United States General Accounting Office

GAO

Testimony

Before the Committee on Governmental Affairs
United States Senate

For Release on Delivery
Expected at
9:30 a.m.
Thursday,
December 14, 1995

FINANCIAL MANAGEMENT

Continued Momentum Essential to Achieve CFO Act Goals

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Mr. Chairman and Members of the Committee:

I am very pleased to be here today to discuss the steady progress being made to improve financial management in the federal government through implementation of the Chief Financial Officers (CFO) Act of 1990. This landmark legislation was enacted 5 years ago thanks to the hard work of this Committee and its House counterpart. But, as I will outline today, a great deal more perseverance will be required to sustain the current momentum and successfully overcome decades of serious neglect in fundamental financial management operations and reporting methods.

To address these problems, the 1990 CFO Act spelled out an ambitious agenda of long overdue reforms. The CFO Act established a CFO structure in 24 major agencies and the Office of Management and Budget (OMB) to provide the necessary leadership and focus. To help instill greater accountability and fix pervasive and costly control breakdowns, financial statements were required to be prepared and audited, beginning with those for fiscal year 1991, for revolving and trust funds and commercial activities. For 10 agencies, audited financial statements were required as part of a pilot program to test this concept for an agency's entire operations. Moreover, the CFO Act set expectations for

- the deployment of modern systems to replace existing antiquated, often manual, processes;
- the development of better performance and cost measures; and
- the design of results-oriented reports on the government's financial condition and operating performance by integrating budget, accounting, and program information.

Important progress is being achieved to bring about these sweeping reforms and rectify the devastating legacy from inattention to financial management. OMB continues to play an important leadership role and a cadre of qualified CFOs are now in place and are seeking to make needed improvements. Similarly, the Inspectors General (IG) are embracing their new financial audit responsibilities. Additionally, much needed comprehensive accounting standards are nearing completion, and efforts are underway to further strengthen the quality of financial reporting. In short, financial management is finally becoming a top priority of federal managers.

Moreover, the regular preparation of financial statements and independent audit opinions required by the 1990 act are bringing greater clarity and understanding to the scope and depth of problems and needed solutions. These annual public report cards are also generating increased pressure to fix long-standing problems. The success of these efforts formed the basis for congressional action last year to pass the Government Management Reform Act of 1994, which expanded to all 24 CFO Act agencies the requirement for the preparation and audit of financial statements for their entire operations, beginning with those for fiscal year 1996. This essential expansion of the CFO Act's requirements provides a greater impetus for accelerated governmentwide implementation of financial management reform.

Also the 1994 act requires the preparation and audit of consolidated executive branch financial statements, beginning with those for fiscal year 1997. For the first time, the American public will have an annual report card on the results of current operations and the financial condition of its national government. This, in conjunction with the 24 CFO Act agencies' financial statements will set the foundation for the federal government to have the same kind of financial reporting as had already been required (1) by the securities laws for the private sector, partly in response to the stock market crash of 1929 and (2) by the Single Audit Act for state and local governments, driven in part by financial crises such as experienced by New York City in the early 1970s.

Making these reforms a reality in the federal government, however, remains a challenge for us all. Today, I want to focus on the four main implementation challenges to build upon the progress to date and put lasting improvements in place. They are:

- first, successfully implementing the expanded requirements for audited financial statements to improve the reliability of data for decision-making and strengthen the efficiency of financial operations and controls;
- second, continuing to build stronger financial management organizations by upgrading skill levels, enhancing training, and ensuring that CFOs possess all the necessary authorities within their agencies to achieve change;
- third, devising and applying more effective solutions to address difficult problems plaguing agencies' underlying financial systems; and
- fourth, designing comprehensive accountability reports to permit more thorough and objective assessments of agencies' performance and financial conditions, as well as to enhance the budget preparation and deliberation process.

In addition to achieving improvements in financial management at the federal level, this Committee has spearheaded greater oversight of hundreds of billions of dollars in federal spending at the state and local levels through the passage of the Single Audit Act in 1984. This act helps provide accountability for federal payments and instill fundamental elements of good financial management in state and local governments. The Committee in considering amendments to the act, which I will also address, to improve the effectiveness of the single audit process.

I want to commend the Committee for holding this hearing; sustained congressional attention to implementation of financial management legislation will be important in instilling greater accountability throughout the federal government and helping better control the cost of its operations. Thanks in large part to the legislative impetus of the expanded CFO Act and the Government Performance and Results Act—efforts led by this Committee—decisionmakers will ultimately have available unprecedented, reliable information on both the financial condition of programs and operations and the performance and costs of these activities.

Also, I will discuss the role this Committee could play in continuing to build on the foundation established through these laws for establishing a strong financial management organizational structure and revolutionizing the type and quality of financial information for decisionmaking. I believe this Committee, with the support of GAO, can work with the rest of the Congress to ensure that the wealth of new information to be generated through these statutory requirements will be provided to and used by appropriations, budget, and authorizing committees of the Congress and to bring the CFO Act's goals to fruition.

Data Reliability and Financial Operations Are Beginning to Improve

To date, CFO Act financial audits have resulted in greater data reliability and improved financial operations. Under the expanded act, all 24 CFO Act agencies can begin to gain the benefits demonstrated by those agencies that have already successfully undergone full-scale financial audits. This is absolutely critical and will put the federal government on a par with the private sector and state and local governments, which have already made the necessary investment in financial management.

There is widespread consensus that the preparation and audit of financial statements has been the primary catalyst to increase the reliability of financial data and improve financial operations. During the past 5 years, due to the CFO Act's requirement, we have seen audit coverage substantially increase to almost half of the government's annual gross budget authority. Beginning with fiscal year 1996, due to the expanded CFO Act, audit coverage will expand to cover the entire operations of the 24 CFO Act agencies, which currently account for virtually all of the government's outlays.

Also, agencies are progressing in receiving unqualified audit opinions. In four cases, (the Social Security, General Services, and National Aeronautics and Space Administrations and the Nuclear Regulatory Commission) unqualified opinions were rendered on fiscal year 1994 financial statements covering agencies' entire operations. These agencies, which covered about 23 percent of the government's fiscal year 1994 outlays, have demonstrated that preparing auditable financial statements is possible and, with priority and emphasis, can be achieved by the remaining 20 CFO Act agencies as well.

In addition, there has been significantly greater commitment by the administration and agencies to effectively implement the CFO Act's expanded financial statement preparation and audit requirements. For example, OMB made it clear from the outset that it would not grant any waivers, although it has the authority to waive the requirement for fiscal years 1996 and 1997; thus, helping to ensure greater adherence to the statutory timetable. Also, OMB, Treasury, and GAO have been meeting with agency CFOs and IGs to build consensus, and we have generally seen a good commitment being given to preparing and auditing financial statements. For instance, some agencies, such as the Departments of Interior and Education, are on an accelerated schedule to having agencywide financial statements 1 year before the act requires. Several CFOs and IGs have caveated their optimism, however, by the prospects that funding constraints could hold for dampening this momentum and hampering plans for meeting the act's fiscal year 1996 requirement.

It is essential that this time frame be met. As we have discussed in prior testimonies before the Congress, audited financial statements have provided significantly more accurate and useful information on the government's financial status and its operations.[1] Further, CFO Act financial audits have provided a greater understanding of the extent and nature of the financial control and systems problems facing the government, and a better appreciation for the limited extent to which the

[1]These testimonies are listed in attachment I.

Congress and program managers can rely on the information they receive. Effective implementation of the CFO Act's expanded requirement for audited financial information is essential for more informed decision-making and better accountability in virtually every major aspect of the government's operations, as the following examples illustrate.

Improving Revenue Collection Operations Essential to Fund the Government

In fiscal year 1994, the federal government collected a reported over $1.3 trillion in revenue, primarily from individual and corporate income taxes and import duties, fines, and fees. Reliable financial data are necessary to ensure that the government assesses and collects more of the revenue that is due from these sources. This, however, is not yet the case, as shown by our financial audits at the Internal Revenue Service (IRS) and the U.S. Customs Service.

The Internal Revenue Service

The process of preparing and auditing financial statements for the government's primary revenue collection agency has surfaced significant problems affecting its operations and credibility. For example, through these audits, it came to light during our first audit of IRS's financial statements—those for fiscal year 1992—that IRS could not

- verify or reconcile its $1.3 trillion in reported revenues to its accounting records;
- substantiate amounts for various types of taxes reported, such as social security, income, and excise taxes, although the amounts of these taxes are to be separately maintained;
- reconcile its cash accounts with Treasury's;
- substantiate its billions of dollars of gross and net accounts receivables, and
- adequately account for its annual operating funds.

To its credit, IRS has made a commitment to institute changes. Through the strong support of the Commissioner, the agency has made important strides to address its far-reaching financial management problems. IRS successfully implemented a new administrative accounting system in fiscal year 1993 that can better account for its more than $7 billion in annual operating funds. It entered into an agreement with the Department of Agriculture's National Finance Center and now has control over its $5 billion payroll operations, which was lacking at the time of our first audit. It has taken physical inventories of its equipment and is beginning to get full control over these assets. IRS has ongoing efforts, including the use of outside contractors, to resolve its cash reconciliation problems and to strengthen its internal controls over payments.

Finally, although necessary systems changes to bring revenue accounting up to reasonable expectations have not been completed, better estimates of collectible delinquent taxes are now being developed as part of the financial statement preparation process so that the Congress will have the information needed to better gauge potential collectibility and to ask questions as to why amounts are not collectible. For example, the audit for fiscal year 1992 disclosed that IRS had $65 billion in delinquent taxes outstanding, not the $110 billion IRS reported and, of the $65 billion, only $19 billion was estimated to be collectible. This type of data would provide a more reliable basis than has been available in the past on the merits of adding collection personnel.

The future holds even greater potential. First, IRS is beginning to address the systems issues that will enable it to reliably show by type of tax how much has been actually received and who pays the tax. For example, excise taxes, such as petroleum companies and chemical manufacturers, among others, pay to fund environmental cleanup activities, are to be segregated by type and are used to achieve specific policy goals. But our financial audit showed that IRS's accounting system does not have this capability. Consequently, whether it be the Superfund Trust Fund or the Highway Trust Fund, a fund may be receiving more or less than it is due.

Social security taxes are somewhat different in concept but the problem is the same. Under law, the Social Security Administration (SSA) receives social security taxes based on wage information reported by employers to IRS even if the taxes are ultimately not paid. This results in amounts going to the Social Security Fund from other tax sources, and while the IRS knows that there is a discrepancy, it cannot yet identify that amount so that decisionmakers will know the cost of this policy. As a result of the financial audit, IRS is now working to address these problems.

Future systems changes should also result in extending the application of accrual accounting to the tax revenue stream so that IRS and the Congress will have somewhat better information about the taxes IRS should be collecting. Further, because the CFO Act calls for the development of better cost and performance data, IRS will have an opportunity to better justify and manage tax compliance initiatives. For example, over the years, questions have been raised over the amount of revenue to be generated from adding revenue agents or initiating special compliance initiatives.

Such questions can only be conclusively answered by improving the basic reliability of IRS's underlying data.

The U.S. Customs Service

Financial audits of the Customs Service, the government's second most important revenue collector, revealed problems similar to those at IRS. These problems impaired Customs' ability to effectively ensure that carriers, importers, and their agents complied with laws intended to ensure fair trade practices and protect the American people from unsafe and illegal imported goods. Further, these audits found that Customs did not

- adequately ensure that all goods imported into the United States were properly identified and that the related duties, taxes, and fees on imports, reported to be over $21 billion for fiscal year 1993, were properly assessed and collected;
- have adequate controls to detect and prevent excessive or duplicate refund payments;
- have adequate accountability over tons of illegal drugs and millions of dollars of cash and property seized or used in its enforcement efforts; and
- have adequate controls over the use and reporting of its operating funds.

The Commissioner of Customs has expressed a strong commitment to resolve these problems and recognizes that a significant and sustained effort by Customs' management will be required. Acting on this commitment, Customs has developed and tested nationwide, a new program to reliably measure the trade community's compliance with trade laws. This program is expected to achieve better overall compliance with trade laws and tighter controls to ensure that the government receives all of the import taxes, duties, and fees to which it is entitled. This information will also help Customs ensure that it is making the best use of its limited inspection and audit resources.

Moreover, Customs has developed and applied methodologies for more accurately reporting its collectible accounts receivable. It also reorganized its debt collection unit, formalized its collection procedures, and aggressively pursued collection of old receivables. According to Customs, this effort resulted in collections of over $35 million. Customs also began conducting nationwide physical inventories of its seized assets to improve the safeguards over this property and has taken steps, such as implementing basic reconciliations of records, to ensure more adequate control over the use and reporting of its operating funds.

Providing Accountability for National Defense Expenditures

The Department of Defense (DOD) must have accurate financial information and internal controls to manage the Department's vast resources—over $1 trillion in assets, 3 million military and civilian personnel, and a budget of over $250 billion for fiscal year 1995. Effective financial management is critical to assuring that these resources are productively employed in meeting our nation's defense objectives.

Unfortunately, DOD does not have effective financial management operations and the seriousness of its financial management problems caused us to add it to our high-risk list. No single military service or major component has been able to withstand the scrutiny of a financial statement audit. This failure has serious implications. Good financial management runs deeper than the ability to develop accurate financial records. It is being able to (1) provide managers with visibility and control over inventories, (2) project material needs, and (3) effectively balance scarce resources with critical needs.

The CFO Act audits have served as an important catalyst for identifying and focusing management attention on the full extent and scope of the financial problems facing the Department. Since 1990, we and the DOD auditors have made over 350 recommendations to help resolve the financial management weaknesses identified throughout the Department. These audits have consistently identified fundamental deficiencies in DOD's financial operations. For example, these audit have served to highlight that:

- As of August 1995, DOD problem disbursements—those for which the Department can not match a disbursement with a related obligation—were reported to be $28 billion—and DOD continues to make hundreds of millions of dollars in overpayments to its contractors. As a result, DOD can not ensure that it does not spend more than it is authorized—a basic fund control responsibility.
- DOD does not have adequate records or controls over the multibillion dollar investment in government furnished property and equipment.
- DOD has failed to properly report billions of dollars in potential future liabilities, such as environmental cleanup costs.

Further, beginning for fiscal year 1996, the Navy general fund operations will be subject to audit. We reviewed the Navy's fiscal year 1994 financial reports as a measure of the Navy's current ability to prepare reliable financial statements. In our pending report, we conclude that, to an even greater extent than the other military services, the Navy is plagued by troublesome financial management deficiencies involving tens of billions of dollars.

DOD has recognized the seriousness of its financial management problems and the need to take action. Secretary Perry and Comptroller Hamre have been candid in their assessments of the status of current processes and practices. Further, the Department's financial reform blueprint—presented in February 1995—offers a good perspective of the corrective actions which must be taken. We believe this plan represents an important first step in committing DOD to real action.

As we testified earlier this year, however, very serious management challenges face the Department as it moves to make the blueprint a reality.[2] We recommended that DOD determine what skills are required to ensure that the plan is developed and implemented and to establish an independent, outside board of experts to provide counsel, oversight, and perspective to reform efforts.

We are also concerned about the pace of needed improvements at DOD. According to a recent DOD IG report, DOD's development of new accounting systems will not be completed until the end of fiscal year 1998 and, consequently, DOD's IG will not be able to render audit opinions on any of the military services' general fund operations until March 2000 at the earliest.

As we testified last month, given the serious and pervasive nature of DOD's financial management problems, and the need for more immediate progress, the Department needs to consider additional steps to (1) establish a skilled financial management workforce, (2) ensure that financial management systems are capable of producing accurate data, and (3) build an effective financial management organization structure with clear accountability.[3] We will continue to review more detailed implementation plans intended to carry out DOD's blueprint—including assessments of DOD's strategy and timing of proposed actions—and to work with DOD on implementing recommended improvements.

[2] Financial Management: Challenges Confront DOD's Reform Initiatives (GAO/T-AIMD-95-143, May 16, 1995) and Financial Management: Challenges Confront DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

[3] Financial Management: Challenges Facing DOD in Meeting the Goals of the Chief Financial Officers Act (GAO/T-AIMD-96-1, November 14, 1995).

Instituting Better Management of Federal Lending Programs

The federal government is the nation's largest single source of credit. It lends or guarantees hundreds of billions of dollars of loans for a wide variety of programs, such as housing, farming, education, and small business. At September 30, 1994, the government reported (1) $241 billion in nontax receivables, of which $49 billion, or over 20 percent, was reported to be delinquent and (2) $694 billion in guarantees of outstanding loans for which it was contingently liable. There are four principal credit agencies: the Department of Agriculture, with 56 percent of the loans; the Department of Housing and Urban Development (HUD), with 11 percent of the loans and 55 percent of the guarantees; the Department of Education, with 7 percent of the loans and 11 percent of the guarantees; and the Department of Veterans Affairs, with 23 percent of the guarantees.

We have long been concerned about the quality and reliability of financial information on credit programs. Our audits, as well as those by the IGs, have consistently disclosed serious weaknesses in agency systems that account for and control receivables, and three of the lending programs—(1) farm loans, (2) student financial aid, and (3) housing guarantees—are on our high-risk list. Agency managers need accurate and reliable information on a day-to-day basis to effectively manage multibillion dollar loan and loan guarantee portfolios and to determine the value and collectibility of debts owed the government. For example, audits have disclosed weaknesses in agency approaches to estimating losses on these loans and, in some cases, have resulted in significant adjustments to the recorded loss reserves.

- In response to problems identified in the Federal Housing Administration's (FHA) fiscal year 1991 financial statement audit and to prepare for the fiscal year 1992 audit, FHA's management initiated a special study to better estimate loan loss reserves. As a result, in fiscal year 1992, FHA's loan loss reserves for the multifamily General Insurance (GI) and the Special Risk Insurance (SRI) funds increased by $6.4 billion. The GI reserve increased from $5.8 billion to $10.6 billion and the SRI reserve increased from $156 million to almost $1.9 billion.
- Financial audits of the Federal Family Education Loan Program identified that Education's estimates of the cost to the government of loan guarantees, estimated at $15.2 billion as of September 30, 1994, were derived using unreliable data. Education is now working more closely with the guaranty agencies to understand and resolve some of the student loan data errors.

As a result of these and other on-going financial audits, there now exists a clearer picture of the government's performance and loss estimates for lending programs. The loss estimates will become more accurate as agencies gain experience in implementing the Credit Reform Act of 1990 and the related accounting standard for direct loans and loan guarantees developed by the Federal Accounting Standards Advisory Board (FASAB). These efforts and the ongoing audit process should result in appropriate systems and methodologies being implemented to provide critical program cost and budget information.

Bringing Other Key Federal Investments and Activities Under Financial Audit Scrutiny

The expansion of the CFO Act's financial statement preparation and audit requirement will bring a significant amount of the federal budget under examination for the first time. For example, the first full audit of almost $300 billion of Medicare and Medicaid expenditures, or about 19 percent of the federal government's expenditures, will be performed. This will be especially important, given the role of Medicare and Medicaid spending in driving the growth of federal expenditures in the foreseeable future.

Moreover, some health care experts have estimated that as much as 10 percent of national health care spending is lost to waste, fraud, and abuse. Also, we and others have reported many prior problems with these programs, and limited financial audits to date have shown a lack of detailed supporting records. For example, the Health Care Financing Administration's fiscal year 1994 balance sheet audit disclosed inadequate or no documentation supporting over $100 million of Medicare receivables under contractor supervision, making collectibility questionable.

A full financial audit of these expenditures will provide a much better understanding of the reliability of reported Medicare and Medicaid payments, control weaknesses that permit waste, fraud, and abuse to occur and needed corrective actions, and the impact of noted problems on program operations.

Another significant area to be audited is the federal government's substantial environmental cleanup costs relating to federal facilities that were contaminated with nuclear materials or other hazardous substances. OMB estimated in October 1995 that the federal government's known environmental cleanup costs could range from $200 billion to $400 billion in the years ahead. The agencies included in this estimate are the Departments of Energy, Defense, Interior, and Agriculture and NASA.

The full magnitude of the government's environmental cleanup liability is unknown. For example, $200 billion to $350 billion of the above amount was estimated for Energy alone; however, Energy's estimate excludes certain costs, such as costs related to those items for which technological solutions do not currently exist, such as most groundwater contamination.

The agencywide audits conducted under the expanded CFO Act requirements will provide an indication of the reasonableness of current agency estimates. In addition, financial statement disclosures will provide information on the nature, location, and magnitude of the federal government's overall exposure for environmental cleanup.

In addition to these major investments, there are other key federal investments that will come under scrutiny as well. We are concerned, however, that scrutiny for some of these investments may not occur soon enough because a few agencies may slip in meeting the CFO Act's time schedule. For example:

- The Federal Emergency Management Agency (FEMA), which in fiscal year 1992 through fiscal year 1994 made $7 billion in relief payments, will not be ready to have its Disaster Relief Fund's financial records and reports audited within the next year. The fund's accounting records contain inaccurate data that have never been reconciled to supporting records, including unliquidated obligations of over $4 billion for disasters that date back to FEMA's inception in 1979. To prepare for the audit, FEMA has, with contractor help, begun the necessary reconciliation. FEMA has stated that it plans to have agencywide audited financial statements beginning with fiscal year 1998.
- The Department of Transportation (DOT) had over $47 billion in fiscal year 1994 gross budget authority and is accountable for important aspects of ensuring the development and safety of the nation's highways, railroads, and airways, including those administered by the Federal Highway Administration, the Federal Aviation Administration, and the Coast Guard. DOT has not yet prepared agencywide financial statements and does not plan to do so for fiscal year 1995. Based on DOT's progress to date, without additional impetus, it is uncertain as to whether the Department will be ready to prepare reliable consolidated agencywide financial statements within the statutory time frame.
- Under the requirements of the CFO Act, the Department of Justice (DOJ), which does not have many trust or revolving funds or commercial functions and was not part of the pilot program, was not required to audit many of its significant operations. Of its $13.5 billion in gross budget

authority, only 12 percent, or $1.6 billion was subjected to audit. DOJ's major bureaus, such as the Federal Bureau of Investigation, Drug Enforcement Administration, Immigration and Naturalization Service, U.S. Attorneys Office, and Marshals Service have not been audited, nor have financial statements been prepared for these entities. DOJ is the only department that has requested a waiver from the preparation and audit of departmentwide financial statements for fiscal year 1996 under the expanded CFO Act requirements. The Department has cited as the basis for its request the lack of experienced staff to prepare financial statements and the lack of funds to contract for the audits. We believe DOJ needs to make a commitment to the audited financial statement requirements and view this as a priority because of both technical and cultural challenges that must be overcome.

Addressing and Fixing Control Weaknesses

Financial audits are also continuing to find and propose corrective actions to resolve long-standing material internal control weaknesses at the agencies under audit. These audits also continued to provide a much needed discipline in pinpointing operational inefficiencies and weaknesses, highlighting gaps in effectively safeguarding the government's assets, and preventing possible illegal acts.

Financial audits, for instance, identified information security weaknesses that increased the risk that sensitive and critical computerized data and computer programs will be inappropriately modified, disclosed, or destroyed. For example:

- IRS continued to lack sufficient safeguards to prevent or detect unauthorized browsing of confidential taxpayer records;
- student loan data maintained by Education could have been modified for fraudulent purposes because users had the ability to override controls designed to prevent such actions;
- FHA had continuing weaknesses in systems, including those that process sensitive cash receipt and disbursement transactions;
- at the Customs Service, thousands of users had inappropriate access to critically sensitive programs and data files; and
- the Navy had significant weaknesses involving access to financial data and the adequacy of computer center plans for recovery if service is interrupted.

Further, financial statement audits have continued to identify potential and actual dollar savings. These savings include the recovery of millions of dollars in overpayments to DOD contractors, the collection of receivables, the recoupment of payments incorrectly made to government intermediaries and employees, and reductions in the cost of operations that are excessive.

Further, financial audits are disclosing areas where the government may be paying more than it should or may not be collecting all that it should. For example:

- Education did not have systems or procedures in place to ensure that individual billing reports submitted by guaranty agencies and lenders were reasonable. For fiscal year 1994, these billings paid were estimated to be $2.5 billion.
- The Coast Guard could not provide detailed supporting records for almost $100 million of accounts receivable reported for the Oil Spill Liability Trust Fund and the associated $65 million estimate for uncollectible accounts.

Financial audits have also shown that agencies often do not follow rudimentary bookkeeping practices, such as reconciling their accounting records with Treasury accounts or their own subsidiary ledgers. These audits have identified hundreds of billions of dollars of accounting errors—mistakes and omissions that can render information provided to managers and the Congress virtually useless. This situation could be much improved if more rigor were applied in following existing policies and procedures.

Preparing and Auditing Governmentwide Financial Statements

Beginning with those for fiscal year 1997, Treasury will prepare financial statements for the executive branch as a whole, and we will audit these statements. For the first time, the American public will have an annual report card on the results of current operations and the financial condition of its national government. I am most pleased that this requirement has finally become a reality. My hope is that the requirement for audited financial statements would be extended to the legislative and judicial branches so that these could be included in audited governmentwide consolidated financial reports to the American taxpayers. I am also pleased that the Federal Reserve has contracted for financial audits over the next 5 years. My hope is that other independent agencies of the government would do likewise.

As the consolidated executive branch statements evolve and when the quality of the underlying data can withstand the scrutiny of an independent audit, they will not only be useful for decisionmakers but will help engender public confidence that the federal government can be an effective financial steward, fully accountable for the use of tax dollars. These statements should provide a clear picture of the financial demands and commitments of the federal government, the available resources, the execution of the budget, and the results, both financial and performance, of current operations.

We are working closely with OMB, Treasury, the agency CFOs, and the IGs. We have formed a series of task forces to address accounting and auditing issues and are actively supporting the work of FASAB. This is a tremendous undertaking and will require all parties to work together. For our part, we are going to

- focus on performing the IRS financial statement audit for the fourth year and conducting the first-ever financial statement audit for the Bureau of Public Debt, which accounts for more than $3.4 trillion of federal debt held by the public and the related annual interest payments;
- undertake selective work at selected major agencies involving, for example, SSA's 75-year actuarial projections, DOD's mission assets (valued at over $1 trillion), the almost $200 billion Medicare program, and the almost $100 billion Medicaid program, and at these agencies, we will coordinate our efforts with the IGs; and
- work cooperatively with the IGs at the 24 CFO Act agencies as they audit other major key accounts.

This will be a major challenge. We are very much depending on the 24 CFO Act agency IGs to do their individual audits, and are concerned about the extent to which budget constraints may affect their ability to perform those audits properly and timely. I am also concerned, that GAO's downsizing has left us short of the accounting and financial systems expertise needed in 1997 to conduct the consolidated executive branch financial statement audit. Even though I have reassigned personnel within GAO to the maximum extent possible, we are still short about 100 to 150 people who possess the technical skills we need to do the job. I expect this problem to be even further exacerbated as we experience additional attrition in these areas throughout 1996. We plan to consult with the Congress about this problem in the context of our fiscal year 1997 budget submission.

Continuing to Build Effective Financial Management Organizations

The leadership envisioned by the CFO Act is beginning to take root. In general, we have found that OMB's Deputy Director for Management and Controller and the agency CFOs and Deputy CFOs meet the qualifications outlined by the CFO Act. Also, the CFOs are active in their agencies and as a group through the CFO Council, which the act created, to provide the leadership foundation necessary to effectively carry out their responsibilities.

CFO Act agencies, however, need to ensure that CFOs possess all the necessary authorities within their agencies to achieve change. For instance, because of the interdependency of the budget and accounting functions, many agencies have included both budget formulation and execution functions under the CFO's authority. However, at a few agencies, such as the Department of Agriculture, HUD, and the Agency for International Development, CFOs do not have a full range of budget responsibilities. HUD's CFO, for instance, maintains records of, and provides HUD's budget office with, information on obligations and unexpended balances but is not involved in formulating the budget or allocating and reallocating funds throughout the year. At Education and Labor, CFOs have responsibility for budget execution but not for budget formulation. We believe that each CFO Act agency should recognize that both these functions can best be integrated with the agency's other financial activities by delegating responsibility for them to the CFO.

Also, at many CFO Act agencies, financial management responsibility rests with the CFO but is carried out by the financial leaders at the agencies' components, which can create problems. For instance, we recently reported that the Department of Agriculture's CFO has neither the authority within the Department nor the mechanism to enforce compliance with its financial standards.[4] To overcome this kind of situation, we believe it is important for CFOs to have a strong role in and authority over component financial management matters.

Additionally, some CFOs have responsibility for operational functions, such as procurement and grants management, in addition to those directly related to agency financial management. While functions such as these can provide opportunities for much needed integration of different functional areas, they also have the potential to distract the CFOs from concentrating on financial management issues throughout the agencies.

[4] USDA Financial Systems: Additional Actions Needed to Resolve Major Problems (GAO/AIMD-95-222, September 29, 1995).

Another serious problem the CFOs face in building an effective supporting structure is attracting and retaining well qualified financial management personnel and working to upgrade staff skills in a constrained budget environment. Financial audits have shown with greater clarity the extent and nature of the government's financial management personnel shortages and the importance of overcoming them.

These audits have consistently disclosed agencies having extraordinary financial management problems in even the fundamental areas of making reconciliations, documenting adjustments, ensuring that inventories are taken, and making supervisory reviews of accounts and transactions. Weaknesses such as these lead us to believe that fundamental skill levels and training issues must be addressed quickly.

Moreover, implementing the CFO Act's objective of upgrading financial operations, such as developing performance measurement systems and integrating budget and accounting data, will require significantly enhanced staff skills. Focusing on these areas is difficult when agencies' basic financial and control weaknesses remain unchecked. Top managers are, however, beginning to get a sense of the extraordinary effort that will be needed to upgrade financial management organizations and to fix known problems.

In this regard, OMB's July 1995 Federal Financial Management Status Report and Five-Year Plan addresses the need to develop a quality financial management workforce by implementing methods to assist agencies in recruiting and retaining qualified financial management personnel. CFOs, though, have a significant challenge in building effective organizations to meet the CFO Act's challenges.

To help in this area, in June 1992, the Association of Government Accountants made 30 recommendations covering all facets of the financial personnel challenge, from recruiting talented staff to reducing turnover. The CFO Council's Human Resources Committee is working to implement these strategies through such activities as coordinating efforts to provide low-cost, effective financial management training and developing a plan for establishing core competencies and standards for all CFO-related positions.[5]

[5]Framework for Core Competencies for Financial Management Personnel in the Federal Government (August 1995 (Draft)).

Investments must be made in training to ensure that financial management personnel increase their professional skills to keep pace with emerging technology and developments in financial management. However, financial management training is often a neglected aspect of ensuring high-quality financial operations. In our discussions with the 24 CFO Act agencies, most said they had not established formal training programs to enhance the skills and knowledge of financial management staff.

However, some agencies have acted. The Department of Energy, for example, has established a training program for financial managers that all of its CFO offices are required to implement and that is based on employees' individual development plans. Also, the Department of Education requires its financial personnel to complete 40 hours of continuing professional education annually.

We have called for financial management personnel to be required to participate in a minimum amount of continuing professional education.[6] Government auditors are required to attend 80 hours of continuing professional education every 2 years, and this requirement has helped enhance audit quality and professionalism.

We believe, though, that upgrading and training financial management staff requires much greater short-term attention to identify more specifically the extent of the skills gap and how it can be most effectively narrowed or closed. We plan to study this area in more depth in the coming months and will report the results to the Committee.

In this regard, the Committee can be of assistance by challenging the CFOs to clearly identify financial management skill shortages in terms of personnel needs to effectively achieve the CFO Act's financial management objectives. Further, the Committee can encourage agencies to get the resources and financial management talent needed to make the needed improvements.

Building Sound Financial Management Systems

Seriously inadequate financial management systems are currently the greatest barrier to timely and meaningful financial reporting. Agency systems are old and do not meet users' needs. In March 1995, OMB reported that 39 percent of agency systems were originally implemented over 10 years ago; 53 percent need to be replaced or upgraded within the next 5 years.

[6] Financial Management Issues (GAO/OCG-93-4TR, December 1992).

The CFO Council has designated financial management systems as its number one priority. The need for this emphasis is underscored by the results of self-assessments by the 24 CFO Act agencies, which showed that most agency systems are not capable of readily producing annual financial statements and are not in compliance with current system standards. Equally as important, as a result, managers do not have reliable, timely financial data throughout the year to help manage effectively.

The poor condition of agency financial systems is a symptom of a much broader issue—the federal government's overall inability to effectively manage investments in information technology (IT). Many projects have been poorly managed, cost much more than anticipated, and have not provided intended benefits.

There is a growing recognition that fundamental information technology management problems need to be addressed, and a number of initiatives are underway to do this. For example, our May 1994 executive guide[7] on the best information management practices of leading organizations has been enthusiastically received, and several agencies are actively attempting to implement its tenets. We testified before this Committee on the key practices outlined in this guide.[8]

Also, we have developed several tools to assist agencies in taking a strategic view of their information resource management practices and maximizing their IT investments. Our Strategic Information Management (SIM) Self-Assessment Toolkit,[9] for example, has been used by several agencies, including IRS and HUD, and has already resulted in several million dollars in savings. In August 1995, we issued an exposure draft of our Business Process Reengineering Assessment Guide, which is currently being pilot tested at several agencies. Additionally, we have worked with OMB in finalizing Evaluating Information Technology Investments: A Practical Guide, which will provide agency managers a systematic and objective means of assessing the risk and maximizing the return associated with planned IT investments.

[7]Executive Guide: Improving Mission Performance Through Strategic Information Management and Technology (GAO/AIMD-94-115, May 1994).

[8]Government Reform: Using Reengineering and Technology to Improve Government Performance (GAO/T-OCG-95-2, February 2, 1995).

[9]Strategic Information Management (SIM) Self-Assessment Toolkit (Version 1.0, October 1994 Exposure Draft).

Further, the Congress is taking steps to improve federal IT management. Earlier this year, the Congress amended the Paperwork Reduction Act, which the President signed into law on May 22, 1995. The amendments should improve the management of IT resources and institute stronger controls over investments. Other legislative proposals to strengthen leadership and accountability are being considered, including establishing Chief Information Officers and changing system planning and acquisition practices.

There are also improvement efforts underway specifically aimed at financial systems. For example, in January 1995, the Joint Financial Management Improvement Program (JFMIP) published a model for establishing and maintaining integrated financial management systems. This document, entitled Framework for Federal Financial Management Systems, is an important step in providing needed guidance.

Additionally, OMB's July 1995 Federal Financial Management Status Report and Five-Year Plan sets out broad objectives, tasks, and milestones to help improve systems. The plan, for example, addresses making better use of off-the-shelf technology, cross servicing, and outsourcing. Overall, OMB's objectives have provided the right emphasis and priority for financial systems improvements. OMB and the CFO Act agencies must now focus on specific implementing policies and strategies.

To help these efforts, we are preparing a methodology for reviewing financial management systems. This methodology also could provide a starting point to help agencies develop systems requirements for building integrated information systems to support their missions, operations, and governmentwide reporting requirements. We plan to work with OMB and the CFO Council to move in this direction and will report the results to the Committee next spring.

Also, since the benefits of long-term efforts to improve agency systems often require years to realize, agencies need to make their existing systems work better in the interim. An important aspect of this is to ensure the validity of existing data and implement the routine controls needed to keep these data reliable, such as reconciliations to identify and resolve discrepancies. Such efforts will improve data reliability and help ensure that information transferred to new systems is accurate.

Efforts to Strengthen Accountability Reporting Will Greatly Aid Decisionmakers

One of the CFO Act's primary goals is to enhance the reporting of reliable financial and performance data that are useful and understandable to program managers and congressional decisionmakers. Prior to its enactment, despite good intentions and past efforts to improve financial management systems, the government was not using timely, reliable, and comprehensive financial information when making decisions having a tremendous impact on the American public. The first important step was taken with the CFO Act requirement for the preparation and audit of financial reports to achieve basic data reliability. Now, at least we will know when data are reliable and when they are not.

The next steps, which build on the foundation laid by the CFO Act, will further enhance the usefulness of accountability reporting to decisionmakers by integrating performance measures into the reports and developing reports more specifically tailored to the government's needs. They include the efforts of the Federal Accounting Standards Advisory Board (FASAB) to develop accounting standards and OMB's efforts to implement the Government Performance and Results Act (GPRA) and to develop streamlined Accountability Reports.

FASAB Efforts

As you may know, FASAB was established in October 1990 by the Secretary of the Treasury, the Director of OMB, and myself to consider and recommend accounting principles for the federal government. The nine-member Board is comprised of representatives from the three principals, the Congressional Budget Office, the Department of Defense, one civilian agency (presently from Energy), and three representatives from the private sector, including the Chairman, former Comptroller General Elmer B. Staats. FASAB publishes recommended accounting standards after considering the financial and budgetary information needs of the Congress, executive agencies, other users of federal financial information and comments from the public. OMB, Treasury and GAO then decide whether to adopt the recommended standards; if they do, the standard is published by GAO and OMB and becomes effective.

Early next year, FASAB will complete the federal government's first set of comprehensive accounting standards developed under this consensus approach, which has worked well. While the development of accounting standards as envisioned by FASAB and its three principals is very important to strengthening accountability, the benefits will come from their full implementation.

It is our understanding that Senator Brown plans to introduce legislation that would establish in law the FASAB process, which at this time, is operating under a memorandum of understanding. Among the purposes cited in the legislation is to provide for uniform adoption and application of accounting standards across government and the establishment of systems that meet the requirements of the CFO Act. The legislation being considered calls for each federal agency to give priority to funding and provide sufficient resources to implement the act.

Further, the proposed legislation would require an agency's CFO Act auditor to report whether the agency's financial management system complies substantially with the FASAB accounting standards and other financial management system requirements. We understand that Senator Brown's proposal will also include mechanisms to highlight an agency's compliance problem to the Congress and to work with OMB on remedial actions to bring the agency's financial management systems into compliance.

We support the goals of Senator Brown's proposal, which make permanent the work of FASAB and add additional emphasis on implementing the accounting standards. We will be glad to work with the Committee as it considers this proposal.

Key to the FASAB approach was extensive consultation with users of financial statements early in their deliberations to ensure that the standards will result in statements that are relevant to both the budget allocation process as well as agencies' accountability for resources. Users were interested in getting answers to questions on such topics as:

- Budgetary integrity: What legal authority was provided to finance government activities and was it used correctly?
- Operating performance: How much do programs cost and how were they financed? What was achieved? What are the government's assets and are they well managed? What are its liabilities and how will they be paid for?
- Stewardship: Has the government's overall financial capacity to satisfy current and future needs and costs improved or deteriorated? What are its future commitments and are they being provided for? How will the government's programs affect the future growth potential of the economy?
- Systems and control: Does the government have sufficient controls over its programs so that it can detect and correct problems?

Standards and reports addressing these objectives are being phased in over time. Since the enactment of the CFO Act, OMB's guidance on the form and content of financial statements has stressed the use of narrative "Overview" sections preceding the basic financial statements as the best way for agencies to relate mission goals and program performance measures to financial resources. Each financial statement includes an Overview describing the agency, its mission, activities, accomplishments, and overall financial results and condition. The Overview also should discuss what, if anything, needs to be done to improve either program or financial performance, including an identification of programs or activities that may need significant future funding.

Agencies are beginning to produce reports that do this. For example, SSA's fiscal year 1994 financial statement Overview presented a number of performance measures dealing with the adequacy of the trust fund, service satisfaction, promptness in issuing earnings statements and processing claims, and the adequacy of employee training.

Linking the costs of achieving these performance levels is the next challenge. In this regard, FASAB's cost accounting standards—the first set of standards to account for costs of federal government programs—will require agencies to develop measures of the full costs of carrying out a mission or producing products or services. Thus, decisionmakers would have information on the costs of all resources used and the cost of support services provided by others to support activities or programs—and could compare these costs to various program performance.

GPRA Implementation

GPRA sets forth the major steps federal agencies need to take towards a results-oriented management approach. They are to (1) develop a strategic plan, (2) establish performance measures to monitor progress in meeting strategic goals, and (3) link performance information to resource requirements through the budget. GPRA requires up to five performance budgeting pilots for fiscal years 1998 and 1999. OMB will report the results of these pilots in 2001 and recommend whether performance budgets should be legislatively required.

Cultural changes in federal agencies are beginning as agency pilots develop strategic plans and performance measures. OMB also has prompted progress by giving special emphasis in the fiscal year 1996 Circular A-11, Preparation and Submission of Budget Estimates, to increasing the use of information on program performance in budget justifications. Moreover, OMB Director Rivlin instructed her agency to use performance information in making budget recommendations. In preparation for the fiscal year 1997 budget cycle, OMB held performance reviews in May with agencies on performance measures and recently issued guidance on preparing and submitting strategic plans. Further progress in implementing GPRA will occur as performance measures become more widespread and agencies begin to use audited financial information in the budget process to validate and assess agency performance.

OMB is also making efforts to design new financial reports based on FASAB's recommended standards that contain performance measures and budget data to provide a much needed, additional perspective on the government's actual performance and its long-term financial prospects. While there are a myriad of legislatively mandated reporting requirements which could be presented in separate reports, I think that decisionmakers would find that a single report relating performance measures, costs, and the budget would be most useful. This reporting approach is consistent with the CFO Council's proposal for an Accountability Report, which OMB is pursuing.

The Government Management Reform Act of 1994 authorized OMB, upon proper notification to the Congress, to consolidate and simplify statutory financial management reports. The CFO Council has proposed two annual reports, a Planning and Budgeting Report and an Accountability Report. The two consolidated reports would be used to present a comprehensive picture of an agency's future plans and performance by addressing (1) how well the agency performed (accountability) and (2) the road map for its future actions (planning and budgeting).

The consolidation of current reports into the Accountability Report would eliminate the separate requirements under various separate laws—such as GPRA, the Federal Managers' Financial Integrity Act, the CFO Act, and the Prompt Payment Act. The Planning and Budget Report is intended to provide a comprehensive picture of an agency's program and resource utilization plans within its strategic vision. It is supposed to link resources requested with planned actions.

OMB is undertaking to have six agencies[10] produce, on a pilot basis, Accountability Reports providing a comprehensive picture of each agency's performance pursuant to its stated goals and objectives. We agree with the overall streamlined reporting concept and believe that, to be most useful, the Accountability Report must include an agency's financial statements and the related audit reports. The ultimate usefulness of the Accountability Report will hinge on its specific content and the reliability of information presented. In this regard, OMB and the CFO Council will be more fully defining the information to be included in the Accountability Reports during the pilot phase. We will work with OMB and agencies throughout the pilot program. The pilot concept has worked well in the past under the CFO Act and GPRA.

Performance, Costs, and the Budget

Of course, the ultimate goal of more reliable and relevant financial data is to promote more informed decision-making. This requires that financial data produced be understood and used by program managers and budget decisionmakers. The changes underway to financial reporting have been undertaken with a goal of making financial data more accessible to budget decisionmakers. The budget community's involvement in the FASAB standard-setting process and OMB's accountability proposal have contributed to this. The future challenge is to further integrate financial reports with the budget to enhance the quality and richness of the data considered in budget deliberations. As I will discuss below, improving the linkages between accounting and budgeting also call for considering certain changes in budgeting such as realigned account structures and the selective use of accrual concepts.

Perhaps the chief benefit of improving this linkage will be the increased reliability of the data on which we base our management and budgetary decisions. From an agency perspective, having audited information on the value of assets and liabilities, as well as the full costs of program outputs, will permit more informed judgments in strategic planning and program priority setting. Coupled with internal control assessments, such information will also enable agencies to better target areas requiring greater management attention or reform. For example, as I discussed earlier, the IRS financial audit revealed that the accounts receivable inventory was largely uncollectible—important information that permits IRS to better target its collection resources and permits more informed

[10]The six pilot agencies are the Departments of the Treasury and Veterans Affairs; the General Services, Social Security, and National Aeronautics and Space Administrations; and the Nuclear Regulatory Commission.

appropriations decisions on the level of resources necessary to collect these funds.

From a budgetary decision-making perspective, the new financial reports will improve the reliability of the budget numbers undergirding decisions. Budgeting is a forward-looking enterprise, but it can clearly benefit from better information on actual expenditures and revenue collection. Numbers from the budget will be included in basic financial statements and thus will be audited for the first time.

Having these numbers audited was one of the foremost desires of budget decisionmakers consulted in FASAB's user needs study and stems from their suspicion—well warranted I might add—that the unaudited numbers may not always be correct. For example, decisionmakers rely on data based on IRS systems on the amounts of revenue collected for each type of tax. However, as highlighted earlier, our audit revealed that the IRS's reported revenue of $1.3 trillion for fiscal year 1994 could not be verified or reconciled to accounting records maintained for individual taxpayers in the aggregate and amounts reported for various types of taxes collected could not be substantiated. This means that the amount credited to the Social Security Trust Fund is different than the amount of social security taxes actually collected.

Financial audit reports have also revealed important information on the actual costs of credit programs which can inform future budgetary decisions. Specifically, the fiscal year 1994 financial audit reports of the Farmers Home Administration, the Federal Housing Administration, the Federal Family Education Loan Program, and the Small Business Administration revealed that agencies' estimates of the subsidy costs of their credit programs reflected in the budget are not accurate. Based on these audits, budget decisionmakers know that they have reason to question the amount of future budget requests for these programs.

The new financial reports will also offer new perspectives and data on the full costs of program outputs and agency operations that is currently not reported in our cash-based budget. Information on full costs generated pursuant to the new FASAB standards would provide decisionmakers a more complete picture of actual past program costs and performance when they are considering the appropriate level of future funding. For example, the costs of providing Medicare are spread among at least three budget accounts —the Federal Hospital Insurance Trust Fund, the Federal Supplementary Medical Insurance Trust Fund, and the Program

Management account. Financial reports would pull all relevant costs together.

The different account structures that are used for budget and financial reporting are a continuing obstacle to using these reports together and may prevent decisionmakers from fully benefiting from the information in financial statements. Unlike financial reporting, which is striving to apply the full cost concept when reporting costs, the budget account structure is not based on a single unifying theme or concept. As we reported recently, the current budget account structure evolved over time in response to specific needs.[11]

The budget contains over 1,300 accounts, with nearly 80 percent of the government's resources clustered in less than 5 percent of the accounts. Some accounts are organized by the type of spending (such as personnel compensation or equipment) while others are organized by programs. Accounts also vary in their coverage of cost, with some including both program and operating spending while others separate salaries and expenses from program subsidies. Or, a given account may include multiple programs and activities.

When budget account structures are not aligned with the structures used in financial reporting, additional analyses or crosswalks would be needed so that the financial data could be considered in making budget decisions. If the Congress and the executive branch reexamine the budget account structure, the question of trying to achieve a better congruence between budget accounts and the accounting system structure should be considered.

In addition to providing a new, full cost perspective for programs and activities, financial reporting has prompted improved ways of thinking about costs in the budget. For the most part, the budget uses the cash basis, which recognizes transactions when cash is paid or received. Financial reporting uses the accrual basis, which recognizes transactions when commitments are made, regardless of when the cash flows.

Cash-based budgeting is generally the best measure to reflect the short-term economic impact of fiscal policy as well as the current borrowing needs of the federal government. And for many transactions, such as salaries, costs recorded on a cash basis do not differ appreciably from accrual.

[11]Budget Account Structure: A Descriptive Overview (GAO/AIMD-95-179, September 1995).

However, for a select number of programs, cash-based budgeting does not adequately reflect the future costs of the government's commitments or provide appropriate signals on emerging problems. For these programs, accrual-based reporting may improve budgetary decision-making. The accrual approach records the full cost to the government of a decision—whether to be paid now or in the future. As a result, it prompts decisionmakers to recognize the cost consequences of commitments made today.

The credit arena is a good example of how financial reporting has informed budget decision-making. Beginning in fiscal year 1992, accrual budgeting principles were applied to loans and loan guarantee programs with the implementation of credit reform. Cash treatment of these programs sent misleading signals by recording costs only when cash flowed in and out of the federal Treasury. Under this approach, loan guarantees, for example, were recorded as having no costs in the year in which program commitments were authorized, regardless of future costs flowing from this commitment. By contrast, under credit reform, the budget reflects the present value of subsidy costs to be incurred over time up front at the time when commitments are made.

It may be appropriate to extend the use of accrual budgeting to other programs, such as federal insurance programs—an issue we are currently studying at the request of the Chairman, House Budget Committee. For example, the cash position of the nation's deposit insurance system proved to be a lagging indicator of the underlying troubles faced by thrifts in the 1980s. An accrual approach, should it prove workable, would offer better information on the financial condition of various federal insurance programs.

Putting It All Together

Mr. Chairman, thanks in large part to the legislative impetus of the CFO and GPRA Acts—efforts led by this Committee—decisionmakers will ultimately have available unprecedented, reliable information on both the financial condition of programs and operations as well as the performance and costs of these activities. While these initiatives carry great potential, they require continued support by the agencies and the Congress. Consequently, this Committee's continued leadership and oversight will be important to sustain these initiatives and ensure their ultimate success.

Generating new kinds of information, however valuable, can be a difficult, intensive process calling for new skills and redeployment of resources.

This is a particularly challenging task in our current budgetary environment. Fiscal constraints may make it difficult for agencies to allocate sufficient resources to information gathering and analysis while facing cuts in basic services. However, such information is vital to the downsizing process itself and can help us sort out the kinds of services and operations that government should be engaged in.

Finding the most effective reporting and analytical approaches will require a great deal of collaboration and communication. Appropriations, budget, and authorizing committees need to be full partners in supporting the implementation of these initiatives. This Committee could be instrumental in fostering a constructive dialogue and gaining their support, which is vital to obtaining the resources and investment needed to carry out these efforts.

This type of partnership is needed to better link financial and performance data to the budget and program decision-making. The development of new information may for a time outpace the capacity of the process to fully utilize it. Just as federal accounting standards are being tailored to better address the unique needs of federal policymakers, the cost concepts used in budgeting, as well as the budget presentations themselves, may warrant reconsideration. This calls for a concerted congressional effort to rethink how the budget should be structured and presented to best take advantage of this new information. Again, the Committee could be instrumental in bringing together key congressional stakeholders to consider appropriate changes.

Finally, the Committee can continue to support evolutionary refinements to reporting approaches. For example, the new financial reports can be even more useful when they are streamlined, rather than the present approach of generating separate reports. I have been stressing an approach in which performance measures and costs are reported together and linked to budget data within a single report. This approach is consistent with the CFO Council's proposal for an Accountability Report, which we support.

Improving Single Audit Legislation

Mr. Chairman, in addition to strengthening financial management at the federal level this committee is also considering legislation to improve the effectiveness of accountability for federal payments to the state and local levels through the single audit process. Single audits are important accountability tools over the hundreds of billions of dollars that the federal government provides to state and local governments and nonprofit organizations.

In June 1994, we reported[12] to the Committee on the Single Audit Act's important role. It has helped institutionalize fundamental elements of good financial management in state and local governments, such as preparing financial statements in accordance with generally accepted accounting principles, obtaining annual independent comprehensive audits, assessing internal controls and compliance with laws and regulations, monitoring subrecipients, tracking federal funds, and resolving audit findings.

In addition, the single audit process is an effective way of promoting accountability over federal assistance because it provides a structured approach to achieve audit coverage over the thousands of state and local governments and nonprofit organizations that receive federal financial assistance. Moreover, particularly in the case of block grants—where the federal financial role diminishes and management and outcomes of federal assistance programs depend heavily on the overall state or local government controls—the single audit process provides accountability by focusing the auditor on the controls affecting the integrated federal and state funding streams.

Mr. Chairman, let me emphasize that block grants need not mean the absence of federal accountability provisions. Our extensive studies of the block grant experience in the 1980s led us to conclude that reasonable financial and program accountability provisions can help sustain block grants as a stable source of intergovernmental aid. Of course the definition of what is reasonable can be controversial. Overly-intrusive accountability provisions can threaten to overturn the efficiencies gained from flexible funding, while overly-limited provisions can undermine continued congressional support for the programs by depriving the Congress of information on how the funds are used and what results are achieved.

Clearly, block grants call for a careful balancing of state and federal concerns. It is in this context that the Single Audit Act can play an especially helpful role in promoting financial accountability for the proper stewardship of federal funds. The act's focus on overall state controls applied to state entities supported with federal and state funding is very consistent with the block grant approach where states are encouraged to manage federal and state funds on an integrated basis to support state

[12]Single Audit: Refinements Can Improve Usefulness (GAO/AIMD-94-133, June 21, 1994).

priorities. It also gives state officials an annual report card on the financial management of their own entities.

While strongly supporting the single audit concept, we have identified opportunities to strengthen the single audit process while at the same time reducing the burden on state and local governments and nonprofit organizations. The legislation this committee is considering to amend the Single Audit Act would strengthen the single audit process in several key areas.

First, the bill would expand the Single Audit Act to include nonprofit organizations. The act currently applies only to state and local governments while nonprofit entities are administratively covered under an OMB Circular. Expanding the Single Audit Act to include nonprofit organizations establishes uniform single audit requirements for state and local governments and nonprofit organizations, which would accomplish what this committee contemplated when the act was debated.

Second, the dollar threshold that establishes which nonfederal entities must have audits under the act would be raised. Raising the minimum threshold from $25,000 to $300,000 would exempt thousands of entities from federally mandated audits while still covering 95 percent of federal assistance to state and local governments.

Third, programs would be selected for testing based on risk. Currently, the act requires auditors to select and test programs based solely on the amount of federal financial assistance the programs receive. Adopting a risk-based approach would increase the effectiveness of the single audit process.

Fourth, the single audit reports would be more useful. Program managers we contacted did not find current reporting to be user friendly, principally because of the number of auditor's reports. Single audit reports often include seven separate reports from the auditor. The proposed legislation would require auditors to include a summary of the results of the work. OMB adopted this approach several years ago at the federal level by including in financial statement audit reports under the CFO Act a new Overview section highlighting key results. We found that it was extremely helpful in providing insights to report users.

Fifth, reducing the reporting time frame from the currently allowed 13 months to 9 months would significantly improve the timeliness of the reports. Timeliness alone does not determine the value of a report. But, the lack of timeliness can seriously degrade the value of a report. We understand that some auditors have concerns about meeting a shorter time frame. However, we believe that oversight of the hundreds of billions of federal dollars covered by the single audit process is degraded by reports that are issued more than a year after the end of the period audited. Over time, I hope that it will be the rule, rather than the exception, for the audit reports to be submitted in less than 9 months.

Sixth, the legislative proposal would provide greater flexibility than the current act allows in carrying out this important oversight activity. The proposed legislation does so by providing the OMB Director authority to adjust some aspects of the single audit process to mesh with changing circumstances. For example, the OMB Director could authorize pilot projects to test alternative ways of achieving the goals of the legislation. The authorities provided the Director should not increase the burden on nonfederal entities. Rather, it is designed to make the Single Audit Act process adaptable to changing circumstances while continuing to promote sound financial management and provide effective oversight over federal resources.

The 10 years of experience under the Single Audit Act has shown that the single audit process is a highly effective way to provide accountability for federal awards to state and local governments. The proposed amendments would strengthen this important accountability tool and reduce the burden on thousands of entities. We fully support their enactment.

Mr. Chairman, this concludes my statement. I would be happy to now respond to any questions.

Recent GAO Testimony on the Benefits on Preparing and Auditing Agencywide Financial Statements

Financial Management: Momentum Must Be Sustained to Achieve the Reform Goals of the Chief Financial Officers Act (GAO/T-AIMD-95-204, July 25, 1995).

Financial Management: CFO Act Is Achieving Meaningful Progress (GAO/T-AIMD-94-149, June 21, 1994).

Improving Government: GAO's Views on H.R. 3400 Management Initiatives (GAO/T-AIMD/GGD-94-97, February 23, 1994).

Improving Government: Actions Needed to Sustain and Enhance Management Reforms (GAO/T-OCG-94-1, January 27, 1994).

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