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Chairman Gingrey, Ranking Member Lofgren, and Members of the Committee on House Administration Subcommittee on Oversight, I am both pleased and honored to appear before you today in my capacity as Inspector General of the U.S. House of Representatives (House). Thank you for this opportunity to brief you on the results of the fiscal year (FY) 2009 financial statement audit of the House and to highlight the important work of the Office of Inspector General (OIG). The process of preparing financial statements instills discipline in the financial recording and reporting processes. Financial statements also provide transparency and accountability and tell the public that the House can and does properly account for its funds. For the twelfth year in a row, the House has received an unqualified or “clean” opinion on its financial statements. Specifically, the external auditor determined that the financial statements, including accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the House’s assets, liabilities, net position, net costs, changes in net position, and budgetary resources for FY 2009. Unfortunately, because of the material weaknesses in internal controls that I will discuss later in my testimony, the House did not maintain, in all material respects, effective internal controls over financial reporting as of September 30, 2009, and thus did not provide reasonable assurance that losses, misstatements, or noncompliance material in relation to the financial statements, would be prevented or detected and corrected on a timely basis. As soon as it became clear that the House was in danger of losing its clean opinion on internal controls, the OIG began to take aggressive action to inform management and oversight. As a result, priorities with respect to internal financial controls have shifted dramatically, but not in time to impact the current financial statement.

Background

In 1993, House Leadership directed the newly formed OIG to oversee the first-ever audit of the financial statements of the House and annually thereafter. While the House received a disclaimer in 1994 and qualified opinions from 1995 through 1997, it received its first “clean” or “unqualified” opinion in 1998 and has maintained that opinion every year through FY 2009, the most recently audited set of financial statements. To put this accomplishment into perspective, although preparing and auditing financial statements has been required in the Executive Branch since 1990 with the creation of the Chief Financial Officers (CFO) Act, five departments did not receive a clean opinion on their financial statements in 2010.

Management and Auditor Responsibilities

To ensure auditor independence, there is a clear separation in responsibilities between the auditors and management. In the context of the House, “management” would be defined as the Office of the Chief Administrative Officer (CAO) as they prepare the financial statements and have responsibility for accounting for financial activity. Management is responsible for creating the financial statements; maintaining effective control over financial reporting; and providing an

assessment of the effectiveness of internal controls over financial reporting. The external auditor is responsible for expressing an opinion on the financial statements and on the effectiveness of internal controls over financial reporting based on the audit. The OIG acts as a coordinator between the external auditor and the CAO. In this coordination role, the OIG ensures that the external auditor's requests are reasonable and within scope and that the CAO is responsive to requests made by the external auditor.

Types of Financial Statement Audit Opinions

In their financial statement audit report, the external auditor expresses two opinions. The first is an opinion as to whether the House financial statements present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the House's assets, liabilities, net position, net costs, changes in net position, and budgetary resources for the fiscal year under review. The second opinion addresses internal controls as they relate to financial reporting.

In expressing an opinion on the financial statements, there are four possibilities:

1. **Unqualified (clean opinion)** – Users can rely on information in the financial statements
2. **Qualified** – Users can rely on information in the financial statements, except for "...” (the auditor will explain what and why)
3. **Adverse** – Users cannot rely on information in the financial statements
4. **Disclaimer** – The auditor cannot determine whether users can rely on information in the financial statements because there is not enough reliable information available to audit or the auditee has imposed a scope limitation on audit work.

In expressing an opinion on internal controls related to financial reporting, there are five possibilities:

1. **Unqualified (clean opinion)** – The entity has effective controls over financial reporting. The entities' internal controls would likely identify errors in the financials and loss or misuse of its resources.
2. **Unqualified with reference to significant deficiencies** – Although the entity has effective internal controls over financial reporting, the auditor has also identified significant deficiencies. However, the significant deficiencies do not rise to the level to impact the overall clean opinion.
3. **Qualified** – The entity has effective controls over financial reporting, except for "...” (the auditor will explain what and why).
4. **Adverse** – The entity does not have effective controls. The entity's internal controls may not detect an error in the financial statements or loss or misuse of its resources.
5. **Disclaimer** - The auditor cannot determine whether the entity has effective controls over financial reporting because there is not enough reliable information available or the auditee has imposed a scope limitation on audit work.

Types of Financial Statement Audit Deficiencies

In determining the opinion on the financial statements and on internal controls, the auditor classifies deficiencies into three categories, escalating in severity and materiality: (1) control deficiency, (2) significant deficiency, and (3) material weakness. A control deficiency is the

least severe and occurs when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles. With a significant deficiency, there is more than a remote likelihood that a misstatement of the entity's financial statements, that is more than inconsequential, will not be prevented or detected by the entity's internal controls. Finally, a material weakness, the most severe deficiency, is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal controls.

Internal Controls

According to the U.S. Government Accountability Office (GAO), internal controls comprise an organization's plans, methods, and procedures used to meet its mission, goals, and objectives. It serves as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, and mismanagement. Internal controls also provide reasonable assurance that an organization's objectives are achieved through:

- Effective and efficient operations
- Reliable financial reporting
- Compliance with laws and regulations

To summarize briefly, internal controls help management achieve desired results through effective stewardship of government resources.

Internal Control Program

Having an internal control program (also known as a management control program) provides organizations with a systematic and continuous process to identify, assess, and monitor internal controls. An internal control program established in accordance with best business practices, such as those in the Office of Management and Budget (OMB) Circular No. A-123 (*Management's Responsibility for Internal Control*), gives agencies a tool to continually evaluate their internal control structure to assure it is well operated, is appropriately updated to meet changing conditions, and provides reasonable assurance that objectives are being achieved. An internal control program that is set-up using best practices will typically be organized in relation to the five standards for internal control.

1. **Control Environment** - This standard provides for management and employees to establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal controls.
2. **Risk Assessment** - Once organizational objectives are set, the organization identifies the risks that could impede the efficient and effective achievement of its objectives. Once risks have been identified, they should be analyzed for effect and management will decide on internal control activities to mitigate those risks.

3. **Control Activities** - The internal control activities are the policies, procedures, and techniques that help ensure that management's directives to mitigate risks, which were identified during the risk assessment, are carried out.
4. **Information and Communications** - For the organization to control its operations, it must have and use relevant, reliable information.
5. **Monitoring** - Internal control monitoring will substantially benefit the organization through periodic assessments of the quality of management controls over time and through ensuring that findings of audits and other reviews are promptly resolved.

When an organization does not have an internal control program, the risks increase that:

- Internal control weaknesses can go undetected and deteriorate further.
- Organizational risks are not identified and mitigation strategies to correct the risks are not developed.
- Incorrect or improper transactions can occur and not be detected due to the internal control deficiencies.
- The organization will not have a systematic process to continually monitor internal controls and the need for changes in controls to go along with changes in the operating environment. This can be especially important as changes and updates in technology occur.
- Financial information and reports may not be accurate.

Opinion on the FY 2009 House Financial Statements

For the twelfth year in a row, the external auditor expressed an unqualified, or "clean opinion," on the House's FY 2009 Financial Statements. This is a significant accomplishment given that this is the first year in which the CAO prepared the House's financial statements in accordance with Generally Accepted Accounting Principles for federal agencies (FedGAAP). In the past, the CAO had prepared the House's financial statements in accordance with standards similar to those issued for commercial entities. The OIG supported the CAO's decision to transition to FedGAAP so that the House would be in alignment with government best practices. The potential exists for organizations to lose their clean opinion when transitioning to a different basis of accounting. Because of the hard work and dedication of the CAO's Office of Finance, the House was able to successfully transition to FedGAAP and maintain its clean opinion. Overall, the assessment of finance is more fundamental than that of internal controls.

Weaknesses in internal controls can be a leading indicator of financial issues; however, the clean opinion for FY 2009 should give the public confidence in the fundamental financial activities of the House, particularly as it was received in the face of technical challenges and at a time when management priorities seem to have been elsewhere as indicated by the opinion on internal controls.

In contrast to the financial statement opinion, the external auditor expressed an adverse opinion on the CAO's internal controls, as they relate to financial reporting. The external auditor identified two material weaknesses and determined that the CAO did not maintain, in all material respects, effective internal controls over the House's financial reporting as of

September 30, 2009, and thus did not provide reasonable assurance that losses, misstatements, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis. The specific internal control material weaknesses identified in the financial statement audit pertained to the lack of an internal control program and ineffective controls over information technology.

Material Weaknesses – Lack of an Internal Control Program

The external auditor determined that the lack of an internal control program resulted in the CAO's inability to provide reasonable assurance that the House's financial statements were complete and accurate and prepared in a timely manner. In making the decision to classify the lack of an internal control program as a material weakness, the external auditor took into account several factors: (1) lack of action by management, (2) a deteriorating control environment, and (3) the lack of risk assessment and monitoring processes. As I noted previously, these are all key elements of a functioning internal control program.

Lack of Action by Management. FY 2009 is not the first year that the external auditor indicated that the CAO was in need of an internal control program. In FY 2006, the implementation of OMB Circular No. A-123, which defines management's responsibility for internal controls, was required for Executive Branch agencies. As such, in FY 2007, the external auditor verbally recommended that the CAO implement an internal control program, similar to OMB Circular No. A-123, to be consistent with governmental best practices. After management failed to take any action towards implementing an internal control program, the external auditor reported the issue as a significant deficiency in the FY 2008 financial statement audit. Management concurred with this assessment in their formal response to the FY 2008 financial statement audit; yet, in 2009, management still had not made notable progress in its implementation.

Control Environment. A functioning control environment establishes and maintains an environment throughout the organization that sets a positive and supportive attitude toward internal controls. In contrast, the CAO environment, at the senior management level, had become one which was generally unsupportive of the financial statement process, exhibiting disinterest, lack of cooperation, or possibly even obstruction to auditors' requests for information. Due to this lack of support from key CAO senior officials, CAO personnel were not fully cooperative in providing supporting documentation or answering auditors' questions likely because it was perceived to not support management's priorities. Moreover, there was a lack of understanding of the importance of internal controls over financial reporting.

Risk Assessment and Monitoring Processes. Risk assessments and controls monitoring are key elements of an effective internal control program. For an organization to exercise effective control, it must establish objectives and understand the risks that could undermine achievement of those objectives. Risk assessment is the identification and analysis of relevant risks to achieving objectives, forming a basis for determining how risks should be managed. For the purposes of assessing internal controls over financial reporting, management should identify the risks of a material misstatement in the financial statements. An effective monitoring process entails periodic assessments of the quality of internal controls over time and through ensuring that findings of audits and other reviews are promptly resolved. Risk assessment is the first

critical step in establishing an effective internal control program because it determines the extent of necessary controls. Monitoring is the strength behind an internal control program because it identifies poorly designed or ineffective controls and measures the effectiveness of all internal control activities.

However, the CAO does not have a risk assessment or monitoring process, as they relate to financial reporting. The CAO has not identified both internal and external risks that may prevent it from meeting its objectives. The process of identifying and analyzing risk is a critical component of an effective internal control system that includes how management identifies risks relevant to preparation of financial statements and information; assesses the likelihood of the manifestation of those risks; and decides upon actions to manage and mitigate those risks. Moreover, these risks have not been analyzed for their potential effect or impact on the House.

Additionally, the CAO has not implemented a monitoring program to include periodic reviews, reconciliations, or comparisons of data to determine if existing control activities are designed and operating effectively. Furthermore, the external auditor found that the CAO had not redesigned or improved the controls found to be deficient or communicated internal control objectives to ensure that CAO personnel were committed to sustaining an effective control environment. For example, the lack of an effective internal control program has contributed to the CAO's failure to take corrective actions on outstanding prior year deficiencies identified as part of past financial statement audits. Some deficiencies have been reported for numerous years. Successfully implementing an internal control program is critical to the House for achieving accountability and transparency.

Material Weaknesses – Ineffective Controls Over Information Technology

The external auditor determined that ineffective controls over information technology, as they relate to financial reporting, resulted in reduced assurance that data processed by the CAO's information systems are reliable and appropriately protected. Specifically, the CAO has not adopted an information technology (IT) controls framework or implemented an overarching IT security program that ensures a strong general controls environment for information systems and data processing. The CAO has not implemented, documented, or tested sufficient internal controls over the general IT environment to ensure that financial data are complete, accurate, and reliable. For example, the external auditor found that:

- A process was not created to identify, document, and assess IT controls
- A process was not implemented to ensure all systems had undergone a risk management process, such as Certification and Accreditation
- System security plans for major financial systems have not been developed and maintained
- Security control assessments were not conducted to test the design and operating effectiveness of controls for the House financial systems
- The information system change control process for financial systems did not include adequate documentation to ensure changes were adequately tested and approved
- Account management controls were not adequately managed and enforced

It is important to note that although the IT controls assessment included a review of some of the general controls over the House network, the primary focus was on the controls over the systems supporting the financial statements. As such, the IT controls opinion is an assessment of the effectiveness of controls over information technology, as they relate to financial reporting, and not necessarily over the entire House infrastructure.

Decisive House Corrective Actions

The external auditor first reported its growing concerns with the FY 2009 financial statements to the OIG on January 15, 2010. As a result, the OIG called an emergency meeting with the external auditor, the Chief Administrative Officer, and all senior CAO managers associated with the financial statement process, which was held on January 20, 2010. Although the former Chief Administrative Officer did not participate in this initial emergency meeting, or the weekly sessions held thereafter, all other senior CAO managers did participate. While this intervention helped to re-emphasize the importance of preparing financial statements and being responsive to the external auditors' requests, a lack of commitment and cooperation was still pervasive.

In March 2010, the external auditor notified the OIG that it was growing more likely that the House would either receive an adverse opinion or a disclaimer on the internal controls portion of the financial statements because of scope limitations and the inability for the auditor to review necessary documents. Because the Committee on House Administration serves in an oversight and governance role over of the administrative activities of the House, including preparation of the financial statements, the external auditor and I jointly briefed the Committee on House Administration of this possibility on March 22, 2010. In June 2010, the external auditor confirmed that the House would receive an adverse opinion on the internal controls portion of the financial statements. As such, the external auditor and I jointly briefed the Committee on House Administration on this development on June 30, 2010.

On a bi-partisan basis, the Committee on House Administration took decisive and immediate actions to address the control environment, or "tone at the top," deficiencies. The Committee on House Administration understood the seriousness of the internal control deficiencies. The Chief Administrative Officer announced his resignation on July 1, 2010 and a new Chief Administrative Officer was appointed immediately thereafter. On being appointed, the new Chief Administrative Officer initiated actions to develop an internal controls program by appointing a Director of Internal Controls, hiring an outside expert, and creating a senior assessment team to oversee its implementation. Moreover, the new Chief Administrative Officer appointed a new senior management team who are wholly supportive of the importance of providing transparency and accountability in House financial activity through the issuance of reliable financial statements. Since taking over as the Chief Administrative Officer, Mr. Strodel has made cooperation with the external auditor and with the OIG, as well as correcting internal control weaknesses, a priority. Requested information and supporting documentation is consistently provided to the auditors in a timely manner. The Committee on House Administration's decisive actions combined with Mr. Strodel's leadership have resulted in a complete reversal in tone within the CAO and have contributed to a much more effective and timely audit process during the 2010 audit cycle.

Status of FY 2010 and 2011 Financial Statement Audits

In contrast to the FY 2009 audit cycle in which it took the CAO nearly 14 months to provide finalized financial statements, the CAO provided the FY 2010 financial statements to the external auditor in mid-December 2010—only 2 months after fiscal year-end. This accomplishment was particularly noteworthy because of the CAO's involvement in both the PeopleSoft implementation and the transition to the 112th Congress. It is important to note, however, that despite all of the significant changes that have occurred since the new Chief Administrative Officer's appointment, the House will receive an adverse opinion on its internal controls portion of the financial statements for the FY 2010 audit cycle. During an audit, the controls that were in place during the period of review are what are considered in forming an opinion. Although the new Chief Administrative Officer took significant and rapid actions in correcting identified deficiencies, this did not occur until his appointment in July 2010. Since this was ten months into the fiscal year, it did not allow enough time to have deficiencies corrected by September 30, 2010, the end of the period under review. Although work remains, the CAO has made significant progress in developing and implementing an internal control program. A robust internal control program will help to ensure that processes are repeatable and will enable the CAO to be proactive in addressing issues, rather than reactive. Additionally, with Mr. Strodel's efforts to underscore the importance of internal controls as part of the overall CAO management framework, he has helped to instill this as an institutional value, increasing the chances for success. All of these factors increase the probability of the House regaining its clean opinion on internal controls during the FY 2011 audit cycle.

Conclusion

Chairman Gingrey, I wish to thank you, Ranking Member Lofgren, and the Members of the Committee on House Administration Subcommittee on Oversight for this opportunity to explain the importance of having a strong control environment and how weaknesses, if they exist, they could pose serious risk to the House. Internal controls help shield the House from significant financial losses, damage to the House's reputation, and delays and disruption to House financial and administrative operations.

Over the past 17 years, the OIG has worked closely with the Committee on House Administration and House Officers to help improve the operations of the House, to reduce inefficiencies, and to minimize costs. The OIG looks forward to continuing our role of providing value-added advice and counsel to the Committee on House Administration, House Officers, and joint entities of the House as we focus on issues of strategic importance to the House and its ability to efficiently and effectively conduct its operations in accordance with best business practices. We are dedicated and extremely proud to be able to serve the People's House in this way. I would be happy to answer any questions you may have.