GAO U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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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, 2014, and 2013, we found the following:

- Certain material weaknesses[1] 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[2] as of and for the fiscal years ended September 30, 2014, and 2013.[3]

- 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 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance, prevented us from expressing an opinion on those statements as well as on the 2014 and 2013 Statements of Changes in Social Insurance Amounts.[4]

- Material weaknesses resulted in ineffective internal control over financial reporting for fiscal year 2014.

- Material weaknesses and other scope limitations discussed in this audit report limited our tests of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements for fiscal year 2014.

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[1]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.
[2]The accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2014, and 2013, 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 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance and the 2014 and 2013 Statements of Changes in Social Insurance Amounts, including the related notes, are also included in the consolidated financial statements.
[3]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 2013.
[4]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.

The following sections of this audit report 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),[5] required supplementary stewardship information (RSSI),[6] and other information[7] included with the consolidated financial statements in the *Fiscal Year 2014 Financial Report of the United States Government* (*2014 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 our audit objectives, scope, and methodology.

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.[8] As noted above, the consolidated financial statements consist of the accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2014, and 2013; the 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance; the 2014 and 2013 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 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance; and the 2014 and 2013 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.

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

[5] RSI consists of Management's Discussion and Analysis and information in the Required Supplementary Information section of the *Fiscal Year 2014 Financial Report of the United States Government*.

[6] RSSI consists of information on stewardship investments in the Required Supplementary Stewardship Information section of the *Fiscal Year 2014 Financial Report of the United States Government*.

[7] Other information consists of information in the *Fiscal Year 2014 Financial Report of the United States Government* other than the consolidated financial statements, RSI, RSSI, the auditor's report, and the Statement of the Comptroller General of the United States.

[8] 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.

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.

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.

Basis for Disclaimers of Opinion on the Consolidated Financial Statements

Accrual-Based Consolidated Financial Statements as of and for the Fiscal Years Ended September 30, 2014, and 2013

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, 2014, and 2013, 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.[9] 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;

[9]In addition to the limitations discussed in this audit report, as of the date of this audit report, the Department of Housing and Urban Development's (HUD) audited financial statements for fiscal year 2014 had not been issued. It is possible that additional recordkeeping by HUD and auditing procedures by its Office of Inspector General will result in changes in HUD's financial statements. Based on the audit procedures we have performed, we believe that any such changes will not significantly affect our findings and conclusions in this audit report.

- reasonably assure that the consolidated financial statements are (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in accordance with U.S. generally accepted accounting principles; and

- reasonably assure that the information in the Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget and Other Activities is complete and consistent with the underlying information in the audited entities' financial statements and other financial data.

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.

<u>Statements of Social Insurance for 2014, 2013, 2012, 2011, and 2010 and the Statements of Changes in Social Insurance Amounts for 2014 and 2013</u>

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 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance. As a result of these significant uncertainties, readers are cautioned that amounts reported in the 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance; the 2014 and 2013 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.

For the 2014 Statement of Social Insurance, these significant uncertainties primarily relate to the following.

- Medicare projections in the 2014 Statement of Social Insurance were based on benefit formulas under the Medicare Trustees' *projected baseline* and included a significant reduction in Medicare payment rates for productivity improvements relating to most categories of Medicare providers,[10] based on full implementation of the provisions of the Patient Protection and Affordable Care Act, as amended (ACA).[11]

[10]These categories include, but are not limited to, inpatient/outpatient hospital services, skilled nursing facilities, home health care, ambulance, ambulatory surgical centers, durable medical equipment, and prosthetics.
[11]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). In this report, references to ACA include any amendments made by the Health Care and Education Reconciliation Act of 2010.

- Management has noted that actual future costs for Medicare are likely to exceed those shown by the projected baseline projections presented in the 2014 Statement of Social Insurance due, for example, to the likelihood of modifications to the scheduled reductions in Medicare payment rates for productivity adjustments relating to most categories of Medicare providers. The extent to which actual future costs exceed the projected baseline amounts due to changes to the scheduled reductions in Medicare payment rates for 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. Consequently, there are significant uncertainties concerning the achievement of these projected reductions in Medicare payment rates.

- 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 $28.5 trillion estimate in the 2014 Statement of Social Insurance by $6.7 trillion.

The 2014 Statement of Social Insurance reflects a change from the assumption regarding scheduled reductions in Medicare payment rates for physician services that was used in the 2013, 2012, 2011, and 2010 Statements of Social Insurance. Specifically, the 2014 Statement of Social Insurance reflects a projected baseline that assumes that the physician payment rate reductions will not occur and that physician payment rates will annually increase at a rate equal to the average sustainable growth rate (SGR) override that occurred over the 10-year period ending on March 31, 2015. This revised assumption is based on a similar change in assumption in the 2014 Medicare Trustees Report, which noted that since the scheduled reductions under the SGR formula for updating the physician fee schedule have been overridden by lawmakers each year beginning with 2003, it is a virtual certainty that lawmakers will override this reduction.[12] Because it is difficult to predict the extent to which policymakers will finance future SGR overrides with other Medicare savings, the Medicare projections do not include any such savings. As discussed in Note 24, the projected baseline included in the 2014 Statement of Social Insurance exceeded management's projection based on current law, which included the reductions in payment rates for physician services, by about $1.8 trillion.

The 2013, 2012, 2011, and 2010 Statements of Social Insurance were affected by significant uncertainties primarily related to the achievement of projected reductions in Medicare payment rates for productivity improvements as well as for physician services. Specifically, the Medicare projections in the 2013, 2012, 2011, and 2010 Statements of Social Insurance were based on benefit formulas in current law and included significant reductions in Medicare payment rates for productivity improvements and physician services. Further, for these years, management noted that actual future costs for Medicare were 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 Medicare payment rates for productivity adjustments and physician services.

[12]Statutes have been enacted with provisions that prevented scheduled reductions in Medicare payment rates for physician services from taking effect from 2003 through March 2015, including the most recent provision enacted in the Protecting Access to Medicare Act of 2014, which prevented the scheduled reductions in Medicare payment rates for the period of April 1, 2014, through March 31, 2015. Pub. L. No. 113-93, § 101, 128 Stat. 1040, 1041 (Apr. 1, 2014), which is classified at 42 U.S.C. § 1395w-4(d)(15)-(16).

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.[13] 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 the ACA.

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 *2014 Financial Report* and summarized in Management's Discussion and Analysis. The Required Supplementary Information section of the *2014 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 (except for the 2014 Medicare projections which use the projected baseline) and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs.[14] 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 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.

The scheduled future benefits presented in the Statement of Social Insurance are based on benefit formulas in current law (except for the 2014 Medicare projections which use the projected baseline). 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 *2014 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 2030, respectively, at which time they would be unable to pay the full amount of

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[13]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.
[14]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.

scheduled future benefits.[15] For Social Security, 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 2088. For Medicare Hospital Insurance (Part A), future revenues were projected to be sufficient to pay 85 percent of scheduled benefits in 2030, the year of projected trust fund exhaustion, and then decreasing to 77 percent of scheduled benefits in 2088.

Other Limitations on the Scope of Our Work

For fiscal years 2014 and 2013, 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 2014 and 2013 primarily because of insufficient or no representations provided to them by certain federal entities, including DOD.[16]

Disclaimers of Opinion on the Consolidated Financial Statements

Accrual-Based Consolidated Financial Statements as of and for the Fiscal Years Ended September 30, 2014, and 2013

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 express an opinion on the accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2014, and 2013.

Statements of Social Insurance for 2014, 2013, 2012, 2011, and 2010 and the Statements of Changes in Social Insurance Amounts for 2014 and 2013

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 2014, 2013, 2012, 2011, and 2010 as well as on the Statements of Changes in Social Insurance Amounts for 2014 and 2013. Accordingly, we do not express an opinion on the 2014, 2013, 2012, 2011, or 2010 Statements of Social Insurance or on the 2014 and 2013 Statements of Changes in Social Insurance Amounts.

[15] 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 2034 and 2016, respectively.

[16] For fiscal year 2014, HUD had not provided representations to Treasury and OMB by the date that they provided us with representations regarding the U.S. government's consolidated financial statements because the audit report on HUD's financial statements was not yet issued as of such date.

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 *2014 Financial Report* into context. However, our disclaimers of 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, 2014, continue to include significant equity investments in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) totaling about $96 billion (reported net of about $99 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, 2014, 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 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.[17]

Long-Term Fiscal Challenges

While the near-term outlook has improved, the comprehensive long-term fiscal projections presented in the unaudited Required Supplementary Information section of the *2014 Financial Report* show that absent policy changes, the federal government continues to face an unsustainable long-term fiscal path. In the near term, deficits are expected to continue to decline from the recent historic highs as the economy further recovers and actions taken by Congress and the President continue to take effect. 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.

Under these projections, spending for the major health and retirement programs will increase in coming decades more rapidly than GDP as more members of the baby boom generation become eligible for benefits. These projections, with regard to Social Security and Medicare, are

[17]For additional information on the criteria used to determine which federal entities are included in the reporting entity for the consolidated financial statements, as well as the reasons for not including certain entities, such as Fannie Mae and Freddie Mac, see Appendix A: Reporting Entity of the *2014 Financial Report*.

based on the same assumptions underlying the information presented in the Statement of Social Insurance and assume that the provisions enacted in the ACA 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 more rapidly.

GAO also prepares long-term federal fiscal simulations, which continue to show debt rising as a share of GDP.[18] Under GAO's Alternative simulation,[19] using 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 *2014 Financial Report*.

Both the projections in the *2014 Financial Report* and our long-term simulations follow the spending limits previously enacted in the Budget Control Act of 2011 (BCA).[20] Under these limits, discretionary spending will continue to decline as a share of the economy and in fiscal year 2021 will be lower as a share of GDP than any level seen in the last 50 years. At the same time, revenues are projected to rise in the near term as the economy continues to recover.

Debt held by the public as a share of GDP, however, remains well above historical averages. At the end of fiscal year 2014, debt held by the public reached 74 percent of GDP—the highest it has been as a share of GDP since 1950. Debt held by the public at these high levels could limit the federal government's flexibility to address emerging issues and unforeseen challenges, such as another economic downturn or large-scale natural disaster. Further, our past work has also identified a variety of fiscal exposures—responsibilities, programs, and activities that explicitly or

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[18]GAO, *Fiscal Outlook: Federal Fiscal Outlook* (Spring 2014) (Washington, D.C.: 2014), accessed on February 19, 2015, http://www.gao.gov/fiscal_outlook/federal_fiscal_outlook/overview.

[19]GAO's Spring 2014 Alternative simulation, the most recent one available as of the date of our audit report, incorporates the CMS Office of the Actuary's 2013 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 2024. 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.

[20]The BCA, Pub. L. No. 112-25, 125 Stat. 240 (Aug. 2, 2011), which enacted changes to the Balanced Budget and Emergency Deficit Control Act, as amended (BBEDCA), imposed discretionary spending limits for fiscal years 2012 through 2021 to reduce projected spending by about $1 trillion. The BCA 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. 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 Bipartisan Budget Act of 2013 (budget agreement), which enacted further changes to BBEDCA, as amended, 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. Pub. L. No. 113-67, div. A, tit. I, § 101,127 Stat. 1165, 1166-69 (Dec. 26, 2013). In all, BBEDCA, as amended through December 2013, reduced deficits over the next 10 years in our Spring 2014 Baseline Extended simulation without significantly changing the long-term federal budget outlook. In 2014, sequestration for direct spending programs was extended by 1 year to fiscal year 2024. Pub. L. No. 113-82, § 1, 128 Stat. 1009 (Feb. 15, 2014). The Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, 128 Stat. 2130 (Dec. 16, 2014), enacted discretionary appropriations for fiscal year 2015 consistent with BBEDCA. Our updated simulations for 2015 will incorporate the effects of more recently enacted amendments to BBEDCA.

implicitly expose the federal government to future spending.[21] Fiscal exposures vary widely as to source, extent of the government's legal commitment, and magnitude. Over the past decade, some fiscal exposures have grown due to events and trends and the government's response to them. Increased attention to these fiscal exposures will be important for understanding risks to the federal fiscal outlook and enhancing oversight of federal resources.

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 and RSSI be presented in the *2014 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 *2014 Financial Report* contains a wide range of information, some of which is not directly related to the consolidated financial statements. 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 *2014 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 consolidated financial statements; the 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance; and the 2014 and 2013 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.[22] The Federal Financial Management Improvement Act of 1996 (FFMIA) was designed to lead to system improvements that would result in CFO Act agency

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[21] GAO, *Fiscal Outlook: Federal Fiscal Outlook* (Washington, D.C.: 2015), accessed on February 19, 2015, http://www.gao.gov/fiscal_outlook/federal_fiscal_outlook/overview#t=3, and *Fiscal Exposures: Improving Cost Recognition in the Federal Budget*, GAO-14-28 (Washington, D.C.: Oct. 29, 2013).

[22] 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.

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 2014 and 2013, 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 fiscal years 2014 and 2013, agency management at 10 and 9 of the CFO Act agencies, respectively, 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 management's and auditors' views of 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 certain of the material weaknesses and other limitations discussed in this audit report.

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, 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).[23]

[23] 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.

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 2014 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.[24] 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

[24]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.

the following three 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 a significant deficiency in the federal government's internal control related to implementing effective internal controls over management of federal grants at certain federal entities. This significant deficiency is 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 certain of 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, 2015

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, 2014, and 2013; (2) 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance; and (3) 2014 and 2013 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.[25] GMRA requires GAO to be responsible for the audit of the U.S. government's consolidated financial statements,[26] and the Accountability of Tax Dollars Act of 2002 (ATDA) requires most other executive branch entities to prepare and have audited annual financial statements.[27] The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 37 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.[28] We consider these 37 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 37 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 2013.[29] 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, 2014, and 2013.[30] In fiscal years 2014 and 2013, IRS collected about $3.1 trillion and $2.9 trillion, respectively, in tax payments and paid about $374 billion and $364 billion, respectively, in refunds to taxpayers. For fiscal year 2014, 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. We also reported that we found no reportable

[25] 31 U.S.C. § 3521(e). GMRA authorized the Office of Management and Budget to designate agency components that also would receive financial statement audits. See 31 U.S.C. § 3515(c).
[26] 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).
[27] ATDA, Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002), *codified at* 31 U.S.C. § 3515.
[28] In addition to the 35 entities identified as significant to the consolidated financial statements for fiscal year 2013, for fiscal year 2014, OMB and Treasury identified two additional entities as significant to the consolidated financial statements—the Millennium Challenge Corporation and the Overseas Private Investment Corporation. See *Treasury Financial Manual*, vol. I, part 2, ch. 4700, for a listing of the 37 entities.
[29] GAO, *Financial Audit: U.S. Government's Fiscal Years 2013 and 2012 Consolidated Financial Statements*, GAO-14-319R (Washington, D.C.: Feb. 27, 2014).
[30] GAO, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-173 (Washington, D.C.: Nov. 12, 2014).

noncompliance for fiscal year 2014 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, 2014, and 2013.[31] For these 2 fiscal years, the schedules reported (1) approximately $12.8 trillion (2014) and $12.0 trillion (2013) of federal debt held by the public;[32] (2) about $5.0 trillion (2014) and $4.8 trillion (2013) of intragovernmental debt holdings;[33] and (3) about $260 billion (2014) and $247 billion (2013) of interest on federal debt held by the public. We also reported that Fiscal Service maintained, in all material respects, effective internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2014. In addition, we reported that we found no reportable noncompliance for fiscal year 2014 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, 2014, and 2013.[34] 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, 2014. In addition, we reported that we found no reportable noncompliance for either SEC or IPF for fiscal year 2014 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, 2014, and 2013.[35] We also reported that FHFA maintained, in all material respects, effective internal control over financial reporting as of September 30, 2014. In addition, we reported that we found no reportable noncompliance for fiscal year 2014 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, 2014, and 2013.[36] We also reported that OFS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2014. In addition, we reported that we found no reportable noncompliance for fiscal year 2014 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

[31]GAO, *Financial Audit: Bureau of the Fiscal Service's Fiscal Years 2014 and 2013 Schedules of Federal Debt*, GAO-15-157 (Washington, D.C.: Nov. 10, 2014).
[32]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.
[33]Intragovernmental debt holdings represent federal debt owed by Treasury to federal government accounts, primarily federal trust funds such as Social Security and Medicare.
[34]GAO, *Financial Audit: Securities and Exchange Commission's Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-166R (Washington, D.C.: Nov. 17, 2014).
[35]GAO, *Financial Audit: Federal Housing Finance Agency's Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-147R (Washington, D.C.: Nov. 17, 2014).
[36]GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-132R (Washington, D.C.: Nov. 7, 2014).

- 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, 2014, and 2013.[37] We also reported that CFPB's internal control over financial reporting was not effective as of September 30, 2014, because of a material weakness in internal control over the reporting of accounts payable. In addition, we continued to report a significant deficiency in CFPB's internal control over accounting for property and equipment. Further, we reported that we found no reportable noncompliance for fiscal year 2014 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 2014 and 2013 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 entities' operations. Each entity audit report also contains 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 2014* 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 2014 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,[38] we considered the entity's 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance and the 2014 and 2013 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 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 2014, 2013, 2012, 2011, and 2010 Statements of Social Insurance; and the 2014 and 2013 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.

[37]GAO, *Financial Audit: Bureau of Consumer Financial Protection's Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-146R (Washington, D.C.: Nov. 17, 2014).
[38]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 also 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 control deficiencies in reconciling disbursement activity. For fiscal years 2014 and 2013, inadequate reconciliations of disbursement activity included (1) unreconciled differences between federal entities' and the Department of the Treasury's (Treasury) records of disbursements and (2) unsupported federal entity adjustments, 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 has been made over the past few years; 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 37 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 2014, Treasury continued to actively work with significant federal entities to resolve differences in intragovernmental activity and balances between federal entities through its quarterly scorecard process.[39] This process highlights differences requiring the entities' attention, identifies differences that need to be resolved through a formal dispute resolution process,[40] and reinforces the entities' responsibilities to resolve intragovernmental differences.

[39]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 their respective trading partners, the differences identified in their scorecards.

[40]When an entity and respective trading partner cannot resolve an intragovernmental difference, the entity must request that Treasury resolve the dispute. Treasury will review the dispute and issue a decision on how to resolve the difference, which the entity must follow.

Treasury also implemented the Governmentwide Treasury Account Symbol Adjusted Trial Balance System, which among other things, provided more complete financial data from entities that are intended to improve the analysis of intragovernmental differences. 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 to Treasury were not in agreement by material 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.

Further, there are unreconciled transactions between the General Fund of the U.S. Government (General Fund)[41] and federal entity trading partners related to appropriations and other intragovernmental transactions, which amount to hundreds of billions of dollars on an absolute value basis. In fiscal year 2014, Treasury made significant improvements to the processes used to identify and reconcile General Fund differences. For example, Treasury established more specific guidance regarding General Fund-related activity and balances and issued this guidance for federal entities to follow in reporting their financial data. The General Fund also began reporting monthly intragovernmental information for the majority of the activity and balances related to budget authority, such as the liability for federal entities' Fund Balance with Treasury. In addition, Treasury included the General Fund in its quarterly scorecard process—issuing the General Fund its own scorecard and incorporating General Fund reconciliation metrics in federal entities' scorecards. However, the ability to effectively reconcile General Fund transactions is hampered because a significant amount of the General Fund is not independently accounted for and reported.

As a result of the above-noted 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. 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, has implemented several corrective actions during the past few years related to the preparation of the consolidated financial statements. Corrective actions included implementing new systems to collect certain additional data from entities and to compile the consolidated financial statements, and new procedures to address certain internal

[41]The General Fund is a central reporting entity that tracks activities fundamental to funding the federal government (e.g., issued budget authority, operating cash, and debt financing activities).

control deficiencies detailed in our previously issued report.[42] However, the federal government's systems, controls, and procedures were not adequate to reasonably assure 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). During our fiscal year 2014 audit, we found the following.

- For fiscal year 2014, auditors reported internal control deficiencies at several entities regarding entities' financial reporting processes that could affect information in those entities' closing packages.[43] Further, Treasury had to record significant adjustments to correct errors found in federal entities' audited closing package information. These errors primarily related to intragovernmental activity and balances and totaled tens of billions of dollars. To reasonably assure consistency of underlying entity information and financial data with the U.S. government's consolidated financial statements, entity auditors are required to separately audit and report on the financial information that the 37 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 2014 and 2013 consolidated financial statements balance, Treasury recorded a net increase of $20.4 billion and a net decrease of $9.0 billion, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which were identified as "Unmatched transactions and balances."[44] Treasury recorded an additional net $1.7 billion and $5.9 billion of unmatched transactions in the Statement of Net Cost for fiscal years 2014 and 2013, 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.

- Over the past several years, Treasury has taken significant actions to assist in reasonably assuring that financial information is reported or disclosed in the consolidated financial statements in accordance with U.S. GAAP. For example, Treasury has developed and implemented GAAP compliance operating procedures and checklists. 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.

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[42]Most of the issues we identified in fiscal year 2014 existed in fiscal year 2013, and many have existed for a number of years. Most recently, in June 2014, 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 Processes Used to Prepare the U.S. Consolidated Financial Statements*, GAO-14-543 (Washington, D.C.: June 19, 2014).

[43]The closing package methodology links federal entities' audited consolidated department-level financial statements to certain of the U.S. government's consolidated financial statements.

[44]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.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal entities within those branches have provided Treasury such information. However, while progress was made over the past few years, 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.

- In fiscal year 2014, Treasury implemented corrective actions to resolve several internal control deficiencies in the processes used to prepare the consolidated financial statements. For example, Treasury resolved deficiencies related to the identification of federal entities significant to the consolidated financial statements, disclosure of the reporting entity, and analysis of federal entity-provided data. However, other internal control deficiencies existed in the processes used to prepare the consolidated financial statements, involving (1) inadequate design and ineffective implementation of policies and procedures related to certain areas, and (2) inadequate processes for monitoring and assessing internal controls over the preparation of the consolidated financial statements. As a result, we identified errors, such as incomplete disclosures and disclosures that were inconsistent with the underlying audited entity financial statements, in draft consolidated financial statements that were subsequently corrected.

- In fiscal year 2014, Treasury and OMB made progress with respect to their corrective action plans, for example, by supplementing certain information in the plans. However, Treasury's and OMB's corrective action plans are not adequate to reasonably assure that internal control deficiencies involving the processes used to prepare the consolidated financial statements are efficiently and effectively addressed. The plans continued to lack certain key elements as recommended by the *CFO Council's Implementation Guide for OMB Circular A-123, Management's Responsibilities for Internal Control—Appendix A, Internal Control over Financial Reporting*. For example, these plans did not contain sufficiently detailed and comprehensive 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.

- In fiscal year 2014, Treasury continued to improve its systems and build its staff capacity. For example, Treasury (1) obtained and used interim financial information from federal entities in preparing initial financial statement drafts, (2) enhanced the automated tool used in the compilation process, (3) significantly increased staff to permanently work in the division responsible for preparing the consolidated financial statements, and (4) created lead accountant positions to assist in supervising the compilation process. However, challenges remain related to systems and processes, such as accounting for all transactions that affect the General Fund, including cash activity. It is important that Treasury (1) continues to improve its systems and ensure that it has a sufficient number of personnel with appropriate skills to implement the corrective action plans and (2) remains committed to maintaining the progress that has been made in this area and to building upon that progress to make needed improvements to fully address the magnitude of the financial reporting challenges it faces.

Until these internal control deficiencies have been fully addressed, the federal government's ability to reasonably assure 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.

Reconciliations of Budget Deficit to Net Operating Cost and Changes in Cash Balance

For fiscal year 2014, Treasury improved its process for preparing the Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Reconciliation Statements), for example, by identifying and reporting amounts related to certain entities' credit reform subsidy re-estimates. However, the federal government has not established and implemented effective processes and procedures for (1) identifying and reporting all items needed to prepare the Reconciliation Statements and (2) reasonably assuring the information in these statements was fully consistent with the underlying information in the 37 significant component entities' audited financial statements and other financial data, including Treasury's records of General Fund cash transactions. Until Treasury develops and fully implements an effective process for reasonably assuring completeness and consistency of the information in the statements and is able to fully reconcile this information, the effect on the U.S. government's consolidated financial statements will continue to be unknown.

The Reconciliation Statements report a unified budget deficit for fiscal years 2014 and 2013 of about $483 billion and $680 billion, respectively.[45] 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 2014 Financial Report of the United States Government* use such outlays and receipts. With respect to the reported budget deficit, Treasury and OMB continue to lack an effective process for reasonably assuring the consistency of (1) information used by Treasury to compute the budget deficit reported in the consolidated financial statements, (2) Treasury's records of General Fund cash transactions, and (3) information reported in federal entity financial statements and underlying entity financial information and records. In fiscal year 2014, Treasury continued to make progress through the further 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. For example, Treasury obtained from significant federal entities explanations of and support for certain differences.

In fiscal year 2014, 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*,[46] and in other federal government publications.

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[45]The budget deficit, receipts, and outlays amounts are reported in Treasury's *Monthly Treasury Statement* and the President's Budget.

[46]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. According to Treasury, this report is the 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.[47] 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),[48] 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.

The Office of Management and Budget (OMB) reported that the government-wide improper payment error rate increased to 4.0 percent of program outlays in fiscal year 2014 from 3.5 percent in fiscal year 2013 when including the Department of Defense's (DOD) Defense Finance and Accounting Service (DFAS) Commercial Pay program.[49] When excluding the DFAS Commercial Pay program, the reported government-wide error rate was 4.5 percent of program outlays in fiscal year 2014 compared to 4.0 percent in fiscal year 2013. 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.[50] While DOD reported in its fiscal year 2014 agency financial report (AFR) that it revised its sampling methodology, the foundation of reliable statistical sampling estimates is a complete, accurate, and valid population from which to sample. Because of long-standing financial management weaknesses, DOD also reported in its fiscal year 2014 AFR that it cannot demonstrate that all payments subject to improper payment estimation requirements were included in the population of payments for review. Therefore, the fiscal year 2014 improper payment estimate for the DFAS Commercial Pay program may not be reliable.

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[47]Under the Improper Payments Information Act of 2002, as amended, an improper payment is 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.
[48]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.
[49]Reported error rates reflect the estimated improper payments as a percentage of total program outlays.
[50]GAO, *DOD Financial Management: Significant Improvements Needed in Efforts to Address Improper Payment Requirements*, GAO-13-227 (Washington, D.C.: May 13, 2013).

Without the DFAS Commercial Pay program, federal entity improper payment estimates totaled $124.7 billion in fiscal year 2014, a significant increase from the prior year estimate of $105.8 billion. Increases in reported estimates of improper payments were mostly attributable to increased error rates in three major programs: the Department of Health and Human Services' (HHS) Medicare Fee-for-Service, HHS's Medicaid, and the Department of the Treasury's Earned Income Tax Credit programs. 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.

During fiscal year 2014, 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 40 additional programs were included when compared to fiscal year 2013, most of which pertain to funds received under the Disaster Relief Appropriations Act, 2013.[51] Nevertheless, two federal entities did not report fiscal year 2014 estimated improper payment amounts for four risk-susceptible programs, including HHS's Temporary Assistance for Needy Families.[52] Further, various inspectors general reported deficiencies related to compliance with the criteria listed in IPERA for fiscal year 2013 at their respective federal entities,[53] including risk-susceptible programs that did not report improper payment estimates, estimation methodologies that may not produce reliable estimates, and risk assessments that may not accurately assess the risk of improper payment.

For fiscal year 2014, federal entities reported improper payment error rates for 10 risk-susceptible programs, accounting for more than 50 percent of the government-wide improper payment estimate, that exceeded 10 percent.[54] Under IPERA, an entity that is determined by its inspector general to not be in compliance with the criteria listed in IPERA, such as reporting an improper payment rate of 10 percent or greater for any risk-susceptible program or activity, must

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[51]Pub. L. No. 113-2, div. A, 127 Stat. 4 (Jan. 29, 2013). The Disaster Relief Appropriations Act, 2013, states that all funds received under the act are deemed "susceptible to significant improper payments" for purposes of IPIA, as amended, which requires entities to estimate improper payments for these funds.

[52]The three other programs are at the Department of Homeland Security, which plans to report improper payment estimates for such programs in fiscal year 2015.

[53]IPERA established a requirement for entity inspectors general to report annually on entities' compliance with criteria listed in IPERA. The six criteria are that the entity has (1) published an annual financial statement and accompanying materials in the form and content required by OMB for the most recent fiscal year and posted that report on the entity website; (2) conducted a risk assessment for each specific program or activity that conforms with IPIA, as amended; (3) published estimates of improper payments for all programs and activities identified as susceptible to significant improper payments under the entity's risk assessment; (4) published corrective action plans for programs and activities assessed to be at risk for significant improper payments; (5) published and met annual reduction targets for all programs and activities assessed to be at risk for significant improper payments; and (6) reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published. The most recent inspectors general reports on compliance with the criteria listed in IPERA were issued in 2014 for fiscal year 2013. Pursuant to the OMB implementing guidance in M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* (Oct. 20, 2014), inspectors general reports are due within 180 days of publication of the performance and accountability report or AFR. Therefore, inspectors general reports on fiscal year 2014 compliance with the criteria listed in IPERA are generally expected to be issued by May 2015.

[54]The 10 programs that reported improper payment estimates that exceeded 10 percent in fiscal year 2014 were (1) the Department of the Treasury's Earned Income Tax Credit program, (2) the Department of Agriculture's (USDA) School Breakfast program, (3) USDA's Farm Security and Rural Investment program, (4) USDA's Loan Deficiency Payments program, (5) USDA's National School Lunch program, (6) HHS's Disaster Relief – Administration for Children and Families Social Services Block Grant program, (7) HHS's Medicare Fee-for-Service program, (8) HHS's Disaster Relief - Substance Abuse and Mental Health Services Administration program, (9) the Small Business Administration's Disaster Assistance Loans program, and (10) the Department of Labor's Unemployment Insurance program.

submit a plan to Congress describing the actions that the entity will take to come into compliance.

Further, entity auditors continued to report internal control deficiencies over financial reporting in their fiscal year 2014 financial statement audit reports, such as financial system limitations and information 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

GAO has reported information security as a government-wide high-risk area since February 1997. During our fiscal year 2014 audit, we found that serious and widespread information security control deficiencies continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Specifically, control deficiencies were identified related to (1) security management; (2) access to computer resources (data, equipment, and facilities); (3) changes to and configuration of information system resources; (4) segregation of incompatible duties; and (5) contingency planning.

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.

Although significant challenges remain, the federal government has taken actions toward improving information security. For example, the Federal Information Security Modernization Act of 2014 was enacted, which is intended to strengthen information security across the federal government.[55] In addition, for fiscal year 2015, the administration plans to continue to monitor and track entities' performance in implementing goals for the areas of continuous monitoring

[55]The Federal Information Security Management Act of 2002 was enacted as Title III of the E-Government Act of 2002, Pub. L. No. 107-347, 116 Stat. 2899, 2946 (Dec. 17, 2002). The Federal Information Security Modernization Act of 2014, which largely superseded the 2002 act, was enacted as Pub. L. No. 113-283, 128 Stat. 3073 (Dec. 18, 2014), and amended chapter 35 of Title 44, U.S. Code.

and strong authentication, and has added anti-phishing[56] and malware defense as a priority area.[57] However, 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 2014, 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 in taxpayers' accounts, the federal government's records did not always reflect the correct amount of taxes owed by the public to the federal government. Such errors 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.

[56]Phishing is a digital form of social engineering that uses authentic-looking, but fake, e-mails to request information from users or direct them to a fake website that requests information.
[57]The administration describes anti-phishing and malware defense as implementing technologies, processes, and training that reduce the risk of malware introduced through e-mail and malicious or compromised websites.

Appendix IV

Significant Deficiency

In addition to the material weaknesses discussed in appendixes II and III, we found a significant deficiency in the federal government's internal control related to implementing effective internal controls over management of federal grants at certain federal entities, as described below. In fiscal year 2013, we reported a significant deficiency related to loans receivable and loan guarantee liabilities. During fiscal year 2014, certain corrective actions were implemented, primarily by the Department of Education (Education), such that we no longer consider this area to be a significant deficiency as of September 30, 2014. Education accounted for the largest reported balance of loans receivable.

Federal Grants Management

In fiscal year 2014, several federal entities' auditors continued to identify internal control deficiencies related to grants management.[58] Reported deficiencies primarily related to grant accrual estimation methodologies and monitoring of grant activities. These internal control deficiencies could adversely affect the federal government's ability to provide reliable financial statements as well as reasonable assurance that grants are awarded properly, recipients are eligible, and federal grant funds are used as intended.

[58]The Department of Housing and Urban Development, one of the largest grant-making entities and whose auditor has reported grants-related issues for numerous years, had not issued its audited financial statements for fiscal year 2014 as of the date of our audit report.