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# FINANCIAL MANAGEMENT

# Fostering the Effective Implementation of Legislative Goals

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Mr. Chairman and Members of the Subcommittee:

We are pleased to discuss ways the Congress can help ensure that agencies effectively implement federal financial management reform legislation. This legislative framework includes the 1990 Chief Financial Officers (CFO) Act, as expanded by the 1994 Government Management Reform Act, as well as the 1996 Federal Financial Management Improvement Act (FFMIA). These statutes establish a broad-based set of expectations for improving financial management, such as producing reliable financial reports, generating sound cost and performance information, fixing weaknesses in systems and controls, and building effective financial management organizations.

An essential foundation to help achieve these goals is the requirement that the 24 CFO Act agencies annually prepare financial statements and subject them to an independent audit, beginning with those for fiscal year 1996. Additionally, audited consolidated financial statements for the U.S. government are now required annually, starting with those for fiscal year 1997. To further promote needed reforms, FFMIA calls for agencies to meet various financial management standards and requirements and, if they do not, to prepare remediation plans.

These reforms begin to subject the federal government to the same fiscal discipline imposed for years on the private sector and state and local governments. This discipline is needed to correct long-standing serious weaknesses in federal financial management systems, controls, and reporting practices. Considerable effort is underway across government to make needed improvements and progress is being made, but a great deal of perseverance will be required to fully attain the legislative goals set by federal financial management statutes.

To build upon these efforts, the Subcommittee is exploring ways to expedite fixing the problems that hamper effective financial management across government today. The Subcommittee’s efforts are in concert with the House of Representatives resolution (H.Res. 447), passed on June 9, 1998, which underscored congressional demands for quickly resolving outstanding financial management problems.

The federal government can continue to make progress in implementing financial management reforms, but the pace and extent of improvement will depend upon the dedication of agency heads and their senior management teams, especially the Chief Financial Officers, and the ability to deal with a range of financial management systems issues, as well as continuing emphasis by the Congress on financial management reform. Broad oversight by the Congress will be very important to holding agency heads accountable for needed financial management improvements. The Congress would make a significant contribution to ensuring satisfactory results in this area if the results of financial audits and needed improvements became a routine part of its normal annual appropriation, authorization, and oversight deliberations.

## Progress Is Being Made

Since the CFO Act's passage, steady progress has been made in improving federal financial management. A set of comprehensive accounting standards has been completed by the Federal Accounting Standards Advisory Board (FASAB), agencies are progressing in receiving unqualified audit opinions on financial statements, and structures are in place to identify and resolve governmentwide financial management issues.

FASAB was created by the Secretary of the Treasury, the Director of Office of Management and Budget (OMB), and the Comptroller General in October 1990 to consider and recommend federal accounting standards. Treasury, OMB, and GAO then decide whether to adopt the recommended standards; if they do, the standards are published by OMB and GAO and become effective. Statements of federal financial accounting concepts and standards, which are listed in attachment I, now provide for reporting on the federal government's financial condition, as well as on the costs of its programs.

For fiscal year 1996, when agencywide financial statements were required across government for the first time, 6 of the 24 CFO Act agencies received unqualified audit opinions. For the next year, fiscal year 1997, 9 agencies received unqualified audit opinions, and OMB expects an additional agency to receive an unqualified opinion by the end of June 1998.[1] The preparation of financial statements and independent audit opinions required by the expanded CFO Act are bringing greater clarity and understanding to the scope and depth of problems and needed solutions.

Some individual agencies have successfully solved these problems. For example, the Social Security Administration (SSA) prepared financial

[1]These agencies are the Social Security Administration, the National Aeronautics and Space Administration, the Nuclear Regulatory Commission, the Department of Energy, the General Services Administration, the Department of Labor, the Small Business Administration, the Environmental Protection Agency, and the Department of the Interior. OMB expects the Department of Education to receive an unqualified opinion by June 30, 1998.

statements for fiscal year 1987—prior to the expanded CFO Act's requirement—addressed financial weaknesses, and attained its first unqualified audit opinion for fiscal year 1994. As this Subcommittee heard at its April 17, 1998, hearing, SSA now produces financial statements within 2 months of the close of the fiscal year and continues to receive unqualified audit opinions annually.

At the Department of Energy, the Inspector General identified problems related to the balance sheet Energy prepared for fiscal year 1995. The problems, for example, involved identifying liabilities associated with environmental cleanup and controls over property and equipment, which Energy worked to correct. The following year, fiscal year 1996, Energy prepared agencywide financial statements that received an unqualified opinion and sustained these results for fiscal year 1997.

Many people are actively working to resolve federal financial management problems. For example, OMB has issued guidance to agencies on producing useful financial reports that meet FASAB standards. In addition to individual CFOs working to address issues in their agencies, the CFO Council, working with OMB, develops an annual financial management status report and 5-year plan. Inspectors General are carrying out their responsibilities to ensure annual audits of financial statements.

## Reaction to the First Governmentwide Financial Statement Audit Results

On March 31, 1998, the Secretary of the Treasury, in consultation with the Director of OMB, issued the 1997 Consolidated Financial Statements of the United States Government. These audited governmentwide financial statements were the first prepared and issued under provisions of the expanded CFO Act and included our first report required by the act.[2]

On April 1, 1998, we testified[3] before this Subcommittee on the results of our audit. Our testimony framed the most serious financial management improvement challenges facing the federal government. In summary, significant financial systems weaknesses; problems with fundamental recordkeeping; incomplete documentation; and weak internal controls, including computer controls, prevented the government from accurately reporting a large portion of its assets, liabilities, and costs. Our audit of the federal government's consolidated financial statements and the Inspectors

[2]Financial Audit: 1997 Consolidated Financial Statements of the United States Government (GAO/AIMD-98-127, March 31, 1998).

[3]U.S. Government Financial Statements: Results of GAO's Fiscal Year 1997 Audit (GAO/T-AIMD-98-128, April 1, 1998).

General audits of agencies' financial statements have resulted in an identification and analysis of deficiencies in the government's recordkeeping and control system and recommendations to correct them.

The executive branch recognizes the extent and severity of the financial management deficiencies and that addressing them will require concerted improvement efforts across government. Financial management has been designated one of the President's priority management objectives, with the goal of having performance and cost information in a timely, informative, and accurate way, consistent with federal accounting standards. Also, the administration has set goals for individual agencies, as well as the government as a whole, to complete audits and gain unqualified opinions.

To help achieve these objectives, the President issued a May 26, 1998, memorandum to the heads of executive departments and agencies on actions needed to improve financial management. The President's message points to several areas requiring agencies additional attention: practices related to the government's property, federal credit programs, liabilities related to the disposal of hazardous waste and remediation of environmental contamination, federal government employment-related benefits liabilities, and transactions between federal entities. These areas reflect the serious deficiencies that prevented us from being able to form an opinion on the reliability of the consolidated financial statements of the U.S. government.

The President's directive places additional accountability on agency heads and gives OMB more responsibility for addressing these problems. Specifically, he has directed that:

- OMB identify agencies subject to reporting under the President's memorandum and monitor their progress towards the goal of having an unqualified audit opinion on the governmentwide financial statements for fiscal year 1999.
- The head of each agency identified by OMB submit to OMB a plan, including milestones, for resolving by September 30, 1999, financial reporting deficiencies identified by auditors. The initial agency plans are due to OMB by July 31, 1998.
- The head of each agency submitting a plan provide quarterly reports to OMB, starting on September 30, 1998, describing progress in meeting the milestones in their action plan and any impediments that would impact the governmentwide goal.

- OMB provide periodic reports to the Vice President on the agency submissions and governmentwide actions taken to meet the governmentwide goal.

Specific agencies, such as the Department of Defense (DOD), are also reacting to the results of the most recent financial audits. As we testified before this Subcommittee on April 16, 1998, material financial management deficiencies identified at DOD, taken together, represent the single largest obstacle that must be effectively addressed to achieve an unqualified opinion on the U.S. government's consolidated financial statements.[4] In response to DOD's unfavorable financial audit results over the last several years, the Secretary of Defense announced on May 15, 1998, that initiatives to improve the accuracy, timeliness, and usefulness of financial information are to be developed through the Defense Management Council. The Secretary has (1) instructed the Under Secretary (Comptroller) to oversee departmentwide efforts to improve the manner in which financial information is captured and reported in all DOD systems—not just its financial systems—and (2) directed the secretaries of the military departments, and other top DOD officials, to support the Under Secretary (Comptroller) in DOD's financial business practices reform.

Reactions such as these to address the problems identified through the first audit of the U.S. government's consolidated financial statements are positive steps. In the short term, the quality of the action plans agency heads submit to OMB in response to the President's directive will be critical. It is essential for these plans to define financial management problems precisely, establish specific strategies and corrective measures for resolving them, include implementation time frames, fix accountability for needed actions, and be prepared in consultation with auditors. Moreover, our experience has shown that considerable hard work, commitment, and oversight will be necessary to translate planned steps into concrete improvements.

The aggressiveness with which agencies implement the action plans and pursue solutions to financial management problems will be a strong indication of whether agency heads have a sustained commitment to achieving financial management reform goals. Ultimately, agency heads and their senior management team have to be accountable for results. Again, the auditors have key roles in providing perspectives on actions

[4]Department of Defense: Financial Audits Highlight Continuing Challenges to Correct Serious Financial Management Problems (GAO/T-AIMD/NSIAD-98-158, April 16, 1998).

needed to attain improvements and in assessing progress toward implementing the action plans.

## Year 2000 Computing Crisis and Modernizing Financial Systems

Federal agencies will have great difficulty meeting expectations for modernizing their financial management systems unless they effectively meet the Year 2000 computing challenge.[5] As we have discussed in numerous testimonies before this Subcommittee, this issue is the most sweeping and urgent information technology challenge facing organizations today. Strong leadership is needed to avoid major disruptions in services and financial operations, such as processing financial transactions, reporting financial information, controlling property, and collecting revenue.

Unless this issue is successfully addressed, serious consequences could occur. For example:

- payments to veterans with service-connected disabilities could be severely delayed if the system that issues them either halts or produces checks so erroneous that it must be shut down and checks processed manually;
- the SSA process to provide benefits to disabled persons could be disrupted if interfaces with state systems fail;
- federal systems used to track student loans could produce erroneous information on loan status, such as indicating that a paid loan was in default;
- IRS tax systems could be unable to process returns, thereby jeopardizing revenue collection and delaying refunds; and
- the military services could find it extremely difficult to efficiently and effectively equip and sustain U.S. forces around the world.

This Subcommittee's emphasis has helped to focus on the potential consequences of the Year 2000 computing crisis and the need for added impetus by some agencies to overcome vast difficulties within the next 18 months. In our most recent testimony before the Subcommittee on June 10, 1998, we reported that progress in addressing Year 2000 continues at a slow pace, and that as the amount of time to the turn of the century shortens, the magnitude of what must be accomplished becomes more

[5]For the past several decades, information systems have typically used two digits to represent the year, such as "98" for 1998, in order to conserve electronic data storage and reduce operating costs. In this format, however, 2000 is indistinguishable from 1900 because both are represented as "00." As a result, if not modified, computer systems or applications that use dates or perform date- or time-sensitive calculations may generate incorrect results beyond 1999.

daunting.[6] We have issued over 40 reports and testimony statements detailing specific findings and recommendations related to the Year 2000 readiness of a wide range of federal agencies. Moreover, to reduce the risk of widespread disruptions, we have made several governmentwide recommendations to the President's Council on Year 2000 Conversion and OMB to expedite the efforts of federal agencies and build strong partnerships with the private sector and state and local governments.

This will likely affect the pace of progress on modernizing financial systems, as some agencies' efforts to address the Year 2000 computing crisis are taking precedence over longer-term financial management systems development and improvement initiatives. Unless successfully dealt with, this crisis presents the likelihood of new financial management systems weaknesses occurring, existing problems worsening, and ongoing reform efforts being derailed.

## Congressional Oversight Is Key

Congressional attention is essential to help sustain the current momentum to implement financial management reform legislation. There are clear indications that the results of financial audits are beginning to attract increasing attention from various congressional committees.

One instance involves the audit of IRS's financial statements. During our first audits, beginning with fiscal year 1992, we identified serious problems and were unable to give an opinion on IRS's financial statements. The head of IRS was called before congressional committees in both the House and Senate on numerous occasions to explain the steps IRS was taking, and the progress it was making, to overcome them. On April 15, 1998, we testified[7] before this Subcommittee that after several years of concerted effort by IRS and GAO, we were, for the first time, able to conclude that IRS's custodial financial statements were reliable.[8] These positive results show that focused attention by the Congress and this Subcommittee on IRS's financial management has begun to improve information available to IRS management and to the Congress to help make decisions.

[6] Year 2000 Computing Crisis: Actions Must Be Taken Now to Address Slow Pace of Federal Progress (GAO/T-AIMD-98-205, June 10, 1998).

[7] Internal Revenue Service: Remaining Challenges to Achieve Lasting Financial Management Improvements (GAO/T-AIMD/GGD-98-139, April 15, 1998).

[8] Financial Audit: Examination of IRS' Fiscal Year 1997 Custodial Financial Statements (GAO/AIMD-98-77, February 26, 1998).

In addition, issues raised by financial audits are beginning to prompt inquiries among various congressional committees, as exemplified by the following.

- In its reports for the fiscal years 1997 and 1998 appropriations bills, the Subcommittee on Labor, Health and Human Services, Education and Related Agencies of the House Committee on Appropriations (1) set the expectation that the Departments of Labor, Health and Human Services, and Education work vigorously toward obtaining clean audit opinions, (2) questioned whether these agencies could properly exercise the substantial transfer and reprogramming authority granted to them under the appropriations act if substantial financial management reform progress had not been made, and (3) stated that in subsequent years it would consider the agencies' progress in making such reforms and obtaining clean financial statement audit opinions when scrutinizing requests for appropriations and in deciding whether to continue, expand, or limit transfer and reprogramming authority.
- The Chairman of the House Committee on the Budget asked us to monitor the Forest Service's progress in improving the reliability of its accounting and financial data, which also contributed to a recent joint hearing before the House Committee on Resources, Committee on the Budget, and Subcommittee on Interior and Related Agencies, Committee on Appropriations, focusing on inefficiency and waste resulting from the Forest Service's lack of financial and performance accountability.[9]
- After considering funding for DOD for fiscal year 1998, the Senate Armed Services Committee legislatively required DOD to prepare biennial financial management improvement plans that include a concept of operations for the financial management of the department.[10] The first such plan is to be submitted to the Congress by September 30, 1998. In approving DOD's 1997 and 1998 appropriations, the Congress also put in place a legislative requirement to accelerate DOD's planned timetable for addressing long-standing problems in accurately and promptly accounting for billions of dollars in disbursements.[11] Additionally, as part of DOD's 1999 authorization, the Senate Armed Services Committee has approved a

[9]Financial Management: Forest Service's Progress Toward Financial Accountability (GAO/AIMD-97-151R, August 29, 1997), Forest Service: Status of Progress Toward Financial Accountability (GAO/AIMD-98-84, February 27, 1998, and Forest Service: Lack of Financial and Performance Accountability Has Resulted in Inefficiency and Waste (GAO/T-RCED/AIMD-98-135, March 26, 1998).

[10]Financial Management: Comments on DFAS' Draft Federal Accounting Standards and Requirements (GAO/AIMD-97-108R, June 16, 1997).

[11]Financial Management: DOD Needs to Lower the Disbursement Prevalidation Threshold (GAO/AIMD-96-82, June 11, 1996).

requirement for DOD to provide a detailed annual report on the quantities and locations of DOD's multibillion dollar investment in inventories and military equipment.

- The Chairman of the House Budget Committee asked us to analyze the programmatic and budgetary implications of the financial data deficiencies enumerated by the auditors' examination of the Department of the Navy's fiscal year 1996 financial statements. In March 1998, we advised the Chairman that the extent and nature of the Navy's financial deficiencies identified by the auditors, including those that relate to supporting management systems, increases the risk of waste, fraud, and misappropriation of Navy funds and can drain resources needed for defense mission priorities.[12]
- On April 24, 1998, this Subcommittee and the House Committee on Commerce's Subcommittees on Oversight and Investigations, Health and Environment held a joint hearing on the Department of Health and Human Service Inspector General's audit of the Health Care Financing Administration's fiscal year 1997 financial statements. This helped focus attention on fixing the control weaknesses associated with the more than $20 billion of improper payments in the Medicare fee-for-service program disclosed by the financial audit.
- In February 1998, we assisted the Chairman of the House Committee on the Budget in considering the possible program and budgetary implications of the questions raised about financial statement data deficiencies identified in the Department of Transportation Inspector General's audit report on the Federal Aviation Administration's fiscal year 1996 Statement of Financial Position.[13]

In addition to initiatives by individual congressional committees, the Federal Financial Management Improvement Act provides the Congress another tool in monitoring the progress of all 24 CFO Act agencies in improving financial systems. The act is intended to increase accountability in federal financial management and develop systems with the capability to support FASAB standards. FFMIA also provides for an independent judgment by auditors of agencies' efforts to foster compliance with financial management improvement goals.

Under the act, agencies are required to comply with federal accounting standards, federal financial systems requirements, and the U.S.

[12]CFO Act Financial Audits: Programmatic and Budgetary Implications of Navy Financial Data Deficiencies (GAO/AIMD-98-56, March 16, 1998).

[13]Financial Management: Federal Aviation Administration Lacked Accountability for Major Assets (GAO/AIMD-98-62, February 18, 1998).

government's standard general ledger at the transaction level. This legislation also requires (1) auditors performing financial audits under the CFO Act to report whether agencies comply with these requirements and (2) if agencies do not comply, agency heads are to prepare remediation plans to bring financial management systems into substantial compliance within 3 years.

We reported in October 1997[14] that prior audit results and agency self-reporting all point to significant challenges that agencies must meet to fully implement these requirements. The majority of federal agencies' financial management systems are not designed to meet current accounting standards and systems requirements and cannot provide reliable financial information for managing government operations and holding managers accountable. Auditors' reports for fiscal year 1997 agency financial audits are disclosing the continuing poor shape in which agencies find their financial systems. To date, the financial systems of only four agencies are reported to be in substantial compliance with the requirements and standards FFMIA specifies.[15]

The Congress can build further upon this structure by conducting annual hearings on each agency as part of the regular appropriation, authorization, and oversight process. Each year, congressional committees could review the results of agencies' most recent financial statement audits and FFMIA reports to gauge the progress agencies are making in improving financial management. Agency heads could be required to describe remedial actions being taken to address financial management problems identified by independent auditors.

Through this process, the Congress can, therefore, be in an informed position to assess progress in achieving legislative financial management improvement reforms, addressing the Year 2000 computing crisis, and meeting the President's financial statement audit goals. This would allow thorough consideration of the severity of an agency's financial management problems, the demonstrated commitment to improvement efforts, and the independent perspectives of the auditors on an agency's progress in responding to financial statement audit recommendations.

[14] Financial Management: Implementation of the Federal Financial Management Improvement Act of 1996 (GAO/AIMD-98-1, October 1, 1997).

[15] The agencies reported to be in substantial compliance are the Department of Energy, the National Aeronautics and Space Administration, the National Science Foundation, and the General Services Administration.

Using the results of this assessment, the Congress can clearly determine accountability and tailor needed additional actions.

Based on the circumstances of individual agencies on a case-by-case basis, the Congress could, for example, consider whether (1) in areas of special concern, to require attainment of specified improvements within established milestones before certain funds supporting administrative operations or systems would be available for obligation, (2) to expand, continue, or limit transfer or reprogramming authority depending on the quality of an agency's financial management, (3) to target, or set aside, needed funding for financial management improvement efforts that are deemed necessary to achieve progress and require periodic status reports on the return for this investment, or (4) to scrutinize funding requests, and perhaps consider limiting funds, in areas where agencies cannot provide satisfactory answers to questions raised about the quality of the data underpinning the request or their ability to properly account for the expenditures.

These mechanisms—sustained congressional attention as part of the normal oversight process and agency head accountability—are essential to continue to effectively implement the financial management reform legislative foundation the Congress has established. They are key elements of ensuring that agencies make the investment of time, talent, and resources necessary to achieve needed financial management improvements.

With a concerted effort, the federal government, as a whole, can continue to make progress toward ensuring full accountability and generating reliable information on a regular basis. Annual financial statement audits are essential to ensuring the effectiveness of the improvements now underway and, ultimately, to producing the reliable and complete information needed by decisionmakers and the public to evaluate the government's financial performance. They are also central to assuring taxpayers that their money is being used as intended and helping the government implement broad management reforms called for by the Government Performance and Results Act.

Mr. Chairman, this concludes my statement. I would be happy to now respond to any questions that you or other members of the Subcommittee may have at this time.

# Statements of Federal Financial Accounting Concepts and Standards

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| **Statements of Federal Financial Accounting Concepts (SFFAC)** |
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| Entity and Display (SFFAC 2) |
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| Accounting for Direct Loans and Loan Guarantees (SFFAS 2) |
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