

# INTRAGOVERNMENTAL TRANSACTIONS:



Seeking a Solution to Perennial Imbalances  
in Agency-to-Agency Trading

2008



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Public Administration®

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# **INTRAGOVERNMENTAL TRANSACTIONS:**

## **Seeking a Solution to Perennial Imbalances in Accounting for Agency-to-Agency Financial Transactions**



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## **Forum Panel**

**Edwin Harper\***, *Moderator, Senior Vice President at Assurant, Inc*  
**Ken Bresnahan**, *Partner, Grant Thornton, LLP and former Chief Financial Officer, U.S. Department of Labor*  
**John Cox**, *Chief Financial Officer, U.S. Department of Housing and Urban Development*  
**Robert Reid**, *Deputy Assistant Secretary, U.S. Department of the Treasury*  
**Daniel Werfel**, *Acting Controller, U.S. Office of Management and Budget*

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The views expressed in this report are those of the Forum Panel. They do not necessarily reflect the views of the Academy as an institution. We gratefully acknowledge the financial support of MasterCard International, Kelly, Anderson and Associates and Grant Thornton.

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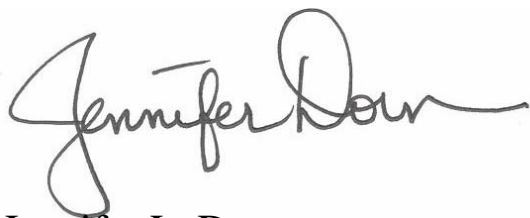
\* *Academy Fellow*

## FOREWORD

Despite significant improvements in recent years, the Federal Government has failed to achieve a clean audit of its consolidated financial statements for 12 years running. One major obstacle has been its inability to adequately account for business transactions between its own departments and agencies—transactions that amounted to over \$63 billion in 2007 alone.

With generous support from MasterCard International, Kelly, Anderson and Associates, and Grant Thornton, the National Academy of Public Administration hosted a forum in April 2008 of seasoned public and private sector leaders to discuss efforts underway to identify and apply both public and private sector solutions to this continuing problem.

We believe this report, which reflects that discussion, sheds light on potential solutions to this difficult challenge to effective financial management in government. The National Academy gratefully acknowledges the support of the sponsors, as well as the thoughtful participation of the forum attendees.

A handwritten signature in black ink, reading "Jennifer Dorn". The signature is fluid and cursive, with a large initial "J" and "D".

Jennifer L. Dorn  
President and Chief Executive Officer  
National Academy of Public Administration



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## INTRODUCTION

When a federal agency wants to purchase a good or service, it has two options: contract with a vendor or secure it from another agency within government. The latter, intragovernmental transactions<sup>1</sup> (IGT), have become a trillion-dollar annual business. Almost one million buy-sell transactions, valued at \$63 trillion, were processed in 2007 alone. Thousands of such transactions occur between federal agencies every day. Typical examples of IGTs include:

- Departments and agencies reimburse GSA for leasing commercial space on their behalf
- U.S. Department of Defense buys satellite services from NASA
- Federal Emergency Management Agency contracted with the U.S. Department of Housing and Urban Development to run the housing voucher program for people affected by Hurricane Katrina
- Departments reimburse the U.S. Department of Justice for litigation support

In departments like Homeland Security, Agriculture and Interior, which have many geographically dispersed functions, interdepartmental<sup>2</sup> transactions are also common. Federal departments maintain approximately 1,700 accounting and reporting locations that report IGTs to the U.S. Department of the Treasury. Prior to reporting, departments have to consolidate and coordinate thousands of locations from which they conduct their operations and programs.

This large volume of purchases and sales between and within departments needs to be processed and reconciled. Imbalances between department's accounts receivable and accounts payable (which should come to zero in total) are a small portion of that cash flow, but they still amounted to about \$42 billion in FY 2007.

These purchases and sales are in addition to investment transactions and transfers of budgetary resources that are also processed as IGTs. The

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<sup>1</sup> Intragovernmental transactions between and among departments in the federal government.

<sup>2</sup> Intergovernmental transactions are those between and among agencies within a single department.

Treasury Department and other government entities like the U.S. Postal Service invest and divest very large balances of funds daily.

Due to the volume of fund transfers back and forth, it appears that the government does much more business with itself than with the private sector. In March 2008, IGTs amounted to nearly \$6 trillion compared with total budget outlays that same month of only \$252 million. Congress has encouraged this business within the federal government, with the caveat that the service or good cannot be obtained for less from the private sector and that it is more readily available from within the government.

## WHAT IS THE PROBLEM?

The reconciliation of differences among the books of government agencies that transact business with each other is a perennial problem for Treasury, as it aggregates agency figures into its consolidated financial statement for the government as a whole. The federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies creates a material weakness. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. This is no simple check-balancing issue. "The problem fundamentally is that when the government's financial statements are rolled together, we are unable to reconcile or adequately account for the intragovernmental activity," says John W. Cox, Chief Financial Officer at the U.S. Department of Housing and Urban Development. Cox also heads the government-wide CFO Council team that is cooperating with Treasury to develop business processes to govern IGTs. There are signs that this effort and other efforts are helping: five years ago, the imbalances amounted to approximately \$300 billion; they are now in the \$50 billion range.

This is not a "green eyeshade" issue confined to the back offices of agencies. It has risen to the status of a major concern at the highest level in departments, including the Department of the Treasury and the Office of Management and Budget (OMB). It is a major concern in the government's efforts to streamline financial systems and reporting.<sup>3</sup> The impact of billion dollar imbalances is significant, and includes the following concerns that emerged at the Academy forum<sup>4</sup>:

- The federal government has not been able to obtain a clean audit opinion from GAO on its consolidated financial statement for 11 years.<sup>5</sup>

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<sup>3</sup> Federal Financial Management Report, 2008, U.S. Office of Management and Budget.

<sup>4</sup> Summarized from presentations by forum participants and subsequent interviews with the panelists and Academy fellows who served as chief financial officers. Also, see the Academy web site, [http://www.napawash.org/intragovernmental\\_forum.html](http://www.napawash.org/intragovernmental_forum.html)

<sup>5</sup> Ibid.

- Material imbalances can impair the auditors’ ability to render an opinion on an agency’s financial statements.
- The problem of intragovernmental imbalances “has a dramatic impact on the budget process,” according to forum participant Danny Werfel, Acting Controller at OMB. “If an agency does not have an accurate understanding of what resources it has, it does not know its full capacity to carry out services and meet its mission to the taxpayer.”
- Agency CFOs are prohibited by law from committing funds they cannot verify are available from their appropriations or reimbursement revenues. CFO’s face severe sanctions, including suspension, if they over-obligate or over-spend.
- If unspent funds remain at the end of the fiscal year as a result of uncertainty about whether they are obligated, they must, for the most part, be returned to the Treasury. Kenneth Bresnahan, a forum participant who served as both a CFO and budget officer in the federal government and is now a principal at Grant Thornton, explains that for “agencies that are constantly scraping the bottom of the barrel, it means returning money that could be available to meet a current need.”
- The effort to resolve differences between buyer and seller agencies is a drain on agency resources. “The need to appear before OMB or a congressional committee to explain your agency’s numbers when the auditors question them is a high-cost exercise,” says Michael Smokovich, a Senior Associate at Kelly, Anderson and Associates, and a former U.S. Agency for International Development CFO and Deputy Commissioner at Treasury’s Financial Management Service.
- Account reconciliation work is always costly; getting it wrong the first time creates an inordinate amount of subsequent work.
- There is underlying public distrust in accountability and transparency of government financial data, and the government’s inability to accurately account for intragovernmental transactions may contribute to this distrust. A Harris Interactive poll conducted in January 2008 on behalf of the Association of Government Accountants found that “American adults believe governments are failing to practice open,

honest and responsible spending while doing a poor job of providing understandable and timely financial management information.”<sup>6</sup>

- Lack of reliable data inhibits the development and use of financial statement information for managing government expenditures and for oversight of budget results and performance.

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<sup>6</sup> “Public Attitudes Toward Government Accountability and Transparency 2008”. Association of Government Accountants, February 2008, <http://www.agacgfm.org/downloads/pollreport2008.pdf>



## WHY THE IMBALANCES?

Aside from the number of transactions and the multiplicity of agencies involved, other obstacles stand in the way of a simple or quick solution to the problem of imbalances.

**Dissimilar accounting systems.** Accounting systems have proliferated within and across agencies over the years. Treasury estimates there may be as many as 5,000 systems of varying age (some 30 to 50 years old, some just two or three), according to forum participant Robert Reid, Deputy Assistant Secretary for Accounting Policy at Treasury, who serves as the department's representative on the Federal Accounting Standards Advisory Board. Each system was configured by a different individual whose job was to make that system work for the agency, and not necessarily for the government as a whole. This approach has made it difficult to exchange and compare data electronically. Much of the reconciliation work has to be accomplished manually at both ends of the transaction.

**Lack of standard account code entries.** One agency may enter a purchase of telephones in a telephone account; the other enters it in a broader information technology account.

**Lack of adherence to business process rules.** Unlike the thousands of pages of federal regulations governing contracting for services and goods with the private sector, the laws governing IGTs provide significant leeway in the manner in which they are conducted.<sup>7</sup> Although Treasury filled a major gap with publication of Federal rules for IGTs, adherence to these rules remains a problem.

**Lack of adherence to accrual accounting standards.** Agencies must uniformly apply accrual accounting standards to every transaction. When they do not, differences in the cash portion of a transaction may work out but amounts due from and due to will be out of balance.

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<sup>7</sup> The authorization and guiding principles are laid out in the GSA FAR guidance for Economy Act transactions. See Appendix A for the original Economy Act provisions governing inter-agency transactions. In 1996, PL 89-473, Making Accounting Adjustments between Appropriations, generally enabled agencies to engage in interagency transactions for reimbursements and transfers between appropriation accounts. Prior to that time, an agency needed explicit authority to engage in intergovernmental business transactions.

**Lack of pre-encumbrance agreements or lack of tracking transactions from the outset through settlement.** As noted above, IGTs do not necessarily require procurement office approval or pre-transaction agreements. As a result, agency accounting offices may be unaware of payables or receivables when closing their books. “What happens,” explains Cox, “is that the program side comes to your door and says, ‘Congratulations, we have this agreement with Department A. Please take care of the accounting.’ That is not the right way to handle this properly from a business process standpoint.” Cox added.

**Missing or incomplete data for audit reconciliation.** Missing elements can include something as fundamental as what agency or division the order came from or the name and telephone number of the person who initiated the purchase. Tracking down such data can be the key resolving differences. According to Reid, “Oftentimes, data are at such a high level that it is almost impossible to dig down and find out where in the agency this particular difference is coming from.” This is especially true “if you’re looking at it 15 to 18 months after that transaction occurred, and people’s memories have gotten a little foggy.”

**Problems in applying technology and the need to train people to maintain accuracy and consistency.** To build a technology platform that can be used effectively to record, analyze and report IGTs throughout their lifecycle, agencies must be willing to agree on common data classifications and business processes, and must invest in training the people who process and record the transactions.



## WHAT HIGH-LEVEL INITIATIVES ARE UNDERWAY?

Over the past five years, Treasury, OMB, departments with large imbalances, and the CFO Council have mounted several initiatives to address the problem. Treasury, for instance, has established the Intra-governmental Payment and Collection System (IPAC) to process disbursements and collections for IGTs. “It’s the bank for tracking what went in and out,” explains Cox. What this mechanism lacks are additional levels of detailed information about the obligation, the accrual and the cash components needed to reconcile and validate the transaction before it is processed. Presently, it does not create any discipline or control around the obligations and the accruals that preceded, or should have preceded, the disbursement or collection.

In addition, Treasury has published and periodically updated a set of business rules that are similar to the practice in commercial transactions.<sup>8</sup> Although they are only guidance to agencies in conducting transactions with each other, they are designed to minimize imbalances. They include such measures as having agency trading partners agree—prior to the transfer of any goods, services and money—on such simple matters as: where in their agency the responsible buyer and payer reside; what accounts will be credited and debited; and standard account codes to be used for specific transactions. The example of the telephone purchase recorded by one side as Information Technology and as telephone by the other describes the need for standard codes. These disciplines are common practice in private sector supply chain management. Achieving wider implementation of the rules in government remains a challenge.

Another initiative is OMB’s “Watch List” of agencies with imbalances (and a separate list of individual transactions where an agency cannot identify its transaction partner). The Watch List had an immediate and dramatic impact on the problem, according to Werfel. Being on the list triggers a requirement for agencies to meet with OMB and explain what they are doing to rectify the imbalance. “Even the threat of meeting with OMB has been enough in some cases to elicit a call from an agency to report, ‘We’ve found a solution’,” Werfel says.

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<sup>8</sup> Treasury Financial Manual, Bulletin No. 2007-03, Vol. 1.

A draft dispute resolution mechanism is being targeted for implementation in 2008. This would be a “last resort” remedy in cases where the issues are “so thorny and complicated” that they require further research and mediation, Werfel reports.

Another CFO Council initiative with OMB is exploring the application of technologies to capture essential data on transactions and track them through their life cycle. “We’re just in the beginning stages of looking at these,” explains Cox. The Council is investigating systems both within and outside the government. One million transactions annually are a lot by government standards, but miniscule in the private sector where transactions must be settled between institutions on a daily basis.

These initiatives and broader financial management system reforms have achieved a steady reduction in the imbalances, according to Reid, “...but not as much as we might like.” He characterized the measures to date as “band aids”, albeit good ones, in lieu of a permanent solution.

## LOOKING TO THE FUTURE

To move forward, Treasury’s Financial Management Service has, as its top priority, to obtain a clean audit for the federal consolidated financial statement. A major element of that effort is to “downgrade” and “reduce...to an immaterial level the material weakness in intragovernmental transaction accounting.”<sup>9</sup>

Some of the measures, such as requiring agencies to establish reciprocal categories for transactions, will be continued and expanded. “We feel that, while these individually may be a little step, collectively may get some progress,” Reid states.

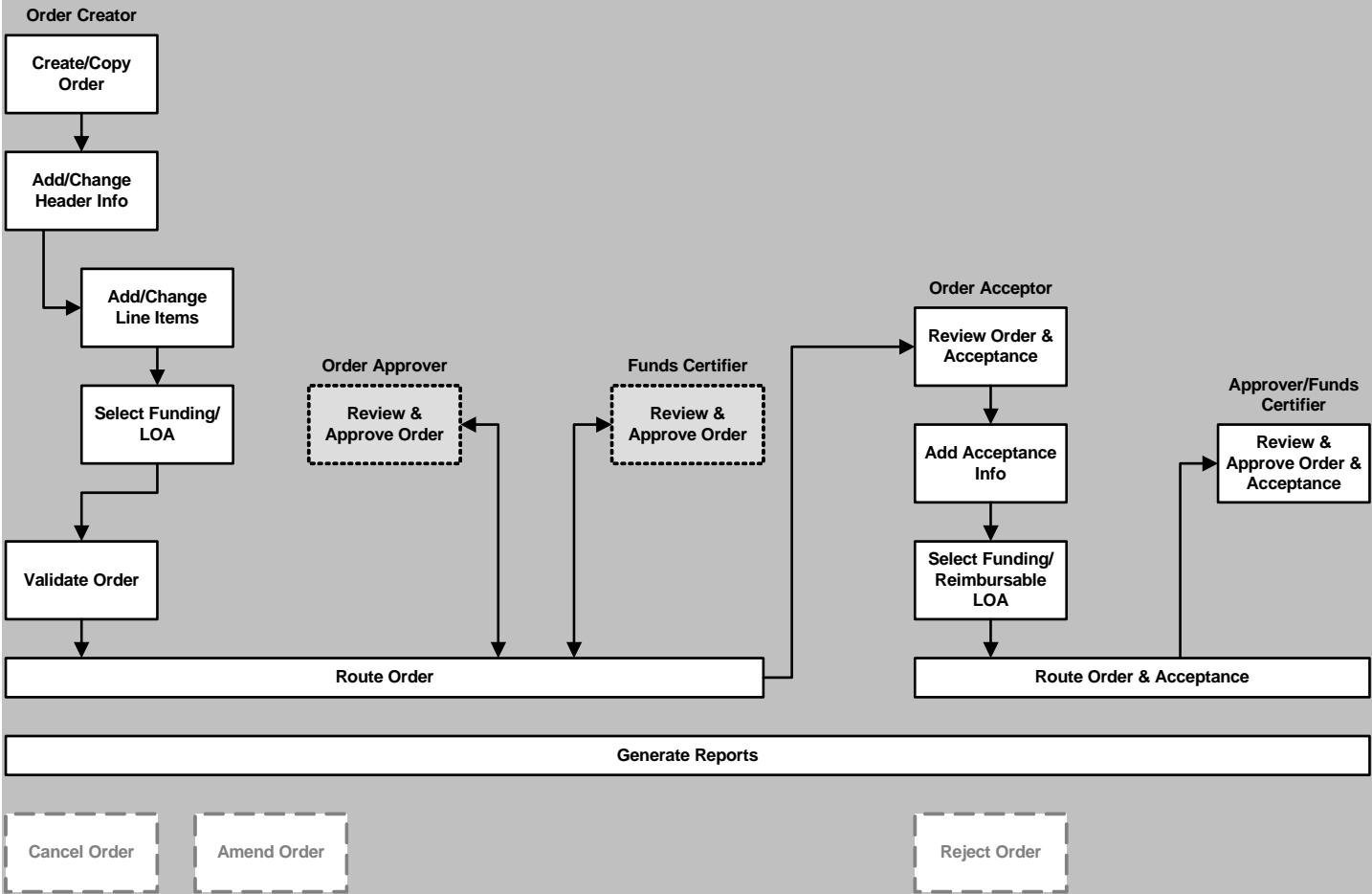
There was a general consensus among forum participants, however, that absent a comprehensive solution, the problem will continue to be a perennial knot in reconciling accounting transactions and achieving clean audits on financial statements. The measures identified for accomplishing this include:

1. Improving reporting and visibility of information and accountability between transaction partners.
2. Improving business processes. Figure 1 displays a summary view of the key steps in a disciplined transaction environment.
3. Investing in government and off-the-shelf commercial solutions to capture and track transactions throughout their life cycle.

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<sup>9</sup> Op. cit, Federal Financial Management Report.

FIGURE 1  
 MODEL BUSINESS PROCESS FOR IGTS<sup>10</sup>



<sup>10</sup> Adapted from Intragovernmental Transactions (IGT) Initiative, DBSAE Directorate, Business Transformation Agency, presentation by Herbert Kaskoff, March 7, 2007.

Forum participants generally agreed that business process improvement was central to achieving a state in which IGT transactions are settled routinely, and in a manner that precludes the need for major management interventions. The most commonly mentioned process improvements included:

- Using disciplined mechanisms to implement Treasury's business rules;
- Expanding and standardizing the use of pre-encumbrance (pre-trade) agreements;
- Adopting reciprocal accounting codes and reconciliation procedures in approved federal accounting systems;
- Using the existing Business Partner Network (BPN) numbers to identify lower levels of agencies, in much the same manner that DUNS numbers are used in commercial accounting, to identify separate business locations (see Box 1). This would assist in the resolution of imbalances by establishing the audit trail to where transactions are occurring.

## **How DUNS Numbers Serve Business Accounting Needs**

In simpler times, if Campbell got an invoice from a retail client, company B, which had a single location of business, they would pay the invoice and everyone would be happy. But today, Company B may have many locations in different parts of the country that are performing different functions. To launch a winter soup promotion, Campbell might want to launch a promotion in the North Central States in early October allowing Company B's stores in the north central region a discount. Campbell might delay the winter promotion in the Southwestern states until mid November. To insure that the discounts are being applied properly you need to know to which specific store or warehouse the soup is being delivered and which store is claiming the discount. The DUN's Number system gave every commercial location a unique identifying number, so we would know exactly where the soup was shipped and where the bill should be sent, allowing us to keep our receivables at the lowest possible number of days consistent with our contractual terms.

*—Edwin Harper, Senior Vice President, Assurant; former Executive Vice President and CFO of Campbell Soup and Deputy Director of OMB*

Pilot programs<sup>11</sup> to test information technology solutions (either government developed, such as IPAC, or commercial off-the-shelf software) could be conducted between a pair of agencies or functions within an agency or between shared service providers in the federal government, listed below.

- BPD: Administrative Resources Center, Bureau of Public Debt, U.S. Department of the Treasury
  
- ESC: Enterprise Services Center, U.S. Department of Transportation
  
- GSA: Federal Integrated Solutions Center, General Services Administration
  
- NBC: National Business Center, U.S. Department of the Interior

## **Prospect**

The forum participants did not envision any single solution, such as one settlement house for all IGTs. The consensus view favored a comprehensive, collaborative solution, while recognizing that this would require much hard work and perhaps several more years of coordinated effort through the CFO Council, Treasury and OMB. It also would require some agency heads “taking a bold step” to be innovators in accommodating the need for shared data and common business processes.

“Building a unified general ledger and full blown accounting system is probably technologically impossible,” according to Reid, given the sheer number of agencies, accounting systems and users. “We know this problem is solvable, and we know that there is technology out there that mechanically can handle the debits and credits. But, we also know that we’re many years away from being able to look at that kind of system.”

Bresnahan views the problem as an opportunity. “The government is moving widely toward the greater use of shared services (between and among agencies).

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<sup>11</sup> Forum participant Kenneth Bresnahan mentioned in follow up interview that MasterCard has developed such a solution, titled Intergovernmental Commerce Exchange.

In this environment, I think it's increasingly possible to concentrate energy around an enforceable solution," he says. "Most importantly, technology can provide a collaborative working environment where trading partners can come together and share information. Technology can help to create that common identifier, which the [lack of] separates buyers and sellers because of the different language they are using."

Cox summed up the challenge this way: "We're not looking to build some grand purchasing system. That's probably not going to work. It's going to be hard, because we're all going to have to collectively do it."



## APPENDIX A

### SUBPART 17.5—INTERAGENCY ACQUISITIONS UNDER THE ECONOMY ACT AGREEMENT FOR PURCHASING GOODS OR SERVICES

- (a) Each Economy Act order shall be supported by a Determination and Finding (D&F). The D&F shall state that—
  - (1) Use of an interagency acquisition is in the best interest of the Government; and
  - (2) The supplies or services cannot be obtained as conveniently or economically by contracting directly with a private source.
- (b) If the Economy Act order requires contract action by the servicing agency, the D&F must also include a statement that at least one of the following circumstances applies:
  - (1) The acquisition will appropriately be made under an existing contract of the servicing agency, entered into before placement of the order, to meet the requirements of the servicing agency for the same or similar supplies or services;
  - (2) The servicing agency has capabilities or expertise to enter into a contract for such supplies or services which is not available within the requesting agency; or
  - (3) The servicing agency is specifically authorized by law or regulation to purchase such supplies or services on behalf of other agencies.
- (c) The D&F shall be approved by a contracting officer of the requesting agency with authority to contract for the supplies or services to be ordered, or by another official designated by the agency head, except that, if the servicing agency is not covered by the Federal Acquisition Regulation, approval of the D&F may not be delegated below the senior procurement executive of the requesting agency.



## **APPENDIX B**

### **EXTRACT FROM TREASURY BUSINESS RULES FOR INTRAGOVERNMENTAL TRANSACTIONS**

#### **II. Assumptions**

- A.** The following accounting methodologies are used to record and report intragovernmental transactions: (1) generally accepted accounting principles and (2) the U.S. Government Standard General Ledger (USSGL).
- B.** Buyers obtain goods or services from another Federal entity via an intragovernmental agreement or “order;” an order is an official request for goods or services. See Section VI for the requirements of the order.
- C.** Once Sellers officially accept orders, both Buyers and Sellers record (obligate) the accepted orders in their respective official accounting systems.
- D.** Sellers start performance on the order after acceptance of the order. However, national emergencies, or statutes and laws may dictate the Seller’s performance start date. Sellers shall track related cost and keep consistent, reliable evidence of performance.



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