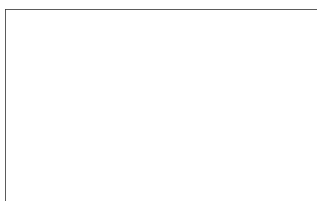


~~SECRET//20290518~~

REPORT OF AUDIT
(U) The Agency's Administration of Transactions
With Other Government Agencies

Central Intelligence Agency
Office of Inspector General
Audit Staff



(b)(3)

29 October 2004
DATE ISSUED

~~SECRET//20290518~~

~~SECRET//20290518~~

(U) Table of Contents

(U) SUMMARY 1

(U) BACKGROUND..... 2

(U) The Economy Act 2

**(U) The Agency's Process for Administering Transactions
 With Other Government Agencies..... 2**

(U) Financial Statement Reporting and Accounting Standards 4

**(U) Implementation of a New Accounting Model for Recording
 Transactions With Other Government Agencies in FY 2004..... 5**

(U) AUDIT RESULTS AND RECOMMENDATIONS..... 5

**(U//FOUO) Amounts Reported for the Agency's Transactions
 With Other Government Agencies Are Not Fairly Presented on
 the FY 2003 Financial Statements..... 5**

**(U//FOUO) Transactions Are Not Reported on an
 Accrual Accounting Basis 5**

**(U//FOUO) Financial Activities of Other Entities Are Included
 Inappropriately on the Agency's Financial Statements..... 7**

(U//FOUO) [REDACTED] 9

**(U//FOUO) Reconciliations With Other Government
 Agencies Are Not Being Conducted..... 9**

**(U//FOUO) Transactions in Certain General Ledger
 Accounts Are Improperly Reported as Intragovernmental
 on the FY 2003 Financial Statements 10**

**(U//FOUO) The Agency Is Not in Compliance With Office of
 Management and Budget Requirements for Financial Statement
 Presentation of Intragovernmental Activity 13**

(b)(3)
(b)(5)

~~SECRET//20290518~~

~~SECRET//20290518~~

~~(U//FOUO)~~ Transactions With Other Government Agencies
Are Not Properly Segregated on the Statement of Net Cost 13

~~(U//FOUO)~~ Disclosures in the FY 2003 Financial Statements
Are Not Accurate or Complete..... 15

(U) Other Matters 16

(U) Objectives, Scope, and MethodologyExhibit A

~~(S)~~ FY 2003 Balance Sheet, Statement of Net Cost,
and Related Notes to the Financial Statements
(Draft, dated December 2003)Exhibit B

(U) List of Recommendations.....Exhibit C

(U) Audit Team MembersExhibit D

~~SECRET//20290518~~

~~SECRET//20290518~~

Report of Audit

(U) The Agency's Administration of Transactions With Other Government Agencies

(U) SUMMARY

(U) The objectives of this audit were to determine whether:

- The financial statements of the CIA fairly present the amounts associated with goods and services ordered from and provided to other government agencies (OGAs), in accordance with generally accepted accounting principles.
- Internal controls related to recording goods and services ordered from and provided to OGAs are adequate to detect or prevent errors or misstatements that have a material effect on the financial statements.
- The Agency complies with laws and regulations that have an effect on the financial statement presentation for transactions involving OGAs.

(U//~~FOUO~~) The amounts presented for the Agency's transactions with OGAs are materially misstated on the financial statements as of 30 September 2003.¹ The Agency's transactions with OGAs are not reported on an accrual accounting basis as required by generally accepted accounting principles. Therefore, revenues and expenses are not recorded in the appropriate accounting period, and the financial statements do not include all of the Agency's activities with OGAs for FY 2003. In addition, the Agency's financial statements continue to include the financial activities of other entities, like the Community Management Staff (CMS), that either: (1) should not be reported on the Agency's financial statements, or (2) should be consolidated with the Agency's financial activities and the statements no longer presented as only the CIA's financial statements.

(U//~~FOUO~~)

The Agency is not conducting required reconciliations of its intragovernmental activity and balances with OGAs to confirm that amounts reported are accurate, complete, and agree with the other agencies' records. In addition, financial transactions in several general ledger accounts are improperly included as intragovernmental activity on the FY 2003 financial statements.

(b)(3)
(b)(5)

¹ (U//~~FOUO~~) Because the FY 2003 financial statements had not been finalized before audit fieldwork ended in January 2004, we based our analysis and conclusions on a draft of the financial statements that was provided to us in December 2003 by Accounting Operations officials.

² (U) The terms "transactions with OGAs" and "intragovernmental activity" are used interchangeably throughout this report.

~~SECRET//20290518~~

~~SECRET//20290518~~

(U//~~FOUO~~) The Agency is generally in compliance with laws and regulations that have a material impact on the financial statement presentation of intragovernmental transactions. However, the Agency is not in compliance with the reporting requirements issued by the Office of Management and Budget (OMB). The Agency's intragovernmental activity is not properly segregated or readily identifiable on the Statement of Net Cost on the FY 2003 financial statements as required by OMB Bulletin No. 01-09. In addition, the FY 2003 financial statements contain inaccuracies in the notes and are missing other required disclosures.

(U) BACKGROUND

(U) The Economy Act

(U) The Economy Act, 31 U.S.C. § 1535, is the primary source of statutory authority for transfers between the appropriations of individual Federal Government agencies. Under the Economy Act, a Federal agency may place orders with any other Federal agency for goods and services if it is determined by the head of the ordering agency to be in the best interest of the Federal Government. The statute was intended to enable an agency to benefit from another agency's ability to provide services at less cost or more conveniently than the ordering agency could provide for itself. In order to avoid illegally supplementing the appropriations of either the agency providing or receiving the goods and services, the Economy Act requires an agency to recover the actual cost of the goods and services provided to another agency.

(U) The Agency's Process for Administering Transactions With Other Government Agencies

(U//~~FOUO~~) The Agency frequently requests that OGAs provide goods and services under provisions of the Economy Act in order for the Agency to complete its mission. Likewise, the Agency assists OGAs by acquiring or providing goods and services on their behalf. [redacted] Office of Finance processes these transactions with OGAs, regardless of whether the Agency is receiving or providing the goods and services.

(b)(3)

~~(S)~~ When the Agency is requesting goods and services from another government agency, an Agency component will submit a procurement requisition to [redacted] through the [redacted] system, citing valid appropriated funding.³ The [redacted] request should provide, at a minimum, all relevant component information and a complete description of the goods and services to be obtained. The component will also appoint a certified Agency Contracting Officer's Technical Representative to manage the requirement. The request is forwarded to the [redacted] within [redacted] in order to initiate correspondence with the other

(b)(3)

(b)(3)

³ ~~(S)~~ [redacted] is the Agency's acquisition and logistics support system. [redacted] provides automated functionality for requesting, purchasing, receiving, and paying for goods and services needed by the Agency.

(b)(3)

(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~

(b)(3)

government agency. A letter request is generated by [redacted] to support the terms of the agreement between the agencies. The other government agency typically bills the Agency for payment as the work is performed, and [redacted] ensures the payment of invoices received by the Agency. During FY 2003, [redacted] reported that the Agency processed payments to OGAs totaling [redacted]⁴

(b)(3)

(b)(3)

(S) When the Agency is providing goods and services to another government agency, [redacted] serves as the focal point for receiving the incoming requests. For reimbursable transactions less than \$1,000, the Agency will bill the other government agency for payment after the goods and services are provided.⁵ The Agency typically requires payment in advance from the other government agency for transactions greater than \$1,000. [redacted] tracks the funds received from the other government agency and allocates the transferred funds to the Agency component responsible for performance. In many cases, the component will apply the funds received from the other government agency to an Agency contract with an outside vendor in order to supply the goods and services requested. The component is responsible for monitoring the status of funds received from the other government agency so that any unused funds can be refunded by [redacted] to the other government agency. During FY 2003, [redacted] reported that the Agency processed nearly [redacted] in payments received from OGAs.⁶

(b)(1)
(b)(3)

(b)(3)

(b)(3)

(b)(3)

(b)(3)

(b)(1)

(b)(3)

(b)(3)

(U//FOUO) [redacted] Office of Finance is responsible for ensuring that transactions with OGAs are properly reported on the financial statements, with the appropriate disclosures. During FY 2004, transactions with OGAs have been recorded in [redacted] general ledger accounts in the Agency's financial management system. In most cases, [redacted] is assigned either primary or secondary responsibility for monitoring the activity that is recorded in these general ledger accounts.

(b)(3)

(b)(3)

(b)(1)

(b)(3)

⁴ (S) The [redacted] includes amounts paid by the Agency to OGAs for goods and services in support of Agency operations. It also reflects payments made by the Agency to OGAs on behalf of Federal entities, like the [redacted] and the National Reconnaissance Office (NRO), which use the Agency's financial management system to process some of their financial transactions.

(b)(1)

⁵ (U//FOUO) The majority of these transactions involve the salaries and benefits of Agency employees who are assigned to OGAs under separate, reimbursable agreements to perform specific tasks on behalf of those OGAs.

(b)(1)

(b)(3)

⁶ (S) The [redacted] includes amounts received from OGAs in exchange for goods and services provided by the Agency. It also reflects payments received by the Agency from OGAs on behalf of Federal entities, like [redacted] and NRO, which use the Agency's financial management system to process some of their financial transactions.

(b)(1)

~~SECRET//20290518~~

~~SECRET//20290518~~**(U) Financial Statement Reporting
and Accounting Standards**

(U) Claims of an agency against other Federal agencies are considered intragovernmental assets; claims against an agency by other Federal agencies are considered intragovernmental liabilities. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires that transactions with OGAs be presented as intragovernmental activity and balances on an agency's financial statements.⁷ The intent of this requirement is to segregate intragovernmental activity so that such amounts may be eliminated from each Federal agency's financial statements when the US Government-wide consolidated financial statements are prepared and the Federal agencies report their financial activities as a single entity.

(U) To ensure consistency in reporting intragovernmental activity by Federal agencies, OMB established a set of standard business rules with the issuance of OMB Memorandum M-03-01, *Business Rules for Intragovernmental Transactions*, dated 4 October 2002. These rules are intended to address material weaknesses in internal controls and financial reporting processes—including issues related to the reconciliation and elimination of intragovernmental activity and balances—that have been identified by the General Accounting Office during its annual audit of the US Government's consolidated financial statements. In addition, the Department of the Treasury issued guidance—*The Federal Intragovernmental Transactions Accounting Policies Guide*, dated 23 October 2002—that provides Federal agencies with government-wide accounting policies related to transactions between Federal agencies, tools to facilitate a reconciliation process, and examples of accounting and reporting for various types of transactions. The guide further explains that each Federal agency is responsible for:

- Establishing and maintaining an internal control structure for its transactions with OGAs. This includes establishing procedures related to the initiating, executing, recording, reconciling, and reporting of transactions with OGAs.
- Documenting and supporting the information recorded in its accounting records related to transactions with OGAs.
- Reconciling the data regarding transactions with OGAs in its accounting records to the supporting documentation and corresponding records in other agencies' accounts.
- Ensuring that the reconciliation and confirmed balances for transactions with OGAs agree to amounts reported on agency audited financial statements.
- Representing that all balances related to transactions with OGAs have been reconciled and that the agency's audited financial statements conform to OMB Bulletin No. 01-09 for intragovernmental requirements.

⁷ (U) Intragovernmental activity does not include transactions with non-Federal entities.

~~SECRET//20290518~~

~~SECRET//20290518~~

**(U) Implementation of a New
Accounting Model for Recording
Transactions With Other Government
Agencies in FY 2004**

(U//~~FOUO~~) During FY 2003, Finance officials completed an internal review of the Agency's process for accounting for transactions with OGAs as part of the [REDACTED]. This review highlighted deficiencies in the existing process. The accounting process that was used did not meet the requirements of the US Standard General Ledger (USSGL) because some USSGL budgetary accounts were either not used or were used incorrectly by the Agency. In view of this, Finance officials developed a new accounting model for processing transactions with OGAs that would bring the Agency into compliance with the USSGL.

(b)(3)

(U//~~FOUO~~) The new accounting model requires alteration of the current general ledger account names and various accounting processes as well as restatement of accounting information already recorded in the financial management system. A phased-in approach, beginning in FY 2004, is being used to implement the new accounting model. Finance officials explained that this will provide the time necessary to negotiate and establish bilateral Intragovernmental Payment and Collection (IPAC)⁸ funding agreements with OGAs that will eliminate the time delays currently experienced between acceptance of the order for goods and services and the subsequent receipt of the funds. In addition, upgrades are being developed for the current financial management system—expected to be operational in FY 2006—that will expand the capabilities of the system and enable the Agency's process to become fully USSGL compliant.

(U) AUDIT RESULTS AND RECOMMENDATIONS

**(U//~~FOUO~~) Amounts Reported for the
Agency's Transactions With Other
Government Agencies Are Not Fairly
Presented on the FY 2003 Financial
Statements**

**(U//~~FOUO~~) Transactions Are Not Reported
on an Accrual Accounting Basis**

(U//~~FOUO~~) The Agency's transactions with OGAs are not reported on an accrual accounting basis as required by generally accepted accounting principles.⁹ Therefore, revenues and expenses are not recorded in the appropriate accounting period, and the

⁸ (U) The IPAC system was implemented by the Department of the Treasury as an internet web-based system that is used by Federal agencies to process intragovernmental payments on an immediate basis.

⁹ (U) Generally accepted accounting principles require that transactions be recorded on an accrual accounting basis so that revenues can be recognized in the period earned and can be matched with the expenses that were incurred during that period to generate the revenues.

~~SECRET//20290518~~

~~SECRET//20290518~~

financial statements do not include all of the Agency's activities with OGAs for FY 2003. As a result, the amounts presented for the Agency's transactions with OGAs are materially misstated on the financial statements as of 30 September 2003.

(U//~~FOUO~~) The Agency has not established policies or procedures to record revenues and expenses related to transactions with OGAs on an accrual accounting basis. In order to record revenues and expenses in the appropriate accounting period, accrual accounting requires adjusting entries at the end of each period to record any revenues that have been earned, but not recorded, and to record any expenses for which the benefits from the expenditures have been received, even though cash payment is made in another accounting period.

~~(S)~~ To determine the significance of not recording transactions with OGAs on an accrual basis, we estimated the accruals that should have been recorded for a judgmental sample of 21 transactions that occurred in FY 2003.¹⁰ Based on our review of the 21 transactions:

- At least [redacted] of expenses should have been recorded for FY 2003 as an accrual adjustment.¹¹
- Over [redacted] of expenses recorded in FY 2003 should have been recorded for either FY 2002 or FY 2004.
- At least [redacted] of revenues should have been recorded for FY 2003 as an accrual adjustment.

(b)(1)
(b)(3)

(b)(1)
(b)(3)

(b)(1)
(b)(3)

(U//~~FOUO~~) Calculating an accurate accrual amount for the Agency's intragovernmental transactions will be complicated. For example, the methodology for determining the amount to accrue must consider all means of payment. Transactions related to intragovernmental activity are not always paid through [redacted]¹² Payments can also be made via the IPAC system or with a payment voucher, so an accrual amount based only on transactions processed through [redacted] would not be complete. In addition, all intragovernmental-related activity processed through

(b)(3)

(b)(3)

¹⁰ (U//~~FOUO~~) We originally selected a judgmental sample of 47 transactions, but we did not estimate accruals for 26 of those transactions for several reasons. We were unable to estimate the accruals for 14 of the 26 transactions that involved the funding of multiple contracts because sufficient records were not maintained to correlate the funds received from the other government agency with the funds dispersed to individual contracts. In addition, 10 of the 26 transactions belonged to NGA or NRO. These transactions are not considered Agency activity and should not be reported on the Agency's financial statements. Accruals for two of the 26 transactions could not be estimated because the data could not be compiled by the program manager in a reasonable time frame.

(b)(1)

¹¹ (U//~~FOUO~~) [redacted]

(b)(3)

¹² ~~(S)~~ Finance officials stated that a [redacted] accrual for all contractual expenses (including some intragovernmental transactions) was recorded for FY 2003 based on data contained [redacted], but this adjustment did not segregate the accrual pertaining specifically to intragovernmental transactions. Based on the results of our testing, the [redacted] accrual adjustment appears to be too conservative, as it purportedly represents all of the Agency's contractual expenses.

(b)(1)
(b)(3)

(b)(3)

(b)(1)
(b)(3)

~~SECRET//20290518~~

SECRET//20290518

[redacted] may not be recorded in the system at yearend—either due to time delays in recording invoices received but not yet processed or because invoices have not been received.

(b)(3)

[redacted]

(b)(3)
(b)(5)

[redacted]

(b)(3)
(b)(5)

(U//~~FOUO~~) Financial Activities of Other Entities Are Included Inappropriately on the Agency's Financial Statements

(U//~~FOUO~~) The Agency's financial statements include the financial activities of other entities—such as the CMS, the NGA, the NRO, and the DCI's Center for Security Evaluation—that are not organizationally part of the Agency.¹⁴ The financial activities of these other entities either: (1) should not be reported on the Agency's financial statements, or (2) should be consolidated with the Agency's financial activities and the statements no longer presented as only the Agency's financial statements. Because the financial activities of these other entities are merged with Agency financial activity—and not consolidated—transactions between the Agency and these other entities are not properly reported on the financial statements. Consequently, transactions between the Agency and these other entities are reflected twice on the financial statements, overstating certain financial statement line items.

(U//~~FOUO~~) The financial activities of these other entities are recorded in the Agency's financial management system for administrative convenience. Although Finance officials are developing an implementation plan to properly segregate non-Agency funds, we were told that the current system configuration makes it difficult

¹³ (U) In its *Federal Intragovernmental Transactions Accounting Policies Guide*, the Department of the Treasury explains that agencies should work together to calculate and estimate accruals and to record corresponding entries in each set of accounting records so that they are in agreement and/or long-term accounting policy differences can be easily identified.

¹⁴ (U//~~FOUO~~) [redacted]

(b)(3)
(b)(5)

SECRET//20290518

to extract the transactions of these other entities from the system with any accuracy.¹⁵ For example, during FY 2003, [redacted] officials were able to manually extract certain financial activities of the NGA and the NRO from the financial statements, but the related assets (cash) and liabilities (advance) transactions are still reflected on the Balance Sheet. The financial activities of other entities, like CMS, continue to be reported entirely as part of the Agency's financial statements.

(b)(3)

~~(S)~~ While there are inherent challenges involved in segregating the financial information of other entities in the Agency's financial system, certain financial statement line items could be materially affected by reporting transactions of other entities on the Agency's financial statements and by not eliminating transactions between these other entities and the Agency. For example, in our sample, we identified two transactions totaling nearly [redacted] that involved CMS funding to the [redacted] within the Directorate of Science and Technology. CMS recorded the total amount of funding as an expense when the funds were passed to the Agency. In addition, the Agency has recorded expenses as the funds are used. No adjusting entries were recorded to eliminate this intra-reporting entity activity. As a result, these expenses are reflected twice on the financial statements.

(b)(1)
(b)(3)

(b)(3)

~~(U//FOUO)~~ Agency management must determine whether the Agency's financial statements will continue to reflect the financial activities of these other entities or whether a means to accurately extract their financial activities will be developed. Other entities, like the newly created Terrorist Threat Integration Center, present unique situations that must be considered because administrative responsibilities for these entities are shared with OGAs. Once a decision is made, however, the Agency's [redacted] must provide appropriate and full disclosures about the nature of the reporting entity and follow standard reporting requirements to properly and accurately present the financial and program performance of the complete entity transactions.¹⁶

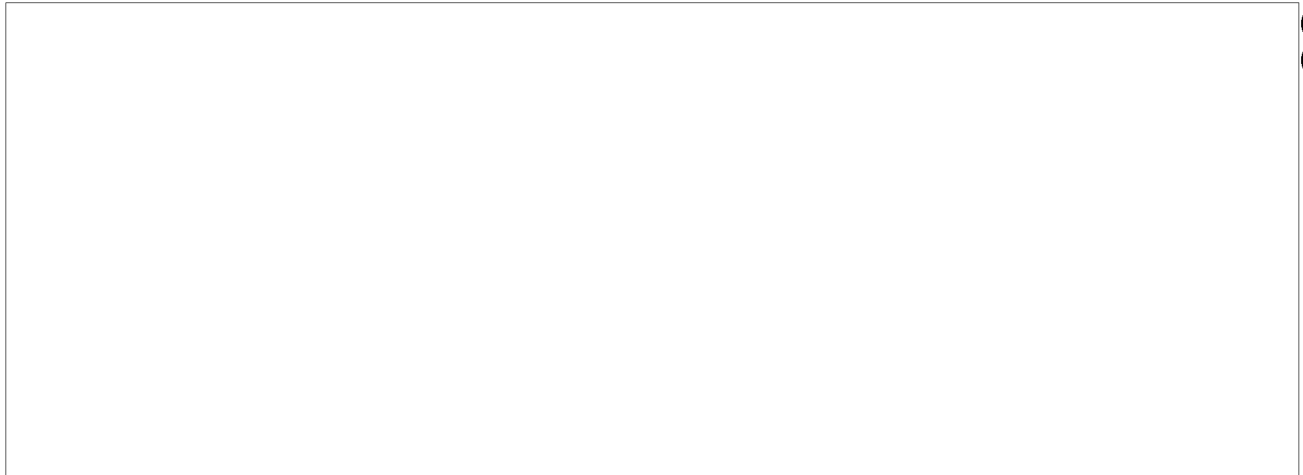
(b)(3)

¹⁵ ~~(U//FOUO)~~ As noted in our prior audit report, *Form and Content of the Agency's Fiscal Year 2001 Financial Statements*, dated 27 March 2002, Finance officials indicated at that time that it would take several years to create new transactions codes, re-code existing reports, retrain users, and modify interface systems in order to extract the financial activities of CMS and other entities from the Agency's financial management system.

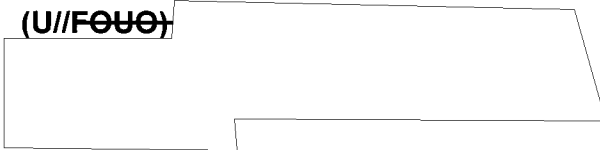
¹⁶ (U) Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, explains that in reporting the transactions and balances of a Federal reporting entity in its entirety, it is conceptually desirable, although not always practicable, to eliminate the intra-entity transactions and balances. Factors to consider are the utility of the information if the intra-entity balances are not eliminated, the misunderstanding that might result if balances are not eliminated, and the cost-benefit of making the eliminations. However, the financial statements must disclose all information that is necessary to inform users adequately about the reporting entity.

SECRET//20290518

~~SECRET#20290518~~



(b)(3)
(b)(5)



~~(U//FOUO)~~

(b)(3)
(b)(5)

~~(U//FOUO)~~ **Reconciliations With
Other Government Agencies Are
Not Being Conducted**

~~(U//FOUO)~~ The Agency is not conducting reconciliations of its activity and balances with the OGAs that are the Agency's trading partners.¹⁷ OMB specifies that agencies should reconcile and confirm balances with their trading partners in accordance with requirements in OMB Bulletin No. 01-09. These reconciliations confirm that activities and balances reported in the intragovernmental accounts are accurate, complete, and agree in amount to the trading partner's accounts.¹⁸ In addition, agencies should investigate and correct any discrepancies identified between their intragovernmental account balances and the reciprocal account balances of their trading partners before preparation of the agencies' financial statements. According to OMB Memorandum M-03-01, this process should be conducted quarterly.

¹⁷ (U) Trading partners are identified as Federal Government agencies, departments, or other components that do business with each other.

¹⁸ (U) In its report, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement* (GAO-04-45), dated 30 October 2003, the GAO reported that Federal agencies were unable to fully reconcile intragovernmental activity and balances for FY 2002. A substantial number of agencies did not fully perform the required reconciliations, citing reasons such as (1) failure of trading partners to provide needed data, (2) limitations and incompatibility of agency and trading partner systems, and (3) human resource issues. It was noted that, without improvement in this area, the Department of the Treasury cannot properly eliminate intragovernmental activity and balances from the government-wide consolidated financial statements. As a result, assets, liabilities, revenues, and costs reported on the US Government financial statements may not be fairly stated.

~~SECRET#20290518~~

~~SECRET//20290518~~

(U//~~FOUO~~) The integrity of the data reported in the Agency's financial records is dependent on timely and accurate reconciliations of intragovernmental activity and the resulting account balances. OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, dated 16 October 2000, specifies that an agency must make statements within its Management Representation Letter to confirm that a reconciliation process is in place.¹⁹ Until an effective reconciliation process is implemented by the Agency, Agency officials will be unable to make the required statements.

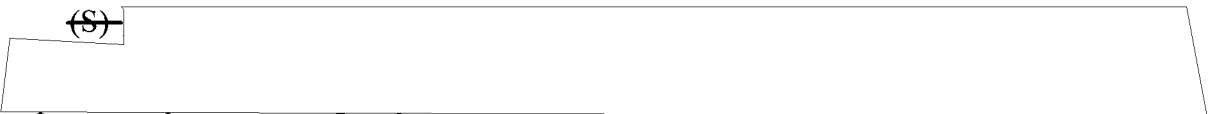


(b)(3)
(b)(5)

**(U//~~FOUO~~) Transactions in
Certain General Ledger Accounts
Are Improperly Reported as
Intragovernmental on the FY 2003
Financial Statements**

(U//~~FOUO~~) Financial transactions in several general ledger accounts are reported improperly as part of the intragovernmental line items on the FY 2003 financial statements. The intragovernmental line items should only include transactions with other Federal Government agencies. However, [redacted] officials explained that they do not always have sufficient time to manually review the activity in each general ledger account before compiling the financial statements. In some cases, assumptions are made incorrectly about the activity in the accounts based solely on the account titles. As a result, certain intragovernmental line items on the financial statements include activity that is unrelated to transactions with OGAs.

(b)(3)



(b)(1)
(b)(3)

In addition, the following issues were identified for several general ledger accounts that are reported as part of the intragovernmental line items on the financial statements:

¹⁹ (U) The Management Representation Letter accompanies an agency's financial statements and is signed by the agency head and the chief financial officer. In this letter, an agency's management typically acknowledges its responsibility for the agency's financial statements and its belief that the financial statements are presented in conformity with generally accepted accounting principles.

~~SECRET//20290518~~

~~SECRET//20290518~~

- *Allowance for Loss on Accounts Receivable* (general ledger account 1319). This account represents a contra asset account and relates to amounts due from employees, rather than OGAs. The balance of the account erroneously offsets the financial statement line item, *Intragovernmental – Accounts Receivable*. As a result, this intragovernmental line item is understated by [redacted] for FY 2003. (b)(1) (b)(3)

- *Prepayments* (general ledger account 1450). The balance in this account at 30 September 2003 was [redacted]. Of this amount, [redacted] represents a yearend adjustment recorded by [redacted] to reclassify the debit balance of Agency imprest fund credit card accountings from a liability account to an asset account for financial reporting purposes. The entire balance of this general ledger account is carried forward to the *Intragovernmental – Other* line item on the financial statements, even though it does not relate exclusively to intragovernmental activity. As a result, the line item is overstated by [redacted]. (b)(1) (b)(3) (b)(3)

- *Accounts Payable – Other* (general ledger account 2112). This account is reported as part of the *Intragovernmental – Accounts Payable* line item on the financial statements. The balance of this account at 30 September 2003 was [redacted]. The account is used primarily to record expense accruals for the Working Capital Fund businesses for items such as building leases, utility payments, furniture costs, etc. Although we noted accruals for lease and utility payments to the General Services Administration, the account balance does not exclusively represent transactions with other Federal agencies. As a result, the *Intragovernmental – Accounts Payable* line item is overstated. (b)(1) (b)(3)

- *Advances from Others* (general ledger account 2310). The balance in this account was [redacted] at 30 September 2003.²⁰ The entire balance is reported as part of the *Intragovernmental – Liabilities* line item on the financial statements. We could not complete a review of this account due to the magnitude of the transactions recorded in this account. (b)(1) (b)(3)

(b)(1)
(b)(3)

²⁰ (S) Of the [redacted] balance for this account at yearend, a summary report shows that over half of the balance is related to the funds of other entities that record their financial transactions in the Agency's financial management system— [redacted] is related to CMS funds, and [redacted] is related to NRO funds. However, it is unclear whether the transactions of these other entities represent business with the Agency or administrative use of the Agency's financial management system, which directly affects whether these transactions should be reported as intragovernmental activity. (b)(1) (b)(1) (b)(3) (b)(3) (b)(1) (b)(3)

~~SECRET//20290518~~

SECRET//20290518

(b)(3)

(b)(3)

Based on a limited review, however, we noted transactions that are longstanding and appear to be unrelated to intragovernmental activity— [redacted] [redacted], etc. [redacted] is assigned primary responsibility for reviewing this account, and [redacted] has secondary responsibility. [redacted] officials explained that they review only transactions that are recorded by their office to this account. At the time of our audit, no one within [redacted] [redacted] had been assigned responsibility for monitoring activity recorded in this account. In addition, the capability to print reports showing the details of the account has been turned off by [redacted] [redacted] due to the size of the report produced. Because internal controls are not in place to ensure that all activity in this account is sufficiently monitored and analyzed, we have no assurances that the entire balance of [redacted] that is reflected as intragovernmental activity on the financial statements is proper.

(b)(3) (b)(3)
 (b)(3) (b)(3)
 (b)(3)
 (b)(3) (b)(3)

[redacted]

(b)(3)
 (b)(5)

[redacted]

(b)(3)
 (b)(5)

~~SECRET//20290518~~

~~(U//FOUO)~~ **The Agency Is Not in Compliance
With Office of Management and Budget
Requirements for Financial Statement
Presentation of Intragovernmental Activity**

~~(U//FOUO)~~ **Transactions With Other
Government Agencies Are Not Properly
Segregated on the Statement of Net Cost**

~~(U//FOUO)~~ Intragovernmental activity is not properly segregated or readily identifiable on the Statement of Net Cost as specified by OMB Bulletin No. 01-09. In some cases, amounts presented as transactions with OGAs are inaccurate. As a result, the Statement of Net Cost does not appropriately reflect the Agency's transactions with OGAs and may be misleading for financial statement users.

(U) According to OMB Bulletin No. 01-09, the Statement of Net Cost should show the net cost of operations for the reporting entity as a whole and for its programs. For each program, the net cost for intragovernmental activity must be reported separately from the other costs identified for that program. The net cost related to intragovernmental activity consists of gross costs less any related exchange revenues. Exchange revenues are amounts earned by an agency for providing goods and services on behalf of OGAs. For illustrative purposes, OMB provides the following format.

**(U) Consolidated Statement of Net Cost
For the years ended September 30, 20x2 and 20x1**

| Program Costs: | <u>20x2</u> | <u>20x1</u> |
|---|----------------|----------------|
| Program A: | | |
| 1. Intragovernmental gross costs | \$ xxx | \$ xxx |
| 2. Less: Intragovernmental earned revenue | - xxx | - xxx |
| 3. Intragovernmental net costs | \$ xxx | \$ xxx |
| 4. Gross costs with the public | \$ xxx | \$ xxx |
| 5. Less: Earned revenues from the public | - xxx | - xxx |
| 6. Net costs with the public | \$ xxx | \$ xxx |
| 7. Total net cost | <u>\$x,xxx</u> | <u>\$x,xxx</u> |

~~(U//FOUO)~~ The programs shown on the Agency's Statement of Net Cost are the Agency's expenditure centers; intragovernmental costs and revenues associated with each expenditure center are not separately reported for FY 2003 (Exhibit B). For example, we identified intragovernmental costs totaling [redacted] (for eight transactions related to three different expenditure centers) that are intermingled with the other costs of the expenditure centers and not separately identified. [redacted] officials explained that intragovernmental activity could not be accurately extracted from other financial activity for FY 2003. As a result, full reporting of intragovernmental activities supporting the Agency's programs could not be achieved as intended by Federal financial accounting standards.

(b)(1)
(b)(3)
(b)(3)
(b)(3)

~~SECRET//20290518~~

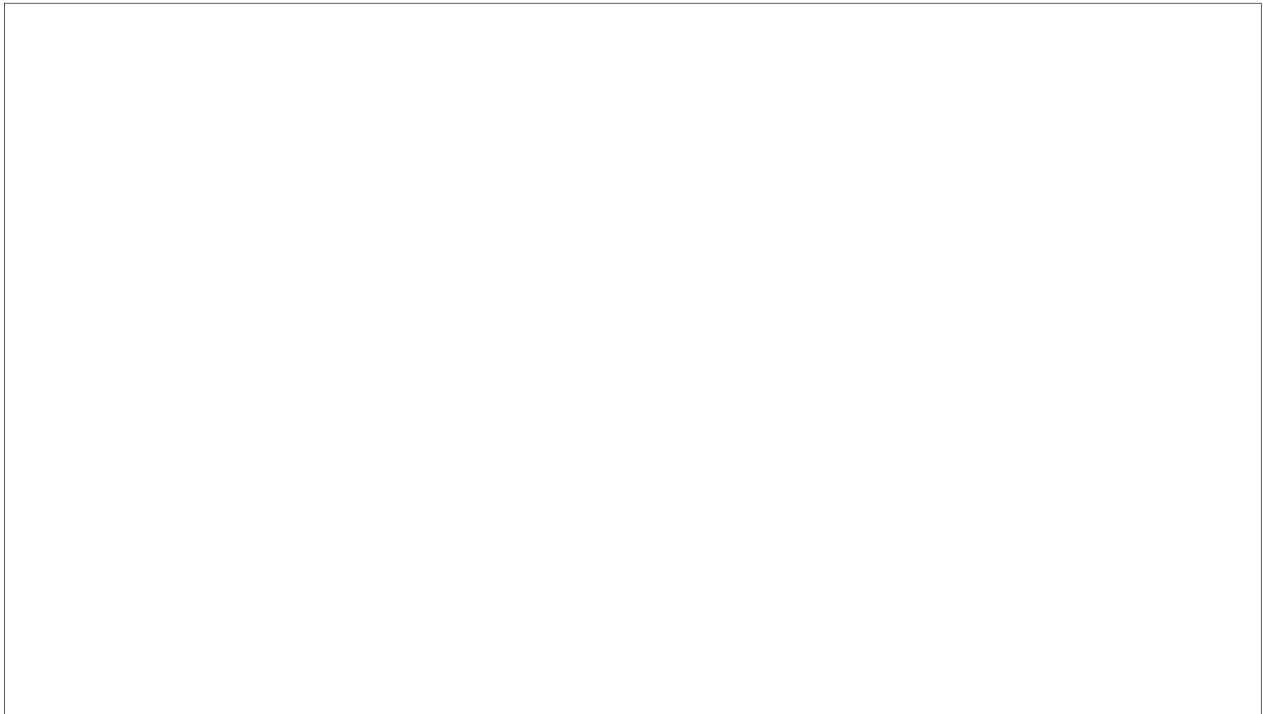
~~SECRET//20290518~~

(U//~~FOUO~~) In another example, a separate expenditure center named “Other Government Agencies” that may appear to a financial statement reader to report intragovernmental activity is included on the Statement of Net Cost. This line item shows a net cost of [redacted] for FY 2003. However, further review showed that transactions included in this line item are assigned to a “blank” expenditure center in the Agency’s financial management system, and it is unclear to which expenditure centers the costs actually belong. As a result, amounts presented for this “Other Government Agencies” line item are misleading.

(b)(1)
(b)(3)



(b)(3)
(b)(5)



(b)(3)
(b)(5)

~~SECRET//20290518~~

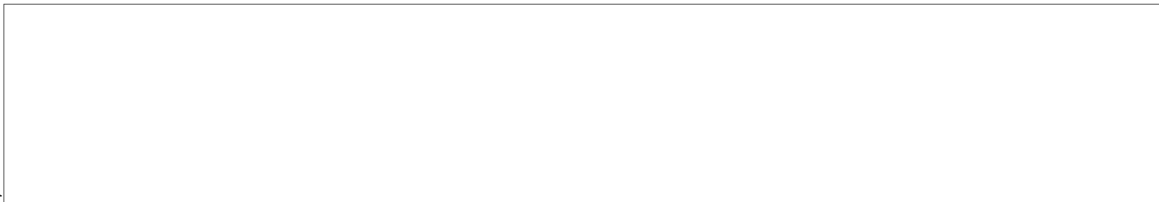
~~SECRET//20290518~~**(U//~~FOUO~~) Disclosures in the FY 2003
Financial Statements Are Not Accurate
or Complete**

(U//~~FOUO~~) The FY 2003 financial statements contain inaccuracies in the notes and are missing other required disclosures. Information presented on the financial statements should be both meaningful and accurate. Agencies are required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, dated 25 September 2001, to disclose more detailed information in the notes to the financial statements or as required supplementary information (RSI) in order to properly convey and explain the summary information that is presented on the financial statements. Users of the financial statements cannot fully comprehend the meaning of financial information provided about the Agency's intragovernmental activity and balances without complete and accurate disclosures.

(U//~~FOUO~~) The notes to the Agency's financial statements contain errors and inaccuracies. For example, note 5 erroneously discusses the allowance for bad debts as related to the Agency's transactions with OGAs. In actuality, this allowance account relates exclusively to the bad debts associated with amounts due from employees. In another example, note 1.C explains that accruals were recorded for the Agency's contractual expenses. However, this note does not explain that accruals related to the Agency's intragovernmental activity are not recorded on the FY 2003 financial statements.

(U//~~FOUO~~) The financial statements are also missing the following required disclosures related to intragovernmental activity:

- Intragovernmental gross costs and earned revenues are not disclosed in the notes by budget functional classification. According to Section 9.25 of OMB Bulletin No. 01-09, *Gross Cost and Earned Revenue by Budget Functional Classification*, agencies reporting intragovernmental earned revenues should also report—by budget functional classification—the gross cost of goods, services, and other transactions that generated the intragovernmental earned revenue.
- The Agency's trading partners are not identified as part of the RSI reporting. Section 11.3 of OMB Bulletin No. 01-09, *Required Supplementary Information for Intragovernmental Earned Revenues and Related Costs*, requires that agencies with total intragovernmental earned revenues from trade greater than \$500 million shall report such revenues by trading partners.

(b)(3)
(b)(5)~~SECRET//20290518~~

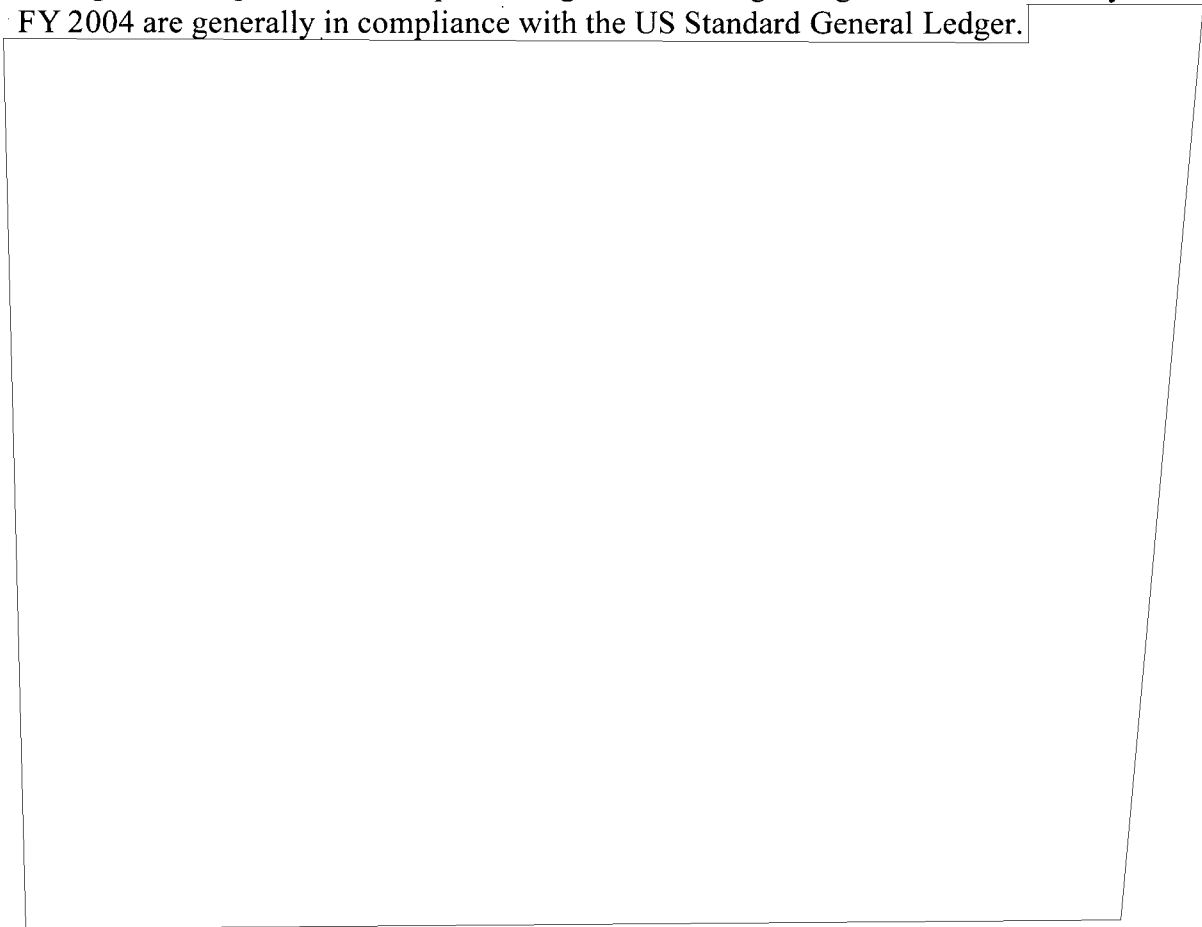
~~SECRET//20290518~~



(b)(3)
(b)(5)

(U) Other Matters

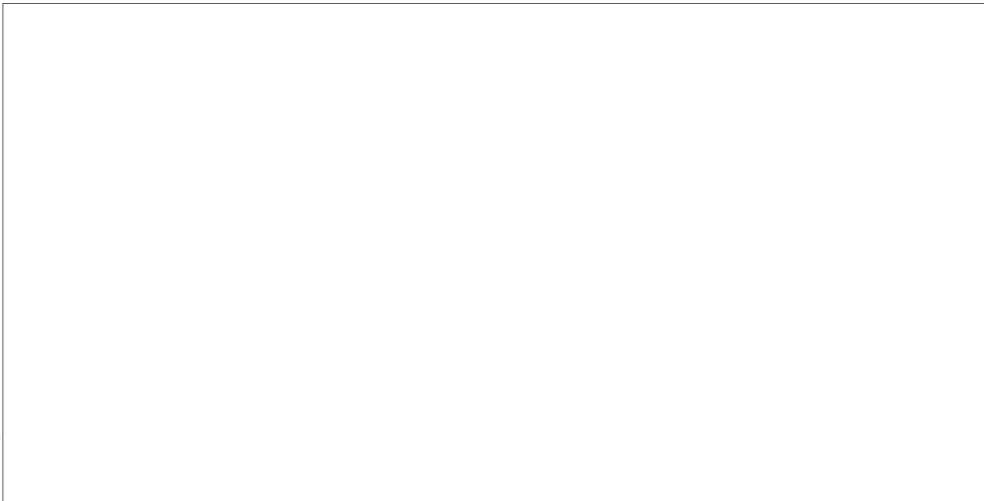
(U//~~FOUO~~) We reviewed the new accounting model for recording transactions with OGAs that is being implemented by Finance officials in FY 2004 in order to improve the Agency's compliance with the Department of the Treasury guidelines. Based on our testing, the new procedures for processing and recording intragovernmental activity in FY 2004 are generally in compliance with the US Standard General Ledger.



(b)(3)
(b)(5)

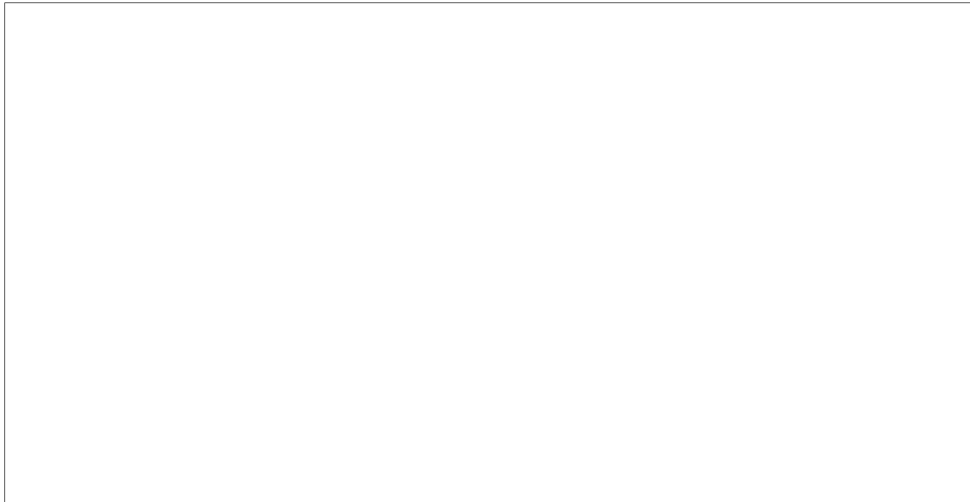
~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(3)
(b)(5)

- Memorandum accounts have been established to track amounts billed from OGAs. However, these memorandum accounts contain some longstanding and mismatched amounts that require further research to clear.



(b)(3)
(b)(5)

~~SECRET//20290518~~

~~SECRET//20290518~~

Exhibit A

(U) Objectives, Scope, and Methodology

(U) The objectives of our audit were to determine whether the financial statements of the CIA fairly present the amounts associated with goods and services ordered from and provided to other government agencies (OGAs), in accordance with generally accepted accounting principles; whether internal controls related to recording goods and services ordered from and provided to OGAs are adequate to detect or prevent errors or misstatements that have a material effect on the financial statements; and, whether the Agency complies with laws and regulations that have an effect on the financial statement presentation for transactions involving OGAs.

(U//~~FOUO~~) In conducting the audit, we:

- Reviewed the presentation of line items on the FY 2003 Balance Sheet, Statement of Net Cost, and note disclosures (Exhibit B) associated with the Agency's transactions with OGAs.¹
- Reviewed the supplemental information accompanying the financial statements, including the Management Discussion and Analysis.
- Examined documentation prepared by the Office of Finance to support the amounts presented in the FY 2003 Balance Sheet, Statement of Net Cost, and related note disclosures.²
- Discussed with personnel from Finance, [redacted], [redacted], and Agency components the process for initiating, recording, and monitoring transactions with OGAs.
- Selected a judgmental sample of 47 transactions to test the procedures for handling intragovernmental transactions. Twenty-six of these transactions were selected from the "OGA Log" maintained by [redacted] to track funds received by the Agency from OGAs.

(b)(3)
(b)(3)

(b)(1)
(b)(3)

¹ (U//~~FOUO~~) Because the FY 2003 financial statements had not been finalized before audit fieldwork ended in January 2004, we based our analysis and conclusions on a draft of the financial statements that was provided to us in December 2003 by [redacted] officials.

(b)(3)

² (U) There are no requirements for separately disclosing transactions with OGAs on the Statement of Financing, Statement of Budgetary Resources, and Statement of Changes in Net Position. Therefore, we did not conduct an in-depth analysis of these statements during this audit.

**This Exhibit is
UNCLASSIFIED//~~FOUO~~
When Separated From Report**

~~SECRET//20290518~~

~~SECRET//20290518~~

(b)(3)

Twenty-one of these transactions were selected from a database maintained by the Interdepartmental Contracts Team within [redacted] to track funds provided to other agencies. Our sample was designed to ensure that we reviewed transactions with various government agencies.

(b)(3)

- Contacted responsible officials in Agency offices and OGAs to determine the percentage of work completed on certain programs in order to ensure that expenses and revenues were reflected in the proper time period.
- Inquired about the processes for ensuring that accurate balances are recorded in the Agency's general ledger accounts and reconciled with OGAs.
- Reviewed activity in the following general ledger accounts, which are reported as intragovernmental activity on the financial statements to verify that the transactions were properly recorded during FY 2003:

| General Ledger Account Number | Account Name |
|----------------------------------|--|
| [redacted] | Accounts Receivable - Unbilled |
| | Accounts Receivable - Billed |
| | Accounts Receivable - Estimated OGA Receipts |
| | Allowance For Loss On Accounts Receivable |
| | Advances to Other US Government Agencies |
| | Prepayments |
| | Receivable from Appropriation |
| | Accounts Payable - Other |
| | Advances From Others |

(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~

- Reviewed the Economy Act in order to determine the statutory requirements associated with the transfer of goods and services between government agencies.
- Reviewed the applicable Statements of Federal Financial Accounting Standards and Office of Management and Budget bulletins in order to identify the Federal requirements for financial statement presentation and internal controls related to transactions with OGAs.
- Reviewed relevant reports and guidelines issued by the General Accounting Office, Department of the Treasury, and other Federal agencies.
- Reviewed our prior audit report, *Form and Content of Agency's Fiscal Year 2001 Financial Statements*, dated 27 March 2002, and other audit reports to identify key issues and concerns that have been previously reported related to the Agency's transactions with OGAs.
- Reviewed documentation regarding a new accounting model for recording transactions with OGAs that was developed by Finance officials in FY 2003 to address deficiencies identified in the existing process.
- Compared the new accounting model to the requirements outlined in the US Standard General Ledger.
- Tested a judgmental sample of 12 of 87 transactions that were recorded in early FY 2004 using the new accounting model to ensure that these transactions were recorded accurately and in compliance with applicable guidelines.

(U) We conducted our audit work at Agency facilities within the Washington, D.C. area from September 2003 to January 2004. Our audit was performed in accordance with generally accepted government auditing standards. Comments on a draft of this report were received from the Director of Finance and were considered in the preparation of this report.

~~SECRET//20290518~~

~~SECRET//20290518~~

(b)(1)
(b)(3)

Financial Statements Were
Provided by the Office of Finance

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(1)
(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(1)
(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(1)
(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(1)
(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~**Central Intelligence Agency***Notes to Financial Statements**September 30, 2003***Note 1. Summary of Significant Accounting Policies****A. Basis of Presentation**

These financial statements have been prepared to report the assets, liabilities, net cost of operations, changes in net position, budgetary resources, and financing of the Central Intelligence Agency, hereinafter referred to as either CIA or the Agency. These statements have been prepared from the books and records of the CIA.

The CIA has prepared these statements using the CFO Act and the OMB Bulletins as guidelines. Further, the Agency recognizes the Statements of Federal Financial Accounting Standards (SFFAS) provided by the Federal Accounting Standards Advisory Board (FASAB) as Generally Accepted Accounting Principles (GAAP) and therefore, where possible, has instituted their guidance.

The formats and instructions included in the OMB Bulletins provide a framework within which individual agencies have some flexibility in the presentation of information. The Agency reviewed the intent of the standards provided and applied this intent consistently throughout the preparation of the financial statements. To present the Agency's financial statements in accordance with the suggested formats, [redacted] produced a crosswalk from the Agency's general ledger to the US standard general ledger (SGL). This permitted the Agency to translate its GL-based trial balance data into financial statements using the US SGL structure.

(b)(3)

B. Reporting Entities

The accompanying financial statements reflect the financial activities of the CIA as well as the activities related to Other Government Agencies (OGA), Community Management Staff (CMS), Center for Security Evaluation (CSE), Central Intelligence Agency Central Services Working Capital Fund (WCF), and Central Intelligence Agency Retirement and Disability System (CIARDS). The Agency's current accounting system does not properly segregate non-agency funds. The Agency is currently working toward an implementation plan to properly segregate non-Agency funds from OGA funds. In an effort to more accurately reflect only Agency related funds on the financial statements for FY03, the financial activities of [redacted] and National Reconnaissance Office (NRO); with the exception of the related assets (cash) and liabilities (advance) transactions, were not included as a CIA reporting entity.

(b)(1)

(b)(1)

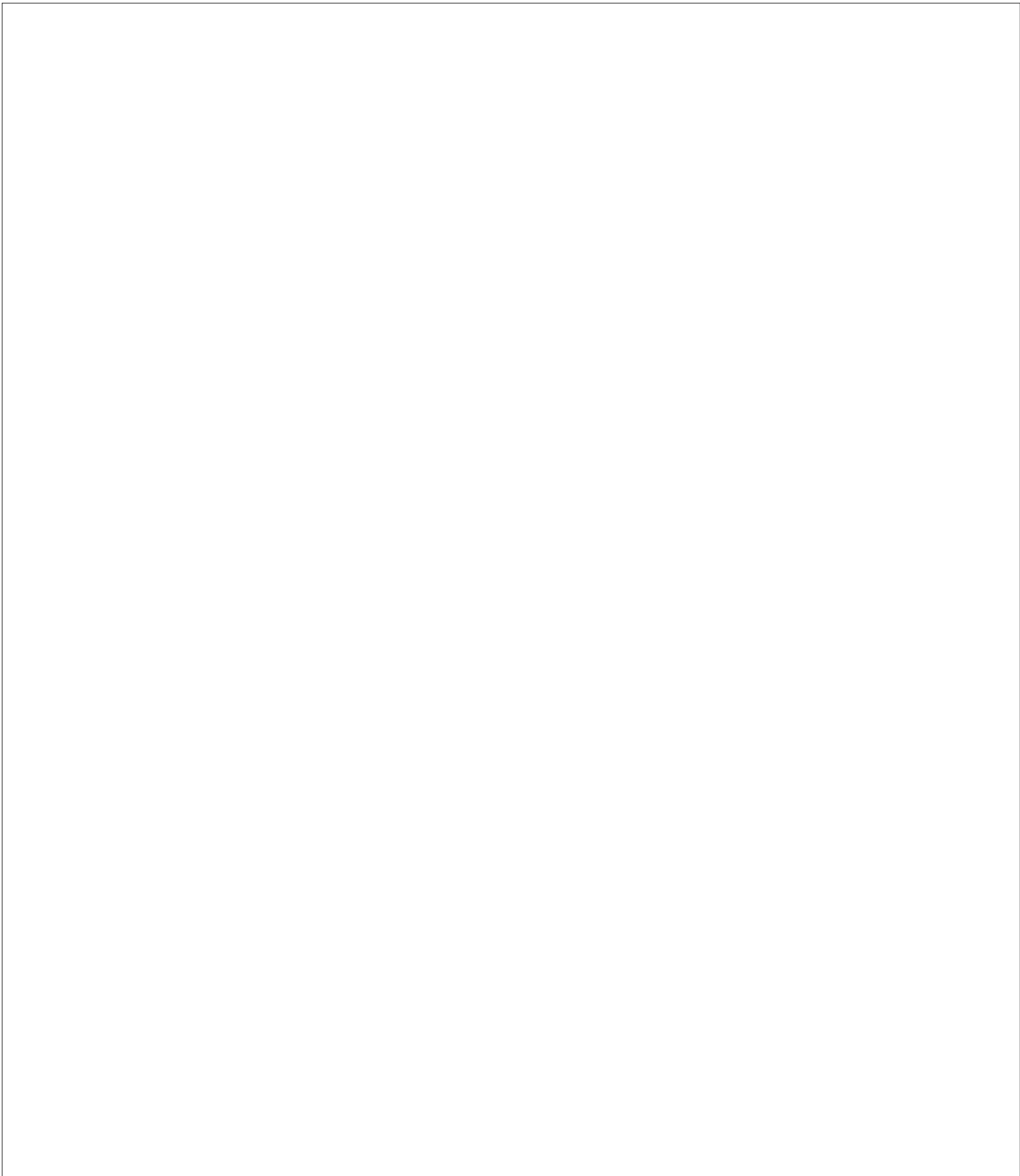
C. Basis of Accounting

The financial statements were prepared to report assets, liabilities, net cost of operations, changes in net position, budgetary resources, and financing at the CIA. The financial statements reflect both accrual and budgetary accounting transactions. The Agency's Working Capital Fund activity records all transactions on an accrual basis and the Agency has continued their effort to report on an accrual basis, this year accruing contractual expenses and pay and benefits. Therefore, the statements do reflect the Agency's continued efforts to report on an accrual basis. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. Budgetary accounting is designed to recognize the obligation of funds according to legal requirements, which in many cases is made prior to the occurrence of an accrual-based transaction. Budgetary accounting is essential for compliance with legal constraints and control over the use of Federal funds.

¹ On 24 November 2003, NIMA was officially renamed the National Geospatial-Intelligence Agency.

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(1)
(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(1)
(b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~

Liabilities (continued)

Intragovernmental Accounts Payable covered by budgetary resources represents advances from other government agencies, foreign governments and WCF related accounts payable transactions. Other intragovernmental liabilities include [redacted] due payable to the thrift savings plan and [redacted] of WCF related unearned revenues. (b)(1) (b)(3)

(b)(1) (b)(3) Included in Contractor payments is [redacted] of accrued liability relating to unpaid vendor invoices, the remaining [redacted] represents the Agency's liability for funds withheld from commercial contracts pending satisfaction of the withholding provisions of the contracts. (b)(1) (b)(3)

The Central Intelligence Agency has no authority to liquidate a liability unless budgetary resources have been made specifically available to do so. Since no budgetary resources have been made available to liquidate the CIARDS pension liability, it is classified as being "not covered by budgetary resources." Per SFFAS No. 5, the CIARDS pension liability is considered to be an intragovernmental liability.

Note 12. Statement of Net Cost

The Statement of Net Cost is designed to display the net cost of the reporting entity's operations, by program, for the period. The Statement of Net Cost includes gross costs incurred by the CIA, the CIA's Working Capital Fund, the CIARDS retirement fund, and the Community Management Staff, which is an administrative entity of the CIA. Earned revenue consists of exchange revenue received by the CIA for performing services on behalf of other government agencies utilizing reimbursable authority from OMB. For the CIARDS Program, earned revenue also includes employer and employee contributions, as well as interest income generated by investments in US Treasury securities. Currently, the Statement of Net Cost is not fully compliant with Federal accounting and reporting standards, for example, not all Agency costs are allocated to the core mission programs and the accounting model for earned revenue is not SGL-compliant. As part of the [redacted] [redacted], the Statement of Net Cost is undergoing a review to improve its accuracy and compliance. (b)(3)

Note 14. Statement of Budgetary Resources

The Statement of Budgetary Resources provides information about how budgetary resources were made available as well as their status at the end of the period. This statement includes all activity, CIA and CMS, that is recorded in the Agency's budgetary accounting records. In addition, due to the co-mingling of entity and non-entity information, it is not possible for the Agency to separate direct obligations incurred vice reimbursable obligations incurred. The Agency's reimbursable and OGA accounting models used in FY2003 are not consistent with US Treasury guidelines for reimbursable activity. However, the Agency did implement new accounting models at the beginning of FY2004 that are consistent with US Treasury guidelines. (b)(3)

~~SECRET//20290518~~

~~SECRET//20290518~~

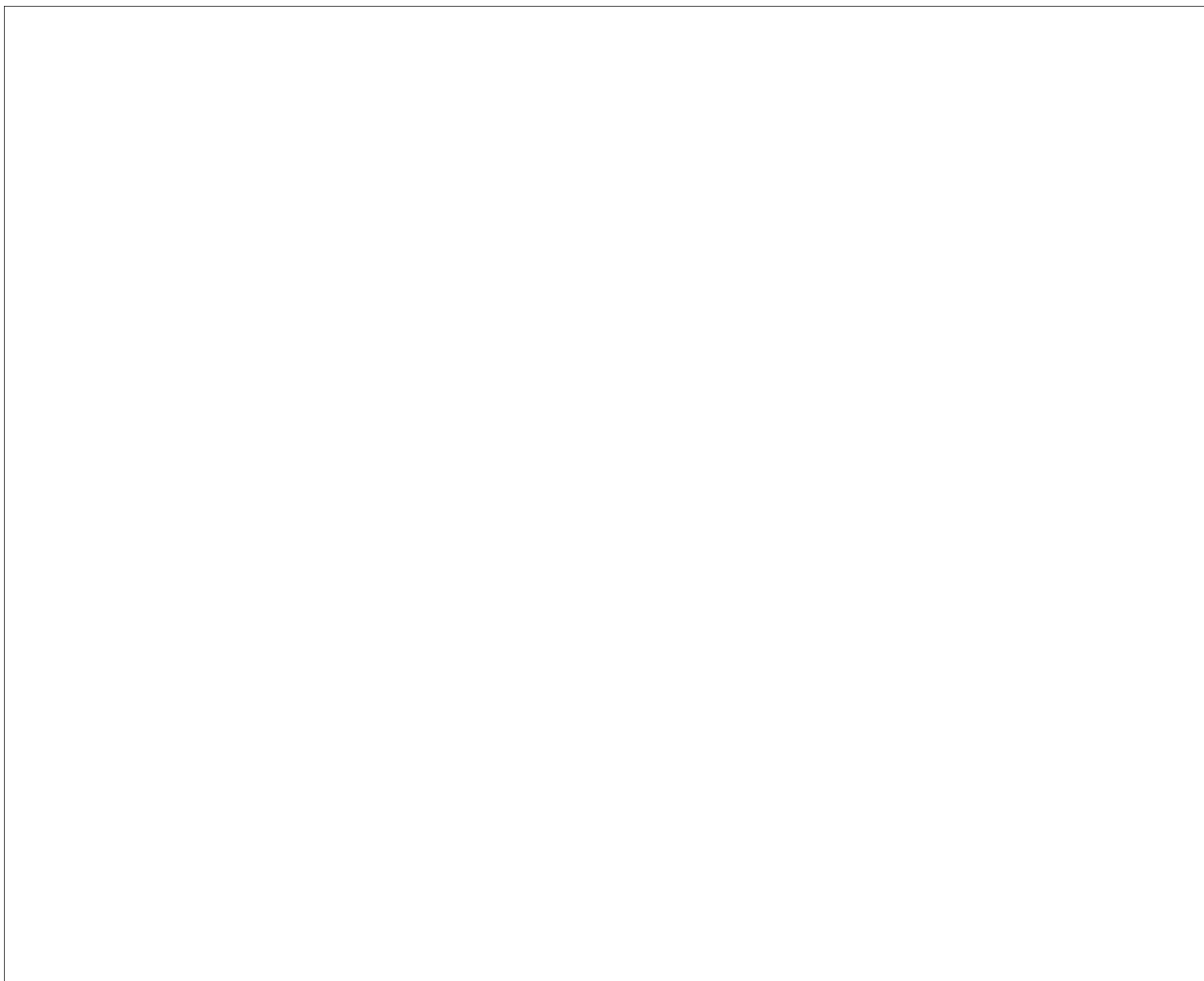
(b)(3)
(b)(5)

This Exhibit is
UNCLASSIFIED//~~FOUO~~
When Separated From Report

1

~~SECRET//20290518~~

~~SECRET//20290518~~



(b)(3)
(b)(5)

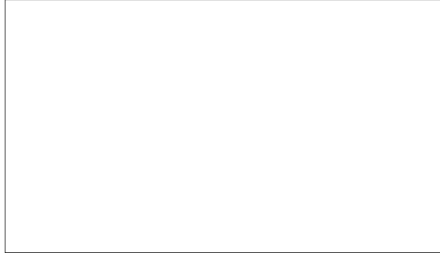
~~SECRET//20290518~~

~~SECRET//20290518~~

Exhibit D

(U) Audit Team Members

(U//~~FOUO~~) This report was prepared by the Financial Management Division,
Audit Staff, Office of the Inspector General.



(b)(3)

This Exhibit is
~~UNCLASSIFIED//FOUO~~
When Separated From Report

~~SECRET//20290518~~