

*U.S. DEPARTMENT OF COMMERCE*  
*Office of Inspector General*

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*ECONOMIC DEVELOPMENT*  
*ADMINISTRATION*

*Financial Statements*  
*Fiscal Year 1997*

*Audit Report No. FSC-9861-8-0001/March 1998*

**PUBLIC  
RELEASE**

*Office of Audits, Financial Statements Audit Division*

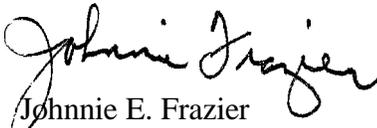


**UNITED STATES DEPARTMENT OF COMMERCE**  
**The Inspector General**  
Washington, D.C. 20230

March 31, 1998

MEMORANDUM FOR: Dr. Phillip A. Singerman  
Assistant Secretary for Economic

FROM:

  
Johnnie E. Frazier  
Acting Inspector General

SUBJECT: Audit of EDA's FY 1997 Financial Statements  
Audit Report No. FSC-9861-8-0001

The attached audit report presents the results of the audit of the Economic Development Administration's (EDA) Statements of Financial Position as of September 30, 1997, and 1996, and the related Statements of Operations and Changes in Net Position for the years then ended. Also provided are reports on EDA's internal controls and compliance with laws and regulations. The accompanying overview and financial statements were prepared by EDA. Management's comments are included as an attachment to the report.

In accordance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, an audited consolidated financial statement must be prepared covering all accounts and associated activities of each office, bureau, and activity of the Department. To facilitate the consolidated audit process, we contracted with the independent certified public accounting firm of Arthur Andersen LLP to audit EDA's FY 1997 financial statements. The Office of Inspector General defined the audit scope, oversaw the process of selecting the contractor, and oversaw the performance and delivery of the audit.

EDA has made substantial progress in improving its financial management. Arthur Andersen LLP expressed a qualified opinion on the Statement of Financial Position as of September 30, 1997. The opinion was qualified because EDA had not established procedures to ensure that accrued grant expenses were recorded accurately in the financial statements and the auditor was unable to obtain sufficient evidence to form an opinion regarding the basis on which accrued grant expenses were stated. EDA received a disclaimer of opinion on its September 30, 1997, Statement of Operations and Changes in Net Position because of the effects of the prior year disclaimer of opinion. The October 1, 1996, balances of assets, liabilities, and net position enter into the determination of FY 1997 net income from operations and of changes in net position, and it was not practical to extend procedures to audit those balances. Accordingly, the scope of the auditors' work was not sufficient to enable them to express an opinion on EDA's results of operations and changes in net position for the year then ended.

In its report on internal control structure, Arthur Anderson LLP identified the following five reportable conditions, of which the first is a material weakness:

- Accrued grant expenses are not accurately recorded.
- The financial management control environment should be strengthened.
- Duties relating to computer program changes for the fund accounting system are not compatible.
- Controls over logical security for the fund accounting system should be improved.
- Annual leave is not reconciled on a timely basis.

Additionally, in its report on compliance with laws and regulations, Arthur Andersen LLP identified the following instance of non-compliance: EDA's financial accounting system did not substantially comply with the Federal Financial Management Improvement Act in that EDA has not established an accounting system that conforms with applicable federal accounting standards with respect to accurately recording grant expenses.

Financial statement audits are a key gauge for measuring the progress of a bureau in meeting the goals and objectives of the CFO Act. The dramatic reduction of identified deficiencies to one material weakness and five reportable conditions as opposed to four and five, respectively, in FY 1996, and the receipt of a qualified opinion on the Statement of Financial Position are clear indications of EDA's commitment to improving its financial management.

Although significant progress has been made, EDA must continue to resolve the remaining material weakness and reportable conditions. Of particular importance is the need to address EDA's methodology for determining accrued grant expenses. This issue will need to be resolved before EDA can receive an unqualified opinion in the future. In the bureau's attached response to the audit reports, EDA strongly objects to categorization of accrued grant expense as a material weakness. The response states that the method of calculating the accrued expense is valid and the statements reflect an accurate September 30, 1997, balance. We concur with Arthur Andersen LLP's assessment that the methodology used to calculate accrued grant expense was not valid and that the issue is properly reported as a material weakness. EDA was not able to provide Arthur Andersen LLP with sufficient evidence to support its claim of what that amount should be. In addition, EDA did not provide at least two full years' worth of data to support a trend analysis. We are committed to working with EDA's recently hired Chief Financial Officer to help resolve this issue.

Our office reviewed a draft version of EDA's FY 1997 overview to its financial statements. The overview provides the link between the financial statements and the Government Performance and Results Act of 1993 (GPRA) that requires government entities to collect and report information on their performance in meeting goals and objectives. We shared our observations and recommendations in a January 7, 1998, discussion paper and a subsequent meeting with EDA management. EDA was responsive to our observations and recommendations and revised this integral component of the financial statements.

The revised overview (1) links EDA's planned performance measures with both its programs and its goals and objectives included in the Department's *Strategic Plan*; (2) identifies management action taken to address identified deficiencies in internal controls; and (3) includes a discussion of such issues as the challenges the bureau faces in measuring its performance. However, EDA needs to strengthen reported results of program performance (e.g., outcome and cost-effectiveness measures) before an assessment can be made of the bureau's success or failure to achieve its goals and objectives. The bureau also needs to improve the presentation of performance data to facilitate trend analysis and the determination of whether target levels of performance are being achieved.

In order to improve the usefulness of the overview to decision-makers, such as OMB and the Congress, we encourage EDA to address the observations contained in our discussion paper. Moreover, continued improvement will be needed for the overview to be consistent with the requirement of OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, to "provide a clear and concise description of the reporting entity and its mission, activities, program and financial results, and financial condition." We realize that improving the overview is an iterative process, and we encourage EDA to strengthen next year's discussion of its results.

We recognize EDA's commitment to preparing high quality and meaningful financial statements. To continue to meet this objective, the accounting requirements set forth in OMB Bulletin 97-01 need to be taken into consideration during preparation of the FY 1998 financial statements. Implementation of OMB Bulletin 97-01 will pose tremendous challenges for various reasons. In particular, this bulletin requires six statements to be prepared, whereas OMB Bulletin 94-01 required two. One of the six statements, the Statement of Net Cost, requires EDA to report its costs by sub-organizations and programs, which should be based on the missions and outputs described in EDA's GPRA strategic and annual plans, its budget structure, and the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards*. As the federal government has not been required previously to report information in such a manner for financial and budgetary purposes, EDA will need to place emphasis on the implementation of OMB Bulletin 97-01.

As required by DAO 213-5, please provide an audit action plan addressing the recommendations in the attached report within 60 days of this memorandum. The format for the plan is Exhibit 7 of the DAO. Under the DAO, the Office of Inspector General must concur with your proposal. The DAO prescribes procedures for handling any disagreements this office may have with the audit action plan.

If you wish to discuss the contents of this report, please contact George E. Ross, Assistant Inspector General for Auditing, on (202) 482-1934, or Thomas McCaughey, Director, Financial Statements Contract Audits Division, on (703) 603-0301. We appreciate the cooperation and courtesies extended by EDA during the audit.

Attachments

cc: W. Scott Gould  
Chief Financial Officer and  
Assistant Secretary for Administration

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