



United States Government Accountability Office
Washington, DC 20548

December 6, 2005

Ms. Kathleen M. Turco
Chief Financial Officer
General Services Administration

The Honorable Brian D. Miller
Inspector General
General Services Administration

Subject: *Financial Audit: Restatement to the General Services
Administration's Fiscal Year 2003 Financial Statements*

As you know, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is required to annually prepare and submit audited financial statements of the U.S. government to the President and Congress. We are required to audit these consolidated financial statements (CFS) and report on the results of our work.¹ An issue meriting concern and close scrutiny that emerged during our fiscal year 2004 CFS audit was the growing number of Chief Financial Officers (CFO) Act agencies that restated² certain of their financial statements for fiscal year 2003 to correct errors.³ Errors in financial statements can result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties. Further, when restatements do occur, it is important that financial statements clearly communicate, and readers of the restated financial statements understand, that the financial statements originally issued by management in the previous year and the opinion thereon should

¹The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. § 331 (e). The federal government has elected to include certain financial information on the legislative and judicial branches in the CFS as well.

²A financial statement restatement occurs when an entity either voluntarily or prompted by its auditors or regulators revises public financial information that has previously been reported.

³According to Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, prior period financial statements presented should be restated only to correct errors that caused such statements to be materially misstated.

no longer be relied on and instead the restated financial statements and related auditor's opinion should be used.

Eleven of the 23 CFO Act agencies⁴ restated certain of their financial statements for fiscal year 2003. Five CFO Act agencies had restatements in fiscal year 2003 covering their fiscal year 2002 financial statements. Three CFO Act agencies had restatements covering both years. We noted that the extent of the restatements to CFO Act agencies' fiscal year 2003 financial statements varied from agency to agency, ranging from correcting two line items on one agency's balance sheet to correcting numerous line items on several of another agency's financial statements. In some cases, the net operating results of the agency were affected by the restatement. The amounts of the agencies' restatements ranged from several million dollars to more than \$91 billion.

Nine of the 11 agencies that had restatements for fiscal year 2003 received unqualified opinions on their originally issued fiscal year 2003 financial statements. The auditors for 6 of these 9 agencies issued unqualified opinions on the restated financial statements, replacing the previous unqualified opinions on the respective agencies' original fiscal year 2003 financial statements. The auditors for 2 of these 9 withdrew their unqualified opinions on the fiscal year 2003 financial statements and issued other than unqualified opinions on the respective agencies' restated fiscal year 2003 financial statements because they could not determine whether there were any additional misstatements and the effect of any such misstatements on the restated fiscal year 2003 financial statements. For the remaining agency, the principal auditor of the agency's fiscal year 2004 financial statements was not the principal auditor of the agency's fiscal year 2003 financial statements, and an audit opinion on the agency's restated fiscal year 2003 financial statements was not issued.

Our review focused on the 9 agencies with restatements for fiscal year 2003 that received unqualified opinions on their originally issued fiscal year 2003 financial statements.⁵ These were the Department of Agriculture, Department of State, Department of Justice, Department of Transportation, Department of Health and Human Services, General Services Administration (GSA), National Science Foundation, Nuclear Regulatory Commission, and Office of Personnel Management.

Because of the varying nature and circumstances surrounding the restatements, we are issuing a number of separate reports on the matter. This report communicates our observations regarding GSA's fiscal year 2003 restatement. Going forward, we hope that the lessons learned from the fiscal year 2003 restatement, together with our

⁴The Federal Emergency Management Agency (FEMA) was transferred to the Department of Homeland Security (DHS) effective March 1, 2003. With this transfer, FEMA was no longer required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies for the remainder of fiscal year 2003 and for fiscal year 2004. The DHS Financial Accountability Act, Pub. L. No. 108-330, 118 Stat. 1275 (Oct. 16, 2004), added DHS to the list of CFO Act agencies, increasing the number of CFO Act agencies again to 24 beginning in fiscal year 2005.

⁵The 2 agencies that had restatements for fiscal year 2003 but did not receive unqualified opinions on their originally issued fiscal year 2003 financial statements were the Department of Defense and the Small Business Administration.

recommendations, will help GSA and its auditor avoid the need for restatements to GSA's future financial statements.

We reviewed four key areas with respect to the restatement of GSA's fiscal year 2003 financial statements: (1) the nature and cause of the errors that necessitated the restatement, including planned corrective actions by the agency and its auditors; (2) the timing of communicating the material misstatement to users of the financial statements; (3) the extent of transparency⁶ exhibited in disclosing the nature and impact of the material misstatement in the financial statements and the reissued auditor's report; and (4) audit issues that contributed to the failure to detect the errors that necessitated the restatement during the audit of the agency's fiscal year 2003 financial statements.

Results in Brief

Improperly transferring costs related to one major construction project out of the Construction in Process (CIP)⁷ account and into the Buildings account led to the material misstatement that necessitated the restatement of two separate and distinct line items on GSA's originally issued fiscal year 2003 Balance Sheet. Specifically, at fiscal year 2003 year end, GSA recorded an adjusting journal entry to transfer about \$952 million of construction costs from the CIP account to the Buildings account. This amount was derived based on a statistical sample of construction projects included in GSA's unadjusted year-end balance for the CIP account. The largest project included in GSA's statistical sample was a multiphase project totaling about \$68.6 million, which was incorrectly classified as substantially complete⁸ at that time. This incorrect classification, when projected to the population of CIP projects, was the basis for about \$921 million of the \$952 million, or over 96 percent, of the estimated costs transferred at year end.

GSA's auditor did not detect the error because its fiscal year 2003 audit tests were not adequately designed to test the validity of GSA's transfers of construction costs between the two accounts. Although the journal entry used to record the transfer between the accounts involved a material amount and GSA's contracted independent public accountant (IPA) had reported a reportable condition relating to CIP transfers in its previous two years audit reports, in our view, the IPA did not adequately understand the significant components underlying this journal entry. As a result, the IPA randomly selected 10 projects from GSA's statistical sample of 99 projects and

⁶Transparency is the full, accurate, and timely disclosure of information.

⁷The United States General Ledger uses the term Construction in Progress, but GSA presents this account as Construction in Process in the fiscal year 2003 financial statements. We will use the term Construction in Process (CIP) to refer to the account.

⁸According to the IPA's Property Cycle memorandum, GSA defines substantial completion as the date when GSA can use the constructed item for its intended use. Substantial completion is not equivalent to the completion date for the contract. Substantial completion is also the date for the transfer of the project from the work in process account to the Buildings account.

did not review the above noted project that GSA had incorrectly classified. Further, in our view, the title of GSA's note disclosure of the restatement could be misinterpreted.

We are recommending that GSA's CFO ensures that GSA fully and effectively implements control procedures to properly transfer costs from the CIP account to the Buildings account. We are also making a recommendation to GSA's Inspector General to work with the IPA so that audit procedures to sufficiently test for any similar errors in the transfer of amounts from the CIP account to the Buildings account in the future are implemented.

GSA, along with its Inspector General concurred with our recommendations for ensuring reliable balances in the CIP and Buildings accounts. In separate responses on a draft of this report, they described the accounting and auditing procedures planned to avoid similar restatements of this nature in the future.

Background

In conducting the fiscal year 2004 audit of the CFS, we reviewed the 23 CFO Act agencies' performance and accountability reports for possible restatements and identified 11 agencies that had restated certain of their audited fiscal year 2003 financial statements.

The primary intended users of federal agencies' financial reports are citizens, Congress, federal executives, and federal program managers.⁹ Each of these groups may use federal agencies' financial statements to satisfy their specific needs. Citizens are interested in many aspects of the federal government, particularly federal programs that affect their financial well-being. Congress is interested in monitoring and assessing the efficiency and effectiveness of federal programs. Federal executives, such as central agency officials at OMB and the Department of the Treasury (Treasury), are interested in federal financial statements to assist the President of the United States. OMB assists the President in overseeing the preparation of the federal budget by formulating the President's spending plans, evaluating the effectiveness of agency programs, assessing competing funding demands among agencies, and setting funding priorities. Treasury assists the President in managing the finances of the federal government and prepares the CFS, which is based on audited financial statements prepared by federal agencies. GAO audits the CFS and reports on the results of its audit. Finally, federal program managers use agency financial statements as tools for managing their operations within the limits of the spending authority granted by Congress.

The primary accounting and auditing standards that apply to restatement disclosures by federal entities are the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Corrections of*

⁹Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*.

Errors and Changes in Accounting Principles, and the American Institute of Certified Public Accountants (AICPA) Codification of Auditing Standards, AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.¹⁰

Objective, Scope, and Methodology

The objective of our review of the restatement of GSA's fiscal year 2003 financial statements was to determine the nature and cause of the errors, the transparency and timing of communicating the material misstatements, any audit issues relating to such misstatements, and any actions being taken to help preclude similar errors from occurring in the future.

We reviewed the nature and causes of the restatement, and we also examined corrective action plans to be implemented by GSA to help preclude similar errors from occurring in the future. We interviewed the preparers and auditors of GSA's fiscal year 2003 financial statements, including staff from the agency's Office of Inspector General (OIG), and we obtained and reviewed relevant audit documentation. Our work was not designed to and we did not test the accuracy or appropriateness of the restatement.

In our review, we considered certain accounting and auditing standards, including SFFAS No. 21; the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 16, *Prior Period Adjustments*; and the AICPA Codification of Auditing Standards, AU section 420, *Consistency of Application of Generally Accepted Accounting Principles*, AU section 508, *Reports on Audited Financial Statements*, and AU section 561.

We performed our review of the restatement of GSA's fiscal year 2003 financial statements from December 2004 to October 2005 in accordance with U.S. generally accepted government auditing standards.

We requested comments on the draft of this report from GSA's CFO and Inspector General or their designees. Written comments from GSA's Acting Administrator and Inspector General are reprinted in enclosures I and II, respectively, and are also discussed in the Agency Comments section.

Issues Related to Restatement of GSA's Fiscal Year 2003 Balance Sheet

With respect to the restatement of GSA's fiscal year 2003 Balance Sheet, we identified the following three areas that need improvement: (1) identification of substantially complete CIP transfers, (2) design of audit procedures relating to adjusting journal

¹⁰Generally accepted government auditing standards incorporate AICPA reporting standards and Statements on Auditing Standards unless the Comptroller General of the United States excludes them by formal announcement.

entries used to transfer amounts from the CIP account, and (3) the title of the note disclosure of the restatement. These issues are discussed in detail below.

Adjustment to CIP and Buildings Accounts Were Erroneous

GSA's Balance Sheet for fiscal year 2003 was restated because of an error in the adjusting journal entry that was used to transfer approximately \$952 million of estimated costs from the CIP account to the Buildings account. The error caused the Buildings line item on the Balance Sheet to be materially overstated by approximately \$921 million and the CIP line item on the Balance Sheet to be materially understated by this same amount.

The CIP general ledger account includes construction of, and major improvements and renovation projects to, buildings that GSA owns and leases to other federal entities. Upon substantial completion, certain costs are to be transferred to the appropriate Property and Equipment (P&E) asset account. The transfer from the CIP account to the appropriate P&E account is necessary for proper classification of assets in the Balance Sheet as well as accurate and complete reporting of depreciation expenses. Depreciation is not calculated and recorded until the asset is transferred from CIP to the appropriate asset account.

When a new CIP project is established, regional personnel are expected to enter all necessary information, including the expected date of completion into the Inventory Reporting Information System (IRIS) that GSA management uses to monitor the status of construction projects. Construction costs are accumulated in the CIP account. Once a project is substantially complete, the project manager is supposed to enter the date of substantial completion into IRIS so that the CIP account project costs will be automatically transferred into the Real Property Accounting Depreciation System (RPADS). Also, building projects that meet certain capitalization criteria and are determined to have been substantially completed during the reporting period should be transferred to the Buildings account from the CIP account.

Transfers of the costs of substantially completed projects from the CIP to the appropriate P&E account are necessary for proper classification of the related assets in the Balance Sheet. For fiscal year 2003, GSA's net Buildings account and CIP account totaled about 52 percent of its total assets. However, according to the IPA's fiscal year 2004 Report on Internal Control, since fiscal year 2001, GSA has experienced problems related to cost transfers from CIP to the appropriate P&E account. Specifically, the IPA's report noted that GSA's Public Buildings Service (PBS) controls over transferring substantially complete CIP projects continue to need improvement.

GSA has been aware that weaknesses in these processes can lead to the failure to recognize the completion of construction projects on a timely basis. Among the causes of the underlying weaknesses previously reported by GSA's auditor are regional personnel not entering completion dates in IRIS, and manual procedures performed by central staff not addressing all CIP issues. In order to mitigate these control weaknesses, each quarter GSA's PBS uses a random statistical sample to

assess the accuracy of data in its RPADS and makes an adjusting journal entry to correct for any errors for reporting purposes.

Based on PBS's review of a statistical sample of projects still classified in IRIS as CIP at the end of fiscal year 2003, GSA recorded an adjusting journal entry to transfer about \$952 million of estimated costs from the CIP account to the Buildings account. In September 2004, during GSA's OIG review of GSA's quarterly financial statements, the OIG discovered an error in the agency's classification of the largest project included in GSA's end of fiscal year 2003 statistical sample. Specifically, the OIG found that PBS incorrectly classified a \$68.6 million multiphase project from the fiscal year 2003 CIP sample as substantially complete when it should have remained in CIP. PBS identified the multiphase project as substantially complete without obtaining written documentation from the region responsible for the project to support such a determination. This incorrect classification, when projected to the population of CIP projects, was the basis for about \$921 million of the approximately \$952 million of the estimated costs that were transferred. As a result, GSA's adjusting journal entry to transfer approximately \$952 million in estimated costs from the CIP account to the Buildings account was overstated by about \$921 million. GSA's OIG communicated the error to GSA management and to the IPA in September 2004, which was appropriate. After researching the issue, GSA management concurred that the error warranted an adjustment to restate the CIP and Buildings line items on the fiscal year 2003 Balance Sheet.

To reduce the risk of similar errors in the future, GSA officials told us that GSA has refined its methodology for determining the CIP transfer amounts. Starting with fiscal year 2005, GSA will semi-annually review all of the CIP projects over \$7 million and statistically sample the remaining lower cost CIP projects to develop an adjusting journal entry, if necessary. In addition, according to GSA's Corrective Action Plan, GSA intends to improve its controls over transferring substantially complete CIP projects by enforcing its control procedures at the project level to ensure that all substantially complete and only substantially complete CIP projects are transferred out of the CIP account. GSA's plan calls for GSA regions to make entries into a weekly nationwide CIP Progress Report to certain GSA officials regarding the number of projects: (1) with no substantial completion date, (2) with substantial completion dates in the past, and (3) marked to be completed in the current month. In addition, according to GSA's Plan, PBS intends to work with regions to develop regional action plans that enforce entering timely substantial completion dates at the project level.

Auditor's Procedures Were Not Adequately Designed to Detect Error in the Transfer of CIP Costs

The above-noted error was not discovered during the audit of GSA's fiscal year 2003 financial statements because the fiscal year 2003 audit procedures performed by GSA's IPA were not adequately designed to detect the error. The journal entry used to record the transfer between the accounts involved a material amount and GSA's IPA had reported a reportable condition relating to CIP transfers in its previous two years audit reports. In addition, as noted above, over 96 percent of the estimated costs that were transferred resulted from the incorrectly classified multiphase project.

Nevertheless, the IPA randomly selected 10 projects from GSA's statistical sample of 99 projects and did not review the largest cost project in the sample, which is the above noted project that GSA had incorrectly classified.

The *Financial Audit Manual* (FAM)¹¹ states that during the audit planning process, the auditor should identify conditions that significantly increase inherent, fraud, and control risk. Among other things, the auditor should perform procedures to identify account balances and transactions that might signal inherent risk. According to FAM 260.40, the auditor should obtain an understanding of the financial reporting process and the controls over journal entries and other adjustments; identify and select journal entries and other adjustments for testing; determine the nature, timing, and extent of the testing; and inquire of individuals involved in the financial reporting process about inappropriate or unusual activity related to the processing of journal entries and adjustments. In our view, if the IPA had had a better understanding of the significant components of the calculations used to determine the material adjusting journal entry that transferred construction costs from the CIP account to the Buildings account and had then designed and performed sufficient audit procedures over such components, the error that necessitated the restatement might have been detected.

According to GSA's IPA, future audits will include testing more projects from GSA's sample. Specifically, the IPA intends to increase the sample size from 10 to about 45. Given the known risks in this area, it will be important for the IPA to perform adequate audit procedures over any significant adjusting journal entries made by GSA to transfer CIP costs.

The Title of GSA's Note Disclosure of the Restatement Could Be Misinterpreted

The notes to GSA's comparative fiscal years 2004 and 2003 financial statements included a note disclosure titled "Prior Period Reclassification." In our view, this title could be misinterpreted, since the note disclosure discussed the adjustment to correct the \$921 million material misstatement and the adjustment represented a restatement as defined by SFFAS No. 21 rather than a prior period reclassification.

Conclusions

The restatement was caused by an error that GSA's OIG identified. GSA corrected the error and issued restated financial statements. Going forward, the key will be for GSA to ensure that the planned corrective actions established to help prevent future errors in the transfer of CIP costs are fully and effectively implemented. In addition, it will be important that GSA's OIG work with GSA's IPA so that audit procedures to detect any similar errors in the future are fully and effectively implemented.

¹¹GAO/President's Council on Integrity and Efficiency, *Financial Audit Manual*, GAO-01-765G (Washington, D.C.: July 2001), updated by GAO-04-1015G and GAO-04-924G (July 2004).

Recommendations for Executive Action

We recommend that GSA's Chief Financial Officer ensure that GSA fully and effectively implements control procedures to properly transfer costs from the CIP account to the Buildings account.

We recommend that GSA's Inspector General, work with GSA's IPA so that audit procedures to sufficiently test adjusting journal entries related to the transfer of amounts from the CIP account to the Buildings account are fully and effectively implemented.

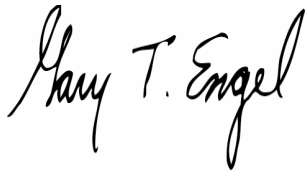
Agency Comments

In commenting on a draft of this report, GSA's Acting Administrator stated that GSA concurs with our recommendation to implement control procedures to properly transfer costs from the CIP account to the Buildings account and has made changes in the statistical sample process as we acknowledged in our report. He also stated that GSA developed a weekly report that is sent to the regional offices to highlight the CIP projects where the estimated substantial completion date is overdue, missing, or scheduled to occur within 30 days to assist in ensuring the CIP projects are accurately capitalized and depreciated in a timely fashion. GSA's Inspector General concurred with our recommendation and stated that his office will continue to work with the IPA regarding auditing the transfer of CIP to the Buildings account and that since fiscal year 2003, the IPA's testing in this area has expanded to reduce the likelihood that a similar error would occur in the future. He also stated that his office will continue to monitor the IPA's efforts to plan and perform its tests of the adjusting journal entries related to the transfer of amounts from the CIP account to the Buildings account.

Within 60 days of the date of this report, we would appreciate receiving a written statement on actions taken to address these recommendations.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Homeland Security and Governmental Affairs; the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Government Reform; and the Subcommittee on Government Management, Finance and Accountability, House Committee on Government Reform. In addition, we are sending copies to the Fiscal Assistant Secretary of the Treasury and the Controller of OMB. This report is also available at no charge on GAO's Web site at www.gao.gov.

We appreciate the courtesy and cooperation extended to us by your staff throughout our work. We look forward to continuing to work with your offices to help improve financial management in the federal government. If you have any questions about the contents of this report, please contact me at (202) 512-3406 or engelg@gao.gov.

A handwritten signature in black ink that reads "Gary T. Engel". The signature is written in a cursive, flowing style.

Gary T. Engel
Director
Financial Management and Assurance



GSA Administrator

November 28, 2005

The Honorable David M. Walker
Comptroller General of the United States
Government Accountability Office
Washington, DC 20548

Dear Mr. Walker

The General Services Administration (GSA) appreciates this opportunity to review and provide comments to the Government Accountability Office's (GAO's) draft report, **FINANCIAL AUDIT: Restatement to the General Services Administration's Fiscal Year 2003 Financial Statements**, GAO-06-70R.

The draft report recommends that GSA's Chief Financial Officer ensure that GSA fully and effectively implements control procedures to properly transfer costs from the Construction in Process (CIP) account to the Buildings account.

GSA concurs with the recommendations to implement controls procedures to properly transfer cost from the CIP account to Buildings account and has made changes in the statistical sample process as you acknowledged in the report. Specifically, beginning with the September 2004 statistical sample, the Public Buildings Service (PBS) Chief Financial Officer's (CFO's) Office required the Regional Offices to provide documentation that supports the status of the project as of the date the sample was pulled. In addition, beginning in March 2005, the sample process was restructured to segregate the CIP universe into strata. Stratum one contains all projects over \$7 million dollars in addition to some other special projects that are reviewed 100 percent, thus eliminating the need to project the error rates on large projects over the population. These projects are reviewed every quarter and represent approximately 75 percent of the total adjusted CIP account balance. Stratum two contains all projects that make up 1 percent of the adjusted CIP account balance. Stratum three contains all remaining CIP projects. A statistical sample is drawn semi-annually from both Stratum two and three and the error rate is projected over each Stratum's universe. Also, the PBS CFO's Office developed a weekly report that is sent to the regional offices to highlight the CIP projects where the Estimated Substantial Completion date is overdue, missing, or scheduled to occur within 30 days. The report highlights those projects to assist in ensuring the CIP projects are accurately capitalized and depreciated in a timely fashion.

U.S. General Services Administration
1800 F Street, NW
Washington, DC 20405-0002
Telephone: (202) 501-0800
Fax: (202) 219-1243
www.gsa.gov

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Should you have any questions, please contact Kathleen M. Turco, Acting Deputy Administrator. Staff inquiries may be directed to Mr. Donzell Jackson, Director, Financial Consulting and Analysis Division at (202) 501-0110.

Sincerely,

A handwritten signature in black ink, reading "David L. Bibb". The signature is written in a cursive style with a large, stylized "D" and "B".

David L. Bibb
Acting Administrator



U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

NOV 21 05

Mr. Gary T. Engel
Director
Financial Management and Assurance
Government Accountability Office
441 G St., NW
Washington, DC 20548

Dear Mr. Engel:

Thank you for the opportunity to respond to your report entitled, *Financial Audit: Restatements to the General Services Administration's Fiscal Year 2003 Financial Statements*.

Your report recommends "GSA's Inspector General work with GSA's independent public accountant (IPA) so that audit procedures to sufficiently test adjusting journal entries related to the transfer of amounts from the Construction in Progress (CIP) account to the Buildings account are fully and effectively implemented." We concur with your recommendation, and continue to work with GSA's IPA regarding the transfer of CIP to the Building account. Since Fiscal Year 2003, the IPA's testing in this area has expanded to reduce the likelihood that a reclassification would occur in the future. The IPA has achieved this through segregating the CIP population and increasing the sample size. We will continue to monitor the IPA's efforts to plan and perform its tests of the adjusting journal entries related to the transfer of amounts from the CIP account to the Buildings account.

We understand and appreciate the impact of financial statement errors on the public's trust and confidence in GSA and the Federal Government as a whole, and remain deeply committed to working with GSA's IPA to ensure that tests are sufficient. If you should have any questions or would like to discuss this issue further, please contact Eugene Waszily, Assistant Inspector General for Auditing, of my staff on (202) 501-0374.

Sincerely,

Brian D. Miller
Inspector General

1800 F Street, NW, Washington, DC 20405-0002

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