

**PEGASYS ACCOUNT BALANCE AND
TRANSACTION ANALYSIS:
CONSTRUCTION IN PROGRESS –
OFFICE OF THE CHIEF FINANCIAL OFFICER
REPORT NUMBER: A040106/B/F/F05020
MAY 9, 2005**



U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

Date: May 9, 2005

Reply to: Deputy Assistant Inspector General
Attn of: Finance and Administrative Audit Office

Subject: Pegasys Account Balance and Transaction Analysis: Construction
in Progress – Office of the Chief Financial Officer
Report Number: A040106/B/F/F05020

To: Kathleen M. Turco
Chief Financial Officer (B)

This report presents the results of our audit of the General Services Administration's Pegasys account balance and transaction analysis for Construction in Progress specific to the Office of the Chief Financial Officer (OCFO). Our audit objective was to determine whether sufficient evidence exists that controls are in place and functioning to ensure management's assertions related to Construction in Progress are properly reflected in the quarterly financial statements as of March 31, 2004.

Our review found that the OCFO should strengthen the internal controls over the review and approval of adjusting journal entries. Specifically, we found that the procedures employed to review the adjusting journal entries submitted by the Greater Southwest Finance Center and the Public Buildings Service's Chief Financial Officer should be improved to ensure that adjustments are based on sufficient, relevant and reliable data. A draft of this report was previously submitted to your office and comments received have been included.

If you have any questions regarding this report, please contact me at (202) 501-0006.

Kristin R. Wilson
Deputy Assistant Inspector General for
Finance and Administrative Audits (JA-F)



**Pegasys Account Balance and Transaction Analysis:
Construction In Progress – Office of the Chief Financial Officer
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**Pegasys Account Balance and Transaction Analysis:
Construction in Progress – Office of the Chief Financial Officer
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EXECUTIVE SUMMARY

Purpose

The purpose of this audit was to provide a basis for reporting on the internal controls over the quarterly financial statement reporting process for the General Services Administration (GSA). Specifically, we focused on the controls over the adjusting journal entries for Construction in Progress¹ (CIP) as recorded in the Federal Buildings Fund (FBF). The objective of our audit was to determine if sufficient evidence exists that the controls asserted to by management were in place and functioning to ensure that the CIP line item was properly reported in the quarterly financial statements as of March 31, 2004.

Background

GSA is required to submit interim unaudited financial statements to the Office of Management and Budget Office of Federal Financial Management (OMB) on a quarterly basis. According to OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, the quarterly statements should include full accruals.

Results in Brief

We found that GSA should strengthen its internal controls over the review and approval of adjusting journal entries as part of its quarterly financial statement reporting process. During our evaluation of the controls over the quarterly financial reporting process for March 31, 2004, we found the procedures employed to review the adjusting journal entries submitted by the Greater Southwest Finance Center and the Public Buildings Service's Chief Financial Officer should be improved to ensure that adjustments are based on sufficient, relevant, and reliable data.

Recommendations

We recommend that the Chief Financial Officer (CFO) strengthen controls over the financial reporting process to ensure that balances are appropriate, assign specific responsibility for review and approval of adjusting journal entries, and develop a control process that clearly documents who prepared, reviewed, and approved each adjusting journal entry.

¹ The United States General Ledger uses the term Construction in Progress, but the General Services Administration presents this account as Construction in Process in the Quarterly Financial Statements as of March 31, 2004 and the Fiscal Year 2003 Financial Statements. The Office of Inspector General will use the term Construction in Progress to refer to the account Construction in Process.

INTRODUCTION

This report presents the results of our audit of GSA's controls over quarterly financial reporting for the financial statements as of March 31, 2004. The audit was conducted in coordination with the Audit of the Pegasys Account Balance and Transaction Analysis-Construction in Progress, and the results are based in part on the work performed for the aforementioned audit.

Background

Under OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, GSA is required to submit interim unaudited financial statements to OMB's Office of Federal Financial Management on a quarterly basis. According to OMB Bulletin No. 01-09, the quarterly statements should include full accruals. Agencies are also required to develop reliable estimates for line item account balances where quarterly information is not readily available.

In their efforts to comply with these requirements, officials from the Office of the Chief Financial Officer's (OCFO) Financial Consulting and Analysis Division (BCP) download the unadjusted trial balance from Pegasys, GSA's accounting system of record, into Excel spreadsheets and Caseware, a financial preparation system used to prepare unadjusted reports, on a quarterly basis. After the unadjusted reports are prepared, the staff accountants test and analyze account balances for reasonableness to identify causes for significant variances between the current and previous fiscal year to determine if worksheet adjustments are necessary. In cases where an adjustment is required, BCP either prepares or requests the appropriate worksheet adjustment from either the regional finance centers or the Services.

Upon receipt from the regional finance centers or Services, BCP officials analyze the worksheet adjustments for appropriateness and to obtain an understanding of the significant issues underlying any adjustments made. Once BCP officials have determined that all adjustments are appropriate, the adjustments are posted to Caseware for the applicable account balances. BCP officials then re-analyze all significant variances at the line item level to better determine the causes of these variances. Once all worksheet adjustment have been received, reviewed, and entered by BCP staff, BCP creates a Balance Sheet and Adjusted Income Statement for each of GSA's funds. The BCP staff accountant responsible for each fund subsequently reviews these financial statements to ensure that all adjustments have posted properly.

One account balance for which quarterly information is not readily available, requiring a worksheet adjustment, is PBS's CIP. In order to generate the worksheet adjustment, PBS uses a statistical sample during its quarterly financial reporting process to assess the accuracy of data in the Real Property Accounting and Depreciation System (RPADS), which interfaces Pegasys. From the results of this statistical sample, PBS estimates the worksheet adjustments needed to correct the CIP account balance for

errors discovered and submits an adjusting journal entry to BCP. For the quarter ended March 31, 2004, this process resulted in a reclassification of \$286 million from CIP to Property and Equipment (P&E). Consequently, the CIP account balance for FBF was reported as \$1.634 billion on GSA's March 31, 2004 quarterly financial statements submitted to OMB.

Objective, Scope, and Methodology

The objective of our audit was to answer the following question as related to controls over GSA's quarterly financial reporting process:

Does sufficient evidence exist that the controls asserted to by management were in place and functioning to ensure that the CIP line item was properly reported in the quarterly financial statements as of March 31, 2004?

To accomplish our objective, we:

- Reviewed policies and procedures related to the quarterly financial reporting process;
- Reviewed the documentation supporting financial statement adjustments;
- Interviewed OCFO officials to gain an understanding of the Quarterly Financial Reporting Cycle;
- Judgmentally selected the CIP statistical sample adjusting journal entry for testing;
- Reviewed the methodology and evaluated the process for developing the CIP statistical sample adjusting journal entry;
- Performed substantive analytical procedures on the variance for CIP and the CIP statistical sample adjusting journal entry;
- Performed substantive tests on the CIP statistical sample; and
- Reviewed the effectiveness of GSA's systems of accounting and internal control over quarterly financial reporting as of March 31, 2004, based on the internal control objectives in OMB's Bulletin No. 01-02 *Audit Requirements for Federal Financial Statements*.

Initially, our survey work focused on the overall quarterly financial statement process. However, based on the results of our survey work, we limited our scope to the adjusting journal entries for CIP. Concurrently, we expanded our testing to include the controls employed by the PBS Chief Financial Officer over these adjustments. The results of this review will be reported separately. The audit was conducted from January to November 2004 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

We found that GSA should strengthen its internal controls over the review and approval of report level adjusting journal entries as part of its quarterly financial statement reporting process. During our evaluation of the controls over the quarterly financial reporting process for March 31, 2004, we found the procedures employed by BCP to

review the adjusting journal entries submitted by the Greater Southwest Finance Center and PBS's Chief Financial Officer should be improved to ensure that adjustments are based on sufficient, relevant, and reliable data. Our testing found several factors that may have hindered BCP's ability to discover errors and deficiencies in the adjusting journal entries. The inability to discover errors and deficiencies in the adjusting journal entries may increase the risk that misstatements in the quarterly financial statements will occur.

Controls over the financial reporting process should be strengthened to reasonably ensure that the OCFO accurately reports the balance of CIP.

The financial reporting procedures used by BCP may not be sufficient to detect errors and deficiencies in the adjusting entries submitted by the Greater Southwest Finance Center and PBS's Chief Financial Officer. Our review of the March 31, 2004 and September 30, 2003 financial statements found that several errors occurred in the CIP statistical sample adjusting journal entry that were not discovered by the controls currently in place, including a material classification error in the September 30, 2003 financial statements.

BCP's informal procedures used in the preparation of quarterly and annual financial statements, entitled *Documentation of Procedures for Financial Reporting*, state that "the Consolidated Financial Statement Team reviews all adjustments and reclassifications for appropriateness..." The document further states that "the Consolidated Financial Statement Team also re-analyzes all significant variances from the previous fiscal year at the line item level..." According to BCP officials, one of the primary controls used to review appropriateness is an analysis by staff accountants based on significant line item balances with variances of approximately 5 percent or greater. These variance percentages are generated by Caseware and compare the current period to the same period for the prior fiscal year (i.e., March 31, 2004 to March 31, 2003).

To test the reasonableness of this control we reviewed the variance between the March 31, 2004 and March 31, 2003 CIP balance, as well as the variance between the December 31, 2003 and December 31, 2002 CIP balance. While the variance between the March 31, 2004 and March 31, 2003 CIP balance was within the tolerable range established by BCP, the variance between December 31, 2003 and December 31, 2002 was \$655 million or 47.84 percent, exceeding BCP's tolerable range. We found no evidence that this large variance prompted BCP officials to further analyze the balances prior to submission of the December 31, 2003 quarterly financial statements to OMB. Follow-up with BCP officials and subsequent review of the December 31, 2003 adjusting journal entries found that the primary cause for this variance was that the CIP statistical sample adjusting journal entry was inadvertently excluded from these statements. Although BCP discovered the omission, the controls in place did not detect this error in a timely manner to permit accurate financial reporting to OMB.

We also attempted to test the variance between the CIP statistical sample adjusting journal entries for March 31, 2004 and December 31, 2003. However, because the CIP statistical sample adjusting journal entry was not entered for December 31, 2003, as stated above, we expanded the scope of our testing to include an analysis of the variance between the CIP statistical sample adjusting journal entries for March 31, 2004 and September 30, 2003. We determined that this variance was \$722 million. Our review of the transactional data supporting both CIP statistical sample adjusting journal entries found an error in the September 30, 2003 CIP statistical sample adjusting journal entry. The error occurred when a project, classified as CIP, was incorrectly determined to be substantially complete by regional officials and was projected by PBS as part of the reclassification rate for the September 30, 2003 CIP statistical sample. This project represented 96.75 percent of the value used by PBS to estimate the total reclassification between CIP and Property and Equipment (P&E). This resulted in a \$921,285,004.64 misclassification between the balances reported for the CIP line item and the P&E--Buildings line item in GSA's Fiscal Year 2003 Financial Statements².

In addition, while BCP's current financial reporting procedures provide for analysis of account balances for reasonableness and the determination of causes for significant variances, the procedures do not require BCP to review the methodology designed by the Services to estimate balances in order to ensure the reliability of the reported account balance. Accordingly, the adjusting journal entries prepared by the Services may not result in reliable estimates of account balances.

As previously stated, the variance between the March 31, 2004 and the March 31, 2003 CIP balances was within BCP's tolerable range, prompting no further evaluation by BCP. Our testing, however, found that several factors in the PBS CIP sampling methodology hindered the projection of a reliable estimate of the CIP balance. Specifically, prior to the determination of the sample size for March 31, 2004, PBS did not define the confidence level or precision and adequately analyze the characteristics of the population for determining the estimated adjustment to CIP that would reasonably ensure a reliable estimate.

Despite the fact that the Services share a responsibility in GSA's financial reporting efforts, per the CFO Act of 1990, it is ultimately the responsibility of the Chief Financial Officer to oversee all financial management activities related to GSA's programs. Further, OMB Bulletin No. 01-09 states that "reporting entities should assure that information in the financial statements is presented in accordance with Federal GAAP³ and the requirements of this Bulletin, and that the underlying records fully support the information."

While BCP's procedures for financial reporting require analysis of all significant variances from the previous fiscal year at the line item level, the controls did not operate effectively and may not have been sufficient to ensure that GSA accurately reported the

² The specifics of this misclassification are detailed in our [Alert Report on the Audit of Pegasys Account Balance and Transaction Analysis: Construction in Progress](#) (Report Number A040106/P/F/W04001).

³ Federal GAAP (Generally Accepted Accounting Principles) is now simply referred to as GAAP.

balance of CIP. As such, BCP should strengthen its controls over the financial reporting process to ensure that balances are appropriate.

Formal supervisory review and approval of adjusting journal entries was not evident.

Our review of the controls over financial reporting for the Federal Buildings Fund found that adjusting journal entries lacked evidence, such as authorized signatures, indicating that supervisory management formally approved the individual adjusting journal entries. As a result, we found adjusting journal entries that were incorrectly recorded in the financial statements.

During our testing of variances for the CIP adjusting journal entry we noted that depreciation for the September 30, 2003 statistical sample adjusting journal entry was not entered correctly. PBS submitted an adjustment to the September 30, 2003 trial balance for Depreciation on Improvement and Renovations for Buildings of \$4,327,242.18, whereas BCP officials entered \$432,724.18 into the adjusting journal entry worksheets. As a result, total depreciation estimated by the OCFO was understated by \$3,894,517.37.

BCP's *Documentation of Procedures for Financial Reporting* states that "approved worksheet adjustments are posted to the financial statement preparation system" and staff accountants "ensure all adjustments have been posted properly." However, we found no evidence that the CIP statistical sample adjusting journal entry for September 30, 2003 was formally reviewed and approved. While supervisory level BCP officials are involved in the process, supervisory approval does not appear to be based on the review of source documentation supporting the adjusting journal entry. Without a formal review and approval process, BCP may not be able to reasonably ensure that adjusting journal entries have been accurately and appropriately recorded. BCP should develop a formal review and approval process to ensure that adjusting entries are properly recorded.

RECOMMENDATIONS

We recommend that the Chief Financial Officer:

- 1) Strengthen controls over the financial reporting process to ensure that balances are appropriate by:
 - a) Reviewing the methodology used by the Services and finance centers to prepare adjusting journal entries;
 - b) Performing variance analyses and investigating results outside the tolerable range established by BCP procedures; and
 - c) Documenting the results of the procedures performed.

2) Assign specific responsibility for review and approval of adjusting journal entries and develop a control process that clearly documents who prepared, reviewed, and approved each adjusting journal entry.

MANAGEMENT COMMENTS

The Deputy Chief Financial Officer for Financial Policy and Operations has provided comments to this report, which have been included in their entirety as Appendix A. The Deputy Chief Financial Officer concurs with the findings of the report and has no further comments.

INTERNAL CONTROLS

As discussed in the Objective, Scope and Methodology section of this report, we reviewed the effectiveness of GSA's systems of accounting and internal control over quarterly financial reporting as of March 31, 2004. We found that the OCFO should strengthen its internal controls over quarterly financial reporting to reasonably ensure the appropriateness of adjusting journal entries recorded in the financial statements.

APPENDIX A – MANAGEMENT RESPONSE TO DRAFT REPORT



GSA Office of the Chief Financial Officer

MAY 03 2005

MEMORANDUM FOR KRISTIN R. WILSON
REGIONAL INSPECTOR GENERAL FOR AUDITING
(JA-F)

FROM:

Marcus M. Myers
DOUGLAS A. GLENN
DEPUTY CHIEF FINANCIAL OFFICER FOR FINANCIAL
POLICY AND OPERATION (BC)

SUBJECT: OIG Draft Audit Report, Pegasys Account Balance and
Transaction Analysis Report Number A040106 #1

This memorandum transmits the CFO management response to the subject draft audit report dated March 17, 2005. The CFO concurs with the two recommendations contained in the draft audit report. Action plans are being developed to address the recommendations herein.

If you have any questions on the management responses provided, please contact Mr. Donzell Jackson at (202) 501-0110.

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