1 trillion, respectively.<sup>42</sup> The budget deficit is calculated by subtracting actual budget outlays (outlays) from actual budget receipts (receipts). Also, the Fiscal Projections for the U.S. Government included in the unaudited Required Supplementary Information section of the *Fiscal Year 2013 Financial Report of the United States Government* use such outlays and receipts.

Treasury and OMB continue to lack an effective process for ensuring the consistency of (1) information used by Treasury to compute the budget deficit reported in the consolidated financial statements, (2) Treasury's records of cash transactions, and (3) information reported in federal entity financial statements and underlying entity financial information and records. In fiscal year 2013, Treasury made progress through the development and implementation of procedures to reconcile certain outlays and receipts between Treasury's records used to compute the budget deficit reported in the consolidated financial statements and underlying federal entity financial information and records, which included obtaining from significant federal entities explanations of and support for certain differences. However, until Treasury develops and fully implements an effective process for ensuring

---

<sup>42</sup>The budget deficit, receipts, and outlays amounts are reported in Treasury's *Monthly Treasury Statement* and the President's Budget.

consistency as noted above and is able to fully reconcile this information, the effect on the U.S. government's consolidated financial statements will continue to be unknown.

In fiscal year 2013, we again noted that several entities' auditors reported internal control deficiencies 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' Statements of Budgetary Resources. In addition, 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*,<sup>43</sup> and in other federal government publications.

---

<sup>43</sup>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 audit 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 is unable to determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce them. Reducing improper payments is critical to safeguarding federal funds.<sup>44</sup> During fiscal year 2013, the federal government continued to make progress in identifying and reporting on improper payments. While the specific programs included in the government-wide improper payment estimate may change from year to year, a net of 10 additional programs were included when compared to fiscal year 2012. Most notably, the Department of Education's improper payment estimate for the Direct Loan program, approximately \$1.1 billion, was included in the government-wide improper payment estimate for the first time in fiscal year 2013.

Nevertheless, the federal government continues to face challenges in determining the full extent of improper payments. For example, four federal entities did not report fiscal year 2013 estimated improper payment amounts for four risk-susceptible programs, including the Department of Health and Human Services' (HHS) Temporary Assistance for Needy Families. The Improper Payments Information Act of 2002 (IPIA), as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA),<sup>45</sup> requires federal executive branch entities to (1) review all programs and activities, (2) identify those that may be susceptible to significant improper payments, (3) estimate the annual amount of improper payments for those programs and activities, (4) implement actions to reduce improper payments and set reduction targets, and (5) report on the results of addressing the foregoing requirements. IPERA also established a requirement for entity inspectors general to report annually on entities' compliance with criteria listed in IPERA.<sup>46</sup>

The Office of Management and Budget (OMB) reported that the government-wide improper payment error rate decreased to 3.5 percent of program outlays in fiscal year 2013 from 3.7 percent in fiscal year 2012 when including the Department of Defense's (DOD) Defense Finance and Accounting Service (DFAS) Commercial Pay program. When excluding the DFAS Commercial Pay program, the reported government-wide error rate was 4.0 percent of program outlays in fiscal year 2013 compared to the

---

<sup>44</sup>Under the Improper Payments Information Act of 2002, as amended, improper payments are statutorily defined 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 good or service, any duplicate payment, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts.

<sup>45</sup>IPIA, Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002), as amended by IPERA, Pub. L. No. 111-204, 124 Stat. 2224 (July 22, 2010), and IPERIA, Pub. L. No. 112-248, 126 Stat. 2390 (Jan. 10, 2013), and reprinted in 31 U.S.C. § 3321 note.

<sup>46</sup>The most recent inspectors general reports on compliance with the criteria listed in IPERA were issued in 2013 for fiscal year 2012. Pursuant to the Office of Management and Budget implementing guidance, inspectors general reports on fiscal year 2013 compliance with the criteria listed in IPERA are expected to be issued by April 2014.

revised 4.3 percent in fiscal year 2012.<sup>47</sup> In May 2013, we reported on major deficiencies in DOD's process for estimating fiscal year 2012 improper payments in the DFAS Commercial Pay program, including deficiencies in identifying a complete and accurate population of payments and developing a statistically valid sampling methodology.<sup>48</sup> According to its fiscal year 2013 Agency Financial Report, DOD is reevaluating its sampling methodology for fiscal year 2014 for the DFAS Commercial Pay program based on our recommendation. Consequently, the fiscal year 2013 improper payment estimate for the DFAS Commercial Pay program may not be reliable.

Without the DFAS Commercial Pay program, federal entity improper payment estimates totaled \$105.8 billion in fiscal year 2013, a decrease from the prior year revised estimate of \$107.1 billion. Decreases in reported estimates of improper payments were mostly attributable to three major programs: the decrease for the Department of Labor's Unemployment Insurance program was attributable to a decrease in reported outlays, and the decreases for HHS's Medicaid and Medicare Advantage (Part C) programs were attributable to decreases in reported error rates.<sup>49</sup> It is important to note that, pursuant to OMB implementing guidance, reported improper payment estimates include overpayments, underpayments, and payments for which adequate documentation was not found, and may also include amounts of payments for years prior to the current fiscal year.

In addition to the issues related to the DFAS Commercial Pay program discussed above, some federal entities face challenges in reporting on and reducing improper payments. Various inspectors general reported deficiencies related to compliance with the criteria listed in IPERA for fiscal year 2012 at their respective federal entities, including risk-susceptible programs that did not report improper payment estimates, estimation methodologies that were not statistically valid, and risk assessments that may not accurately assess the risk of improper payment.

While improper payment estimates have decreased, for fiscal year 2013, federal entities reported improper payment error rates for seven risk-susceptible programs, accounting for more than 50 percent of the government-wide improper payment estimate, that exceeded 10 percent.<sup>50</sup> Under IPERA, an entity reporting an improper payment rate of 10 percent or greater for any risk-susceptible program or activity must submit a plan to Congress describing the actions that the entity will take to reduce improper payment rates below 10 percent.<sup>51</sup>

Further, entity auditors continued to report internal control deficiencies over financial reporting in their fiscal year 2013 financial statement audit reports, such as financial system limitations and information

---

<sup>47</sup>In their fiscal year 2013 Performance and Accountability Reports (PAR) and Agency Financial Reports (AFR), three federal entities updated their fiscal year 2012 improper payment estimates to reflect changes since issuance of their fiscal year 2012 PARs and AFRs. These updates decreased the government-wide improper payment estimate for fiscal year 2012 from \$107.7 billion to \$107.1 billion and from 4.4 percent of program outlays to 4.3 percent.

<sup>48</sup>GAO, *DOD Financial Management: Significant Improvements Needed in Efforts to Address Improper Payment Requirements*, GAO-13-227 (Washington, D.C.: May 13, 2013).

<sup>49</sup>Reported error rates reflect the estimated improper payments as a percentage of total program outlays.

<sup>50</sup>The seven programs that reported improper payment estimates that exceeded 10 percent in fiscal year 2013 were (1) the U.S. Department of Agriculture's (USDA) School Breakfast program, (2) the Department of the Treasury's Earned Income Tax Credit program, (3) the Small Business Administration's (SBA) Disaster Assistance Loan program, (4) the Department of Veterans Affairs' State Home Per Diem Grants program, (5) USDA's National School Lunch program, (6) SBA's Contract Disbursements program, and (7) HHS's Medicare Fee-for-Service program.

<sup>51</sup>IPERA requires each inspector general to annually determine whether the entity is in compliance with the criteria listed in IPERA. Compliance includes an entity reporting an improper payment rate of less than 10 percent for each program and activity for which an estimate was published. Entities determined by the inspector general to not be in compliance with the criteria listed in IPERA must submit a plan to Congress describing the actions that the entity will take to come into compliance.

system control weaknesses. Such deficiencies could significantly increase the risk that improper payments may occur and not be detected promptly.

Finally, IPERIA was enacted in January 2013 to intensify efforts to identify, prevent, and recover payment error, waste, fraud, and abuse within federal spending. Among other things, IPERIA enacted into law elements of the President's "Do Not Pay List" initiative by requiring entities to review prepayment and pre-award procedures and ensure a thorough review of available databases to determine program or award eligibility before the release of any federal funds. IPERIA also directs OMB to annually identify a list of high-priority federal programs for greater levels of oversight and review and requires each entity responsible for administering one of these high-priority programs to annually submit a program report to its inspector general and make a report copy available to the public.

Until the federal government has implemented effective processes to determine the full extent to which improper payments occur and has taken appropriate actions across entities and programs to effectively reduce improper payments, it will not have reasonable assurance that the use of federal funds is adequately safeguarded.

### Information Security

Although progress has been made, serious and widespread information security control deficiencies reported during fiscal year 2013 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. Specifically, control deficiencies were identified related to (1) security management; (2) access to computer resources (data, equipment, and facilities); (3) changes to information system resources; (4) segregation of incompatible duties; and (5) contingency planning. We have reported information security as a high-risk area across government since February 1997.

Such information security control deficiencies unnecessarily increase the risk that data recorded in or transmitted by federal financial management systems are not reliable and available. 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 federal government has taken important actions to improve information security, such as enhancing performance measures and reporting processes necessary for monitoring and assessing the effectiveness of entities' information security programs. In addition, the administration established goals to achieve, by the end of fiscal year 2014, 95 percent use of (1) trusted Internet connections to consolidate external telecommunication access points; (2) continuous monitoring of federal information systems; and (3) strong authentication through the increased use of federal smart card credentials, such as Personal Identity Verification and Common Access Cards. Until entities identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, federal data and systems, including financial information, will remain at risk.

### Tax Collection Activities

During fiscal year 2013, a material weakness continued to affect the federal government's ability to effectively manage its tax collection activities. Due to financial system limitations, as well as errors and delays in recording taxpayer information, the federal government's records did not always reflect the correct amount of taxes owed by the public to the federal government. Such errors and delays may

cause undue burden and frustration to taxpayers who either have already paid taxes owed or who owe significantly lower amounts.

Collectively, these deficiencies indicate that internal controls were not effective in (1) ensuring that reported amounts of taxes receivable and other 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) supporting timely and reliable financial statements, accompanying notes, and required supplementary information and other information without extensive supplemental procedures and adjustments.

## Appendix IV

### **Significant Deficiencies**

In addition to the material weaknesses discussed in appendixes II and III, we found two significant deficiencies in the federal government's internal control related to implementing effective internal controls at certain federal entities, as described below.

#### Loans Receivable and Loan Guarantee Liabilities

Internal control deficiencies were identified at certain significant component entities accounting for the majority of the reported balances for loans receivable and loan guarantee liabilities. The deficiencies related to accounting and financial reporting issues involving loan servicing systems and a system used for managing certain guaranteed loans. During fiscal year 2013, the Department of Education, which accounted for the largest reported balance of loans receivable, implemented corrective actions to address certain of the systems deficiencies reported in fiscal year 2012. Due to these improvements, we determined that control deficiencies related to loans receivable and loan guarantee liabilities, which were reported as a material weakness in fiscal year 2012, constitute a significant deficiency in fiscal year 2013.

Control deficiencies related to accounting and financial reporting over loans receivable and loan guarantee liabilities increase the risk that misstatements in entity and government-wide financial statements could occur and go undetected.

#### Federal Grants Management

In fiscal year 2013, federal grants management internal control deficiencies were identified at several federal entities. Reported deficiencies primarily related to accounting for grant programs, monitoring procedures over grant activities, and the maintenance of related documentation. These internal control deficiencies could adversely affect the federal government's ability to ensure that grant funds are being properly reported and used in accordance with applicable program laws and regulations.