A REVIEW OF REGULATIONS DESIGNED TO STRENGTHENING INTERNAL CONTROL IN FEDERAL GOVERNMENT

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ABSTRACT

The United States legislature has passed several regulations aimed to strengthen internal control and improve the quality of financial reporting by federal agencies. Under these legislations federal agencies are required to evaluate the adequacy of their internal accounting and administrative controls and report any weaknesses in these systems to the Congress and the President. It is the purpose of this study to review these regulations, investigate the current state of internal control systems in the federal agencies, and highlight any significant weaknesses that may need immediate attention.

UNITED STATES FEDERAL ACTS

Early reference to the establishment of internal control in the United States Federal Government can be traced to the Accounting and Auditing Act of 1950, which among other things stipulates that every federal agency must be subject to an ongoing evaluation of the adequacy of its internal accounting and administrative control system. The 1950 Act requires that:

The head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines issued by the Office of Management and Budget (OMB), prepare annual statements that:

> (1) the agency's systems of internal accounting and administrative control fully comply with standards prescribed by the Comptroller General; or
> (2) such systems do not fully comply with such requirements and report any material weaknesses in the system and describe the plans and schedule for correcting any such weakness (P. L. 81-784, 64 Stat. 832).

This Act directed the Comptroller General of the United States, after consultation with the Secretary of the Treasury and the Director of OMB, to develop accounting standards to be used by federal agencies. The head of each agency has the responsibility for establishing and maintaining adequate systems of internal control, and preparing audited financial statements of the agency. In meeting this requirement, the agency must safeguard its assets, use accrual accounting, cost-based budgeting, and consistent classification.

No major revisions or changes were made to this law until 32 years later when the Federal Managers' Financial Integrity Act (FMFIA) of 1982 was passed. According to this act each executive agency was obligated to establish internal accounting and administrative controls in accordance with standards that were developed by the Comptroller General. It was also indicated that the Comptroller General should develop guidelines for the evaluation of agencies' systems of internal accounting and administrative control to determine such systems' compliance with the requirements of the Act. In addition, it was stipulated that the guidelines include provisions to ensure the prompt resolution of all findings.

The Act's specific requirements include:

1. Executive agencies to establish internal accounting and administrative controls to prevent waste or misuse of agency funds or property and to assure the accountability of assets.
2. The Director of the Office of Management and Budget (OMB), in consultation with the Comptroller General, to establish guidelines for reviewing such controls.
3. The head of each executive agency to evaluate such controls annually and to submit to Congress and the President either a statement that the controls are adequate or a report on any weaknesses in such controls with a schedule for corrective measures, and make the statement or report available to the public, excluding any classified information.
4. Each statement on accounting and administrative controls be accompanied by a separate report on the conformance of each agency's accounting system with standards prescribed by the Comptroller General (Pub. L. 97-255, 96 Stat. 814).

This Act specifies that each December (beginning December 31, 1983) the head of each executive agency prepare a statement of compliance with internal accounting and administrative controls established by the Director of the Office of Management and Budget and the Comptroller General of the United States. If the statement of compliance indicates material weaknesses in these areas, the statement must contain the plans and schedules for correcting the weaknesses.

The next major development in this area occurred in 1990 when the most comprehensive financial management reform legislation in 40 years was passed by the United States Congress (the CFO Act, Public Law 101-576). The Chief Financial Officers (CFO) Act of 1990 established a new Office of Federal Financial Management in the Office of Management and Budget (OMB) and designated the position of the Comptroller General of the United States as the head of this office.

To ensure that the financial operations are being properly carried out the CFO of each federal agency is charged to implement organizational plans by using specific guidelines developed by the OMB. The guidelines detail the authorities, functions, and tasks that a CFO is expected to have for fulfilling the responsibilities outlined by the Act. Under the Act, the agency's CFO is held responsible for all aspects of financial management including accounting, budget implementation, reporting, and other day-t0-day financial management operations. In other words the CFO, as a top manager, has the overall responsibility for establishing and executing effective financial management policies, internal controls, and financial management systems. In addition the Act requires that the government agencies prepare financial statements and present them to an independent auditor for review and verification (GAO/AFMD-12.19.4 CFO Act).

The Chief Financial Officer's Act of 1990 specifically referred to twenty three agencies at the Executive Branch of the Federal Government: The Department of Agriculture, Department of Commerce, Department of Defense, Department of Education, Department of Energy, Department of Health and Human Services, Department of Housing and Urban Development, Department of the Interior, Department of Justice, Department of Labor, Department of State, Department of Transportation, Department of the Treasury, Department of Veterans Affairs, Environmental Protection Agency, and the National and Aeronautics and Space Administration. In section (a) (2) of the Act, it refers to The Agency for International Development, Federal Emergency Management Agency, General Services Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management and, Small Business Administration. The Department of Homeland Security was established in 2001, eleven days after the September 11, 2001 terrorist attack on the World Trade Center. It became the twenty fourth Federal agency required to comply with the CFO Act.

Following the passage of the CFO Act, all of the rules and regulations that were used to manage the Federal government and its agency-based financial systems were amended. The Federal agencies' internal control systems were changed and their financial management systems were reorganized or combined. OMB and the agencies' CFOs started to establish financial management systems not only to support program delivery, but to safeguard assets, manage resources, and protect taxpayers' dollars. In order to achieve these goals OMB and the agencies began to improve the data integrity and developed a set of standards for financial management systems. Communication between government financial managers and scrutiny of financial reporting was improved by resorting to the use of technology, internet based systems, and auditing.

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