



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

March 31, 1998

MEMORANDUM FOR: Dr. D. James Baker
Under Secretary for Oceans
and Atmosphere

FROM: 
Johnnie E. Frazier
Acting Inspector General

SUBJECT: Audit of NOAA's FY 1997 Financial Statements
Audit Report No. FSC-9865-8-0001

The attached audit report presents the results of the audit of the National Oceanic and Atmospheric Administration's (NOAA) Consolidated Statement of Financial Position as of September 30, 1997, and the related Consolidated Statement of Operations and Changes in Net Position for the year then ended. Also provided are reports on NOAA's internal controls and compliance with laws and regulations, including management's comments. The accompanying overview and financial statements were prepared by NOAA.

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

We commend NOAA management and staff on the significant progress made since the prior audit. The results of the FY 1997 audit are in marked contrast to the results of the FY 1996 audit in which KPMG issued a disclaimer and 21 reportable conditions, of which 11 were material weaknesses.

KPMG expressed a qualified opinion on the Consolidated Statement of Financial Position as of September 30, 1997. The opinion was qualified because NOAA (1) had not maintained a system to accurately and completely account for all of its capitalizable property and equipment in the financial statements and (2) was unable to support the classification of net position balances between appropriation categories.

NOAA received a disclaimer of opinion on its Consolidated Statement of Operations and Changes in Net Position for the year ended September 30, 1997, because of the effects of the disclaimer of opinion in the previous year. The October 1, 1996, balances of assets, liabilities, and net position enter into the determination of FY 1997 net income from operations and changes in net position, and it was not practical to extend audit procedures to audit those balances. Accordingly, the scope of the auditors' work was not sufficient to enable them to express an opinion on NOAA's results of operations and changes in net position for the year ended September 30, 1997.

In its Report on Internal Control over Financial Reporting, KPMG identified 17 reportable conditions, of which 6 are material weaknesses:

Material Weaknesses

- Preparation, Analysis, and Monitoring of Financial Information Should Be Improved.
- Financial Reporting Structure Should Be Consistent with NOAA's Organizational Structure. (Repeat Condition)
- Transactions Not Recorded in the General Ledger but Made Directly to the Financial Statements ("On-Top" Adjustments) Should Be Supported and Reconciled. (Repeat Condition)
- Budgetary Execution Transactions Should Be Supported and Reconciled. (Repeat Condition)
- Property, Plant, and Equipment Detail Records Should Be Corrected. (Repeat Condition)
- The Grants Management Division Should Improve Monitoring of Grant Recipients. (Repeat Condition)

Reportable Conditions

- Procedures for Year-end Accruals Should Be Improved.
- Civil Monetary Penalties Policy and Procedures Need to Be Followed.
- Loans Subledger Should Reflect Changes in Interest Rates and the Finance Office Should Record the Correct Allowance Amount. (Repeat Condition)
- Accounting for Notes Receivable Should Be Improved. (Repeat Condition)
- Real Property Procedures Should Be Improved at ASCs. (Repeat Condition)
- Finance Office Should Ensure Procedures to Comply with Statement of Federal Financial Accounting Standards No. 2 *Accounting for Direct Loans and Loan Guarantees* Are Implemented.
- Overview Section Should Be Complete and Supported. (Repeat Condition)
- Annual Leave Amounts Should Agree to the National Finance Center's Payroll Information System.
- Capital and Operating Lease Procedures Should Be Improved.
- Inter-agency Agreement Policies and Procedures Should Be Followed.
- Deferred Credits Should Be Adjusted for Revenue Earned.

In its Report on Compliance with Laws and Regulations, KPMG identified the following instances of non-compliance:

- NOAA did not fully fund its capital leases during FY 1997.
- NOAA did not report all of the above noted material weaknesses in its 1997 Federal Managers' Financial Integrity Act report.
- NOAA's financial accounting system does not substantially comply with the Federal Financial Management Improvement Act in that: (1) its financial management systems do not support the preparation of timely, accurate financial systems; (2) transactions are not processed consistent with the Standard General Ledger account descriptions; and (3) the material weaknesses are an indication of noncompliance with applicable federal accounting standards.

Our office reviewed a draft version of NOAA's FY 1997 Management Discussion and Analysis (MD&A) to its financial statements. The MD&A provides the linkage between the financial statements and the Government Performance and Results Act of 1993, the legislation that requires government entities to collect and report information on their performance in meeting goals and objectives. The review revealed that while NOAA has placed significant emphasis on the collection and reporting of performance results, additional improvements to the MD&A would be beneficial. We shared our observations and recommendations in a discussion paper to NOAA on January 14, 1998.

The MD&A (1) identifies that NOAA has established seven goals, with associated performance measures, to support the mission statement of the Department of Commerce; (2) discusses financial results and condition, including the reporting of certain financial measures; (3) presents output and outcome measures, with certain measures highlighted for discussion purposes; and (4) utilizes charts in the presentation of performance information, including both target and actual results. However, NOAA should still make improvements such as (1) continuing to strengthen reported performance measures (i.e., increasing the utilization of outcome and cost-effectiveness measures); (2) providing additional discussion of trends (i.e., performance and financial); and (3) strengthening the definition of measures and discussion of results (i.e., why target levels were exceeded or not met).

In order to improve the usefulness of the MD&A to decision-makers, such as OMB and the Congress, we encourage NOAA to address the observations contained in our discussion paper. Also, continued improvement will be needed for the overview to be consistent with OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, to "provide a clear and concise description of the reporting entity and its mission, activities, program and financial results, and financial condition". The OIG realizes that improving the MD&A is an iterative process and encourages NOAA to strengthen the discussion of its results in future reports.

We recognize NOAA's commitment to preparing high quality and meaningful financial statements. To continue to work toward this objective, it is necessary that the accounting requirements set forth in OMB Bulletin 97-01 are taken into consideration for preparation of the FY 1998 financial statements.

Implementation of OMB Bulletin 97-01 poses tremendous challenges to a reporting entity for various reasons. In particular, this bulletin requires six statements to be prepared as compared to OMB Bulletin 94-01, which required two. One of these six statements, the Statement of Net Cost, will require NOAA to report its costs by sub-organizations and programs, which should be based on the missions and outputs described in NOAA's GPRA strategic and annual plans, its budget structure, and the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards*. As the federal government has not been required previously to report information in such a manner for financial and budgetary purposes, NOAA will need to place appropriate emphasis on the implementation of OMB Bulletin 97-01.

In order to meet these challenges, we encourage NOAA to continue its efforts to recruit a CFO. The individual appointed to the CFO position should have a strong commitment to resolve the many financial management challenges facing NOAA. Also, emphasis should be placed on hiring additional financial management resources to facilitate timely resolution of internal control deficiencies.

While progress has been made in many areas, NOAA needs to address the remaining material weaknesses and reportable conditions. These weaknesses will continue to inhibit accurate and timely financial reporting. We encourage NOAA's management to continue to make concerted efforts to improve the internal control structure; timely implementation of corrective actions is essential for the preparation of financial statements for FY 1998.

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

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

Attachment

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

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