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FINANCIAL MANAGEMENT

Momentum Must Be Sustained to Achieve the Reform Goals of the Chief Financial Officers Act

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the progress executive branch agencies have made in implementing the Chief Financial Officers (CFO) Act. This act establishes a solid foundation for greatly needed, comprehensive reform of federal financial management. I want to commend the Subcommittee for holding this hearing; sustained congressional attention to implementation of this landmark legislation will be important in instilling greater accountability throughout the federal government and helping better control the cost of its operations.

Only through effective implementation by the government's 24 major agencies covered by the CFO Act can the executive branch hope to attain the full range of benefits intended by the act. The potential benefits include the following:

-- giving the Congress and agency managers much more reliable financial, cost, and performance information both annually and, most important, as needed throughout the year to manage programs and make difficult spending decisions.

-- dramatically improving financial management systems, controls, and operations to eliminate fraud, waste, abuse, and mismanagement and properly safeguard and manage the government's assets.

-- establishing effective financial organizational structures to provide strong leadership extending into the next century.

Achieving these goals is central to not only putting the government's financial house in order but also realizing broader management improvements.

Overall, progress is being made. But the remaining problems are difficult, and much remains to be accomplished to successfully implement the CFO Act--especially to improve the quality of financial information and the underlying financial systems and controls, which are in serious disrepair today. My statement today will outline key areas where progress is being made and discuss critical implementation issues that need to be fully confronted.

First, during the past 5 years, financial statement preparation and audit coverage have more than doubled and, for fiscal year 1994, reached 67 percent of the government's gross budget authority. However, only a few of the 24 CFO Act agencies have received unqualified audit opinions on financial statements for their entire operations. Within the next 2 years, financial statement preparation and audit coverage is expected to increase to 98 percent of the government's gross budget authority, as executive branch agencies work toward producing the agencywide financial statements now required by law and subjecting these statements to audit. Moreover, I hope that, eventually, 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.

While few agencies have been as yet able to prepare auditable agencywide financial statements, the process of preparing and auditing annual financial statements continues to strengthen the reliability of financial information. The process also provides a more complete view of agencies' financial conditions, highlights control weaknesses and high risk areas that need to be resolved, and identifies actual and potential savings. But, as I will discuss later, to meet the CFO Act's ultimate goals of providing reliable, useful financial information, CFOs must overcome serious financial reporting and system weaknesses and the Inspectors General (IGs) must better position themselves to perform required financial audits.

Second, Chief Financial Officers with the right qualifications are being placed in leadership positions within the agencies, as well as at the Office of Management and Budget (OMB), as mandated by the CFO Act. At the same time, agencies have a shortage of financial management expertise, and upgrading the qualifications and training of financial management staffs remains a key challenge.

Third, the government is on the threshold of having comprehensive accounting standards. When these standards are implemented, which must be a top priority, they will provide useful financial information to meet the unique needs of those who manage and oversee the federal government. Such information will encompass budget execution, the cost of operations, performance measurement, and the government's stewardship of its assets.

Fourth, agencies have a critical need to greatly improve and modernize financial management systems, which across government, are in abysmal shape today, and, in doing so, to reengineer financial management processes, while at the same time implementing new accounting and financial reporting standards.

The past 5 years have been pivotal to proving the value of audited financial statements and other concepts in the CFO Act--in other words, to changing the long-standing view that good financial management and reporting were not important for the federal government. The next few years must be marked by concrete results in improving financial information and systems.

In the short term, financial statements must be prepared and audits performed. This will require agencies to make sound investments immediately to upgrade the qualifications of financial management staff, fix rudimentary bookkeeping problems, and make existing financial systems work better. At the same time, agencies must concentrate on developing performance measures and cost accounting systems, which are almost universally lacking in the federal government today, and emphasize integrating budget, accounting, and management data.

Let me now address each of the key areas where progress is being made and discuss critical implementation issues related to each area.

PROGRESS IN PREPARING AUDITED FINANCIAL STATEMENTS

Preparing and auditing annual financial statements is essential to improving the usefulness, consistency, and reliability of financial information. Audited financial statements provide an annual scorecard as to where an entity stands financially. Equally as important, they provide the discipline needed to improve the quality of financial information available day-to-day to help managers deal with the range of difficult spending and accountability issues they face.

State and local governments began preparing audited financial statements in the early 1980s in the wake of disclosures such as (1) the poor accounting practices that nearly caused New York City's bankruptcy and (2) the lack of accountability for the financial aid provided to states and localities that led to the Single Audit Act of 1984. State and local governments found that their financial systems and controls dramatically improved as a result, and basic financial information was, therefore, readily available and could be relied upon.[1] The challenge to federal agencies under the CFO Act is to be in a position to prepare auditable financial statements as a normal by-product of an integrated system that pulls together credible financial, program, performance, and budget data into reports that are useful to executive branch decisionmakers and the Congress in its oversight role.

Agencies' CFOs and IGs are progressing in their efforts to meet the CFO Act's audited financial statement requirement. However, agencies must sustain, and in many cases enhance, the progress being made to prepare and audit financial statements to meet the new legislatively established timetable for covering all 24 CFO Act agencies for fiscal year 1996.

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

Audited Financial Statement
Coverage Is Growing

Before 1991, entities subjecting their accounts to audit covered less than one-third of the government's gross budget authority, which now amounts to over $2 trillion. This coverage included primarily government corporations and agencies that voluntarily prepared audited financial statements for their entire operations, such as the Departments of Agriculture, Labor, the Air Force, and Veterans Affairs (VA), the General Services Administration (GSA), and the Social Security Administration (SSA).

Following passage of the CFO Act in November 1990, financial statement audit coverage increased to about 50 percent of the government's gross budget authority. This legislation required agencies to prepare and have audited financial statements for revolving and trust funds, as well as for certain types of commercial activities beginning with fiscal year 1991. Additionally, 10 cabinet departments and large agencies were designated to participate in a 3-year pilot program to test the usefulness of financial statements and audits for their entire operations.[2] As we testified[3] last year, this pilot program was highly successful and demonstrated considerable value in helping to stimulate financial management improvements in the participating agencies.

As a result of the success of the CFO Act's pilot program, financial audit coverage was legislatively expanded last year to cover virtually the government's entire gross budget authority. The Government Management Reform Act of 1994 expanded on the CFO Act to establish an annual requirement, beginning with fiscal year 1996, that all 24 CFO Act agencies prepare and have audited financial statements disclosing the results of their entire operations. In fiscal year 1994, these 24 agencies accounted for over 98 percent of the government's budget outlays or over 92 percent of its gross budget authority, as shown in attachment I. The 1994 expansion of the CFO Act also established a requirement for annual consolidated executive branch financial statements beginning with fiscal year 1997 and gives GAO the responsibility to audit them.

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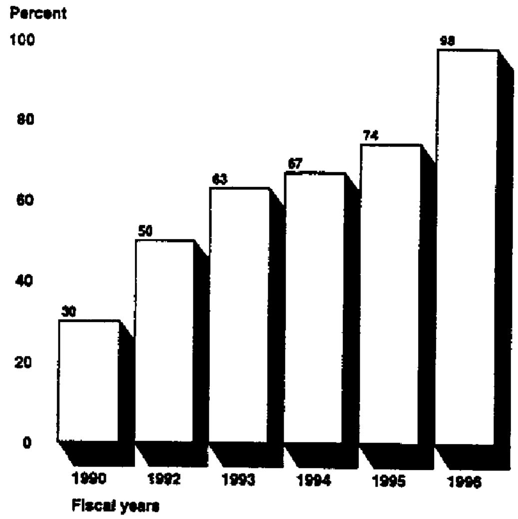
[2]The 10 cabinet departments and large agencies that the CFO Act designated to participate in the audited financial statement pilot program were the Departments of Agriculture, Labor, Veterans Affairs, Housing and Urban Development, the Army, and the Air Force, the Customs Service, GSA, the Internal Revenue Service, and SSA.

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

Figure 1 depicts the growth in the extent to which the government's gross budget authority was subject to audit in fiscal year 1990, prior to passage of the CFO Act, and each fiscal year from fiscal year 1992, when the CFO Act audits began to be phased in, to fiscal year 1996, when all CFO Act agencies will be required to have financial statements.

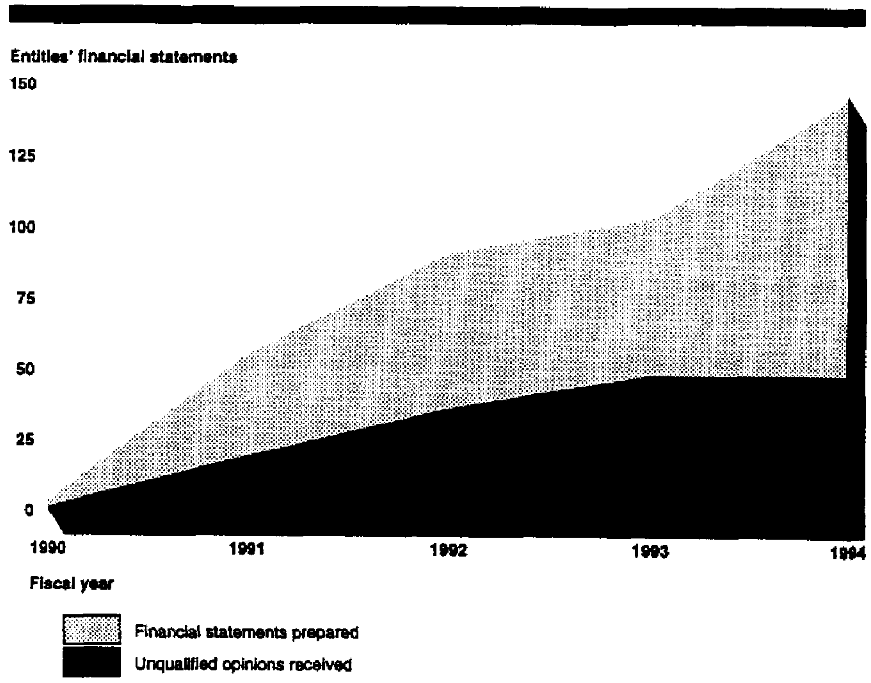
Figure 1: Growth in Audit Coverage of the Government's Gross Budget Authority



Fiscal years 1995 and 1996 respresent planned coverage.

Also encouraging, as figure 2 shows, was the rate of agency progress in receiving unqualified audit opinions for financial statements required by the CFO Act. These unqualified opinions have been steadily rising, increasing from 1 for fiscal year 1990 to 48, or almost 47 percent, of those audited for fiscal year 1993. However, the preponderance of these opinions was for specific trust and revolving funds and commercial activities. In only 4 cases (SSA, GSA, the Nuclear Regulatory Commission, and the National Aeronautics and Space Administration), have unqualified opinions been rendered on financial statements for an agency's entire operations.

Figure 2: CFO Act Entities Preparing Financial Statements and Receiving Unqualified Opinions



Fiscal year 1994 unqualified audit opinions are shown at the same level as those received for fiscal year 1993 because fiscal year 1994 audited financial statements for several entities have not yet been submitted to OMB

For fiscal year 1994, the number of entities for which financial statements were prepared increased to 145. While audited financial statements have not yet been finalized for several of these entities, we anticipate that the number of unqualified opinions for that fiscal year will closely parallel the rate achieved in the preceding fiscal year.

Audited Financial Statements Continue to Demonstrate Their Value

As first demonstrated during the CFO Act pilot program, audited financial statements continue to provide a much clearer picture than any that has ever existed of the government's true financial condition. These audited statements will help to ensure that more reliable and useful information is available to help make critical decisions on spending and the overall direction of government programs. Information being disclosed in audits of financial operations for fiscal year 1994 includes (1) previously unidentified or unverified costs that the government can expect to incur in the future, (2) questionable estimates of costs associated with government programs, (3) the failure to ensure that all revenues are collected, and (4) poor management practices resulting in program losses. Examples include the following:

-- The Internal Revenue Service's (IRS) 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.

-- The audit of the Health Care Financing Administration's (HCFA) fiscal year 1994 financial statements identified potentially billions of dollars of previously undisclosed amounts payable to state governments for medical services provided to Medicaid recipients.

-- The fiscal year 1994 financial audit of the Customs Service disclosed continuing problems, specifically, that Customs (1) cannot reliably detect improper duty refund claims and, thus, cannot prevent duplicate and excessive refund payments, (2) needs to improve controls to ensure that goods entering into the commerce of the United States, or being exported, do so with proper assessment of duties, taxes, and fees and in compliance with trade laws, and (3) does not have adequate controls to ensure proper accounting for all revenues.

-- The fiscal year 1994 financial audit of the Air Force identified almost $28 billion of previously undisclosed contingent liabilities for items such as contract appeals and civil law and litigation claims.

-- The fiscal year 1994 financial audit reports of the Farmers Home Administration, Federal Housing Administration (FHA), Federal Family Education Loan Program (FFELP), and the Small Business Administration reveal that these agencies' estimates of the subsidy costs of their loan and loan guarantee programs, required by the Federal Credit Reform Act of 1990, are not accurate. Also, FFELP continued to base its $15.2 billion estimate of liabilities for loan guarantees and related program costs on unreliable historical loan data.

-- Financial audits continue to highlight poor underwriting and servicing practices in the Department of Agriculture's farm loan program. The IG estimated that, as a result, for fiscal year 1994, (1) borrowers will be approved for unauthorized benefits totaling about $73 million because of loan applications that contain inaccurate and/or incomplete information and (2) delays in servicing delinquent borrowers will increase program losses by about $149 million.

In addition, financial audits are continuing to find material internal control weaknesses at the agencies under audit. Based upon the fiscal year 1994 financial audits completed to date, internal control weaknesses were reported for more than 100 of the 145 entities. The financial audits for fiscal year 1994 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. Examples include the following:

-- 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.

-- HCFA's fiscal year 1994 financial audit disclosed inadequate or no documentation supporting over $100 million of Medicare receivables under contractor supervision, making collectibility questionable. Similarly, 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 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, financial audits disclosed that (1) IRS continues to lack sufficient safeguards to prevent or detect unauthorized browsing of confidential taxpayer records, (2) 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, and (3) FHA has continuing weaknesses in systems, including those that process sensitive cash receipt and disbursement transactions.

Further, financial statement audits have continued to identify potential and actual dollar savings. In addition to billions of dollars in potential savings, which will accrue to the government as long-term corrective measures are implemented and better financial information is regularly available to decisionmakers, financial audits have identified specific savings which could be attained immediately. These savings include the recovery of millions of dollars in overpayments to Department of Defense (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.

Financial audits also have shown that agencies often do not follow rudimentary bookkeeping practices, such as reconciling their accounting records with Department of the Treasury accounts or agencies' 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. The CFOs and IGs have reported that the process of preparing and auditing financial statements brings much needed discipline to accounting and financial reporting and highlights where the real problems are. They also expressed their view that the full benefits are yet to be achieved.

Finally, we are seeing long-term benefits at agencies where financial statements have been prepared and audited for several years, such as at SSA, Labor, GSA, and VA. Financial statements are prepared and audited more quickly and efficiently as these agencies have gained experience over several years. This enables audited statements to be available much earlier during congressional deliberations on the budget and the effectiveness of agency operations.

AGENCIES NEED TO MEET LEGISLATIVE TIMETABLE FOR FINANCIAL AUDITS

The annual public scorecard financial statements provide has given the visibility necessary to get the attention of top managers and has provided the impetus for them to begin fixing the problems financial audits have disclosed. This has clearly been a key motivating factor for agencies, such as DOD and IRS, which have serious financial management weaknesses, to give much higher priority than ever before and to seriously begin to tackle long-standing, significant financial management problems that impede their ability to prepare financial information that can withstand an audit.

We believe that meeting the legislative timetable for agencywide audited financial statements is essential so all CFO Act agencies will begin to gain the benefits demonstrated by those agencies that have already successfully undergone full-scale financial audits. Meeting this schedule is absolutely critical to 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.

Agency Readiness to Prepare Financial Statements

In response to a request from OMB and GAO for a self-assessment of their ability to prepare auditable financial statements, 17 of the 24 CFO Act agencies reported in December 1994 that they would be ready to prepare accurate agencywide financial statements for fiscal year 1996. Regarding the other seven agencies:

-- DOD said that its underlying financial systems and operations were not designed to produce auditable financial statements and that continuing systems problems are a serious challenge that will require a number of years to correct.

-- The Department of the Treasury will have to address the serious financial weaknesses identified in financial audits of its major revenue bureaus--IRS and the Customs Service.

-- The Department of Justice said that while several of its components were preparing financial statements, others have not yet begun, and its overall readiness was doubtful due to such factors as the need to complete ongoing efforts to modernize its financial systems.

-- The Department of State said that its financial management systems were not capable of producing the information needed to prepare accurate and timely financial statements because they are not integrated, are poorly documented, lack sufficient controls, and do not meet applicable accounting requirements.

-- The Department of Transportation reported, for example, that the Coast Guard will be unlikely to produce financial statements that are accurate.

-- The Federal Emergency Management Agency and the Agency for International Development reported problems similar to the agencies discussed above.

While these seven agency assessments represented the CFOs' initial views late last year, we are very concerned that more progress needs to be made as quickly as possible. Of special concern is the monumental financial management weaknesses at DOD, which represents almost 20 percent of the government's fiscal year 1994 gross budget authority. The Secretary of Defense and DOD's CFO have forthrightly acknowledged the magnitude and severity of these problems, which will require intensified efforts if DOD is to turn this situation around before the turn of the century, as now projected by the Department. It is, however, critical for DOD to be ready to prepare accurate financial statements in accordance with the legislative timetable.

We will continue to work with the agency CFOs and OMB to determine the impediments to, and to help start the process of, preparing financial statements in accordance with the legislatively mandated timetable. This will require agencies to devise means to identify problems and to concentrate on short-term solutions until longer term systems modernization efforts can be put in place.

<u>IGs Readiness to Audit Financial Statements</u>

Shifting now to the audit side, since the CFO Act was passed in 1990, we have had a proactive strategy to work with the IGs to build their financial audit capacity. Our strategy included conducting initial financial audits at IRS, Army, Air Force, Navy, Customs, and Education, in conjunction with or with the assistance of the cognizant IG. While we are continuing to perform the IRS financial audit and are working with the Naval Audit Service to perform a financial audit of the Navy, we have now transitioned the financial audit responsibility at the other agencies to their IGs.

In working with the IGs, we have also provided technical assistance by making our audit manuals and training available to agency IG staff. Initially, we helped provide training to over 2,000 IG staff. We also assisted the IG Training Institute in developing financial audit training, which it is now providing to the IG community.

A number of IGs have put forth a good effort in embracing their new responsibilities under the CFO Act and now have several years of financial audit experience. They have worked to train their staffs and arranged for contractor support as needed on these audits.

Based on agencies' self-assessments in December 1994, 20 IGs said they were prepared, or would be ready by fiscal year 1996, to perform an agencywide financial statement audit. However, most conditioned this level of readiness upon continuing to receive current levels of funding. Moreover, at least 17 IGs currently plan to use contractor support to perform financial audits, which will also require sustained funding.

The four IGs who reported that their organizations would not be ready were the Departments of Education, Justice, and Health and Human Services (HHS), and the National Science Foundation. These agencies reported staffing and resource limitations as the primary reason for being unprepared to meet the required timeframe.

Over the next several years during government downsizing, IGs will undoubtedly face resource constraints as they undertake agencywide financial audits. But, in our view, many such limitations can be overcome and should not be a reason not to meet the agencywide audit requirement. The Department of Housing and Urban Development (HUD) IG, for example, faced budgetary and staffing pressures which the IG overcame, in part, by redirecting much of its internal audit work. This has enabled HUD's IG to meet the financial audit responsibilities without seeking additional resources.

We will continue to work with IGs to explore opportunities and creative solutions for surmounting barriers to meeting the fiscal year 1996 statutory timetable. This will be very important, not only to ensure the full and prompt implementation of the agencywide financial audit requirement, but also because the ability of IGs to conduct high-quality and timely financial audits will be key to our audit of the consolidated executive branch financial statements beginning with fiscal year 1997, as required by law. To accomplish this new responsibility, GAO, OMB, and Treasury have been working closely with agency CFOs and IGs to develop a strategy and plan for preparing and auditing these first-ever consolidated executive branch financial statements.

PROGRESS IN ESTABLISHING FINANCIAL MANAGEMENT LEADERSHIP AND ORGANIZATIONAL STRUCTURES

The CFO Act, recognizing the importance of strong financial management leadership, established top-level financial management positions in OMB and the 24 major agencies to better manage financial management operations across government. Together with the CFO Council, which the CFO Act also created, agency CFOs and Deputy CFOs, along with OMB's support, are central to overcoming the long-standing problems hampering effective financial management and accountability. Consequently, sustained progress in establishing effective financial management leadership and organizational structures is key to achieving the financial management reform the CFO Act envisions.

CFOs and Deputy CFOs and Their Qualifications

The CFO Act prescribes that agency CFOs and Deputy CFOs are to be well qualified and have extensive financial management experience. Today, CFOs have been appointed in 19, and nominated in 2, of the 24 CFO Act agencies. In addition, Deputy CFOs have been named at 20 of the CFO Act agencies. In general, we have found that the CFOs and Deputy CFOs meet the qualifications outlined by the CFO Act and OMB guidance. For example, collectively, 13 of the CFOs and Deputy CFOs have degrees in accounting; 27 of the CFOs and Deputy CFOs have advanced degrees covering a wide range of disciplines, including business administration, public administration, finance, and economics; and 15 of them are certified public accountants. Together, the CFOs and Deputy CFOs have a wealth of experience in federal, state, and local government financial management, as well as in the private sector.

While credentials such as these are necessary to effectively carry out CFO Act responsibilities, additional attention by the Congress and the administration will be necessary to complete the CFO leadership structure the act prescribes. Promptly filling CFO vacancies is essential so that top-level financial managers can institute needed financial management reforms. For example, Justice has never had a presidentially appointed CFO. At the Environmental Protection Agency and the Small Business Administration, neither CFOs nor Deputy CFOs have been named, and the responsibilities of these positions is currently being carried out by acting CFOs and acting Deputy CFOs. Also, Deputy CFOs have not been named for GSA and the Office of Personnel Management, nor have people been named to fill these positions in an acting capacity.

CFO Responsibilities

The CFO Act and OMB's implementing guidance[4] establishes a full and comprehensive range of CFO financial management authorities and functions for agency CFOs. Overall, the CFOs generally have been given responsibilities consistent with these authorities, including (1) budget formulation and execution, (2) financial operations and analysis, and (3) information resources management, at least as it relates to financial management systems.

In addition, CFOs are being given other closely related responsibilities. For example, CFOs are actively involved in the implementation of the Government Performance and Results Act of 1993. At least 11 agencies have given the CFO lead responsibility for implementing the act. This role is consistent with, and will further provide impetus for implementing, the CFO Act's requirement for information to measure performance.

The CFO Act provides that CFOs are to oversee all financial management activities relating to the programs and operations of the agency. In this regard, we have noted three issues related to CFO organizational structures and responsibilities that deserve attention: (1) the need for all CFOs to have responsibility for both budget formulation and execution, (2) while many agencies have formed internal CFO Councils, the need for establishing stronger relationships with financial managers at agency component operations, and (3) the need to ensure that CFOs are not overburdened with ancillary duties that can detract from their primary financial management functions.

Regarding the first issue, the CFO Act requires, at a minimum, that CFOs monitor budget execution and develop and maintain systems which provide for the integration of accounting and budget information. Because of the interdependency of the budget and accounting functions in meeting this requirement, 19 of the 24 CFO Act agencies have included both budget formulation and execution functions under the authority of the CFO.

However, at the Department of Agriculture, HUD, and the Agency for International Development CFOs do not have responsibility for either budget formulation or budget execution. At Education and Labor, CFOs have responsibility for budget execution but not for budget formulation. We believe 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.

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[4] Guidance for Preparing Organization Plans Required by the Chief Financial Officers Act of 1990 (OMB, M-91-07, February 27, 1991).

Regarding the second issue, OMB's guidance to agencies for establishing CFO responsibilities provides that the CFOs are, at a minimum, to have a formal role in hiring and evaluating the performance of the financial leaders in agency components. The CFO does not have this role at 12 of 17 agencies where financial management responsibility rests with the CFO but is carried out by the financial leaders at the agencies' components.

The CFO Council has studied the issue of the CFO's role in ensuring that financial personnel in component organizations are full partners in achieving agency financial management objectives. The Council suggested that agency CFOs (1) forge relationships with the heads of financial management in agency components, (2) take a very active role in the recruitment of senior CFO personnel at agency components, (3) have a proactive role in senior financial management personnel selections, and (4) exercise a meaningful role in assessing the performance of component CFOs and be a partner in preparing their annual performance evaluations. OMB is currently reviewing the CFO Council's suggestions for possible adoption as governmentwide requirements.

Regarding the third issue of CFOs having ancillary duties, at 14 agencies CFOs are responsible for operational functions in addition to those directly related to agency financial management. For example, the CFOs at the Departments of Treasury and Justice are responsible for personnel and procurement functions; the CFOs at Education and HHS are responsible not only for procurement but also for grants management; and at Interior, the CFO is responsible for all of these ancillary functions. While these responsibilities 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. This area needs close attention and further inquiry given the serious financial management problems confronting these agencies.

Improving the Quality of Financial Management Staff

The CFO Act gives the CFO responsibility for recruiting and training financial management staff. CFOs must address the serious problem of attracting and retaining well qualified financial management personnel and work to upgrade their skills, which is of ever-increasing relevance in the current trend to downsize government, as opportunities to expand existing financial staff may be limited in the future.

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.

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 an often neglected aspect of ensuring high-quality financial operations. At 19 of the 24 CFO Act agencies, formal training programs to enhance the skills and knowledge of financial management staff have not been established 5 years after the CFO Act was passed.

Upgrading staff skills and knowledge is a fundamental practice that would involve such elements as a training plan and standards for the type and level of skills necessary to effectively carry out financial management functions. 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.[5] 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.

OMB's Leadership Support Is Important

In addition to agency CFOs, the CFO Act created within OMB a Deputy Director for Management and established the Office of Federal Financial Management (OFFM) headed by a Controller. The act also places with OMB broad authority and responsibility for directing federal financial management, modernizing government financial systems, and strengthening financial reporting.

The current OMB Deputy Director for Management and the Controller are both highly qualified. For example, the Deputy Director for Management has over 20 years of private sector experience, which includes installing new financial and management information systems to restore stability to large troubled business enterprises. The Controller is very familiar with federal financial management issues, having served as HUD's CFO, and has extensive experience in dealing with complex financial systems and problems in state and local government and the private sector.

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

During the CFO Act's first several years, OFFM provided central direction and guidance in a number of areas, including prescribing the responsibilities for agency CFO organizations, establishing CFO and Deputy CFO qualification standards, providing financial statement form and content guidance, and setting financial audit requirements. Also, for the first time in 1992, OMB issued the annual federal financial management status report and 5-year plan, as required by the CFO Act, This document has been updated annually. Further, the OFFM staff have worked closely with agencies as they began to establish CFO organizations and prepare financial statements.

More recently, in an effort to better integrate budget and management oversight, OMB realigned its activities, including its financial management functions. The new organization, known as OMB 2000, consists of five new Resource Management Offices (RMOs) that are responsible for budget and management functions of their assigned agencies. The RMOs will be staffed with former members of the budget program divisions as well as some staff from the general management and statutory offices, with 21 of the 41 OFFM staff positions reassigned to the RMOs.

As part of this reorganization, policy development was retained in the statutory offices, but some agency liaison responsibilities for the statutory functions were shifted to the RMOs. Currently, OMB expects the reorganized OFFM to leverage resources of, and place more reliance to implement policy through, the RMOs, the CFO Council, and other interagency groups.

There are potential benefits to better integrating OMB's budget and management functions. We stated in our 1989 management report[6] of OMB that "the budget and management staffs must work together as a team if OMB is to more effectively oversee agency efforts to deal with long-term management issues." Also, the CFO Act calls for integration of budget and financial management information.

The overall impact that the reorganization will have on CFO Act implementation, as well as other OMB responsibilities, will depend in large part on how the reorganization is carried out. At this stage, it is too early to tell. We are monitoring the reorganization implementation to assess its impact on CFO Act implementation and other OMB management responsibilities.

The CFO Council Is Working to Improve Financial Management

The CFO Act created a CFO Council to advise agencies and coordinate their activities on such matters as consolidation and modernization

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[6] Managing the Government: Revised Approach Could Improve OMB's Effectiveness (GAO/GGD-89-65, May 1989).

of financial systems; improved quality of financial information, financial data and information standards; internal controls; and legislation affecting financial operations and organizations. In concert with OMB, the CFO Council, which is comprised of senior OMB and Treasury officials and the CFOs and Deputy CFOs, is working to establish sound financial policies and services governmentwide and to facilitate effective communication.

The CFO Council's role has significantly evolved. The Council now meets monthly, with the meetings attended by both the CFOs and the Deputy CFOs, as well as the Deputy Director for Management and Controller in OMB, Treasury officials, and representatives of other groups such as the IGs and GAO. The CFO Council has formed 15 committees and actively undertaken a wide range of projects to improve financial management across government. The following are examples of the Council's projects:

-- The Financial Systems Committee is involved in projects, such as coordinating OMB's annual financial management systems status report.

-- The Legislative Activities Committee has ongoing activities to promote financial management legislation, such as that involving debt collection, and to provide liaison with congressional staff on financial management matters.

-- The Report Streamlining Committee has the goal of simplifying and streamlining governmentwide reporting requirements through reports consolidation, like that called for in the Government Management Reform Act.

-- The Internal Controls Streamlining Committee disseminates information on streamlining management control programs and activities under the Federal Managers' Financial Integrity Act.

Also, the CFO Council has developed a vision and goals for the financial management community and federal managers, which was issued in July 1994. In May 1995, the CFO Council established the following as its highest priorities for the coming year: (1) the improvement of financial systems, (2) the implementation of the Government Performance and Results Act, and (3) the development of auditable financial statements and accounting standards.

Further, the CFO Council, along with OMB, has developed a series of financial management indicators to track financial management performance, show agencies progress toward achieving financial management goals, and help focus management's attention on areas requiring further oversight. These indicators, which are published in OMB's annual financial management status report and 5-year plan, provide information on the status of financial management in the 24 CFO Act agencies and document the status of agency progress toward meeting critical financial management goals.

Overall, the CFO Council's work is essential to provide a forum to exchange ideas and consider issues of common interest to improve financial management across government--issues that are central to meeting the CFO Act's requirements and objectives. Consequently, the Council serves as a link to surface and collectively help to resolve problems that impede the development of effective financial information, systems, and controls.

COMPREHENSIVE FEDERAL ACCOUNTING STANDARDS NEARING COMPLETION

Establishing new accounting and financial reporting standards is central to achieving the CFO Act's objective of providing relevant and useful financial information for managing government operations. To ensure the relevancy of federal accounting standards, the Director of OMB, the Secretary of the Treasury, and I agreed to a cooperative approach to the standard-setting process by establishing the Federal Accounting Standards Advisory Board (FASAB) in October 1990. By the fall of this year, FASAB will have introduced new financial reporting concepts and completed most of the supporting financial and cost accounting standards necessary to meet the federal government's special needs.

As we testified[7] before this Subcommittee on July 11, 1995, new financial statements are being considered to meet the unique needs of those who manage and oversee the federal government's budgets, operations, and stewardship. In addition to ensuring basic accountability for the proper use of budgetary resources, these reports should address (1) the full costs of achieving program results, (2) the value of what the government owns and what it owes to others, and (3) the government's ability to detect and correct problems in its financial systems and controls.

The standards FASAB is now recommending will provide a sound foundation for federal financial statements that are relevant to the budget formulation process and the need for operating information. The successful implementation of these standards will depend on support both from agency leadership and management as well as the Congress itself. We have been pleased by the support the Congress in general and this Subcommittee in particular has provided for these initiatives and hope to continue working with you on these important issues.

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[7]Managing for Results: Strengthening Financial and Budgetary Reporting (GAO/T-AIMD-95-181, July 11, 1995).

BUILDING SOUND FINANCIAL MANAGEMENT SYSTEMS

Seriously inadequate automated financial management systems are currently the greatest barrier to timely and meaningful financial reporting, including the preparation of annual auditable financial statements. 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 and a little over half (53 percent) need to be replaced or upgraded within the next 5 years.

Existing financial systems have not been designed to provide meaningful financial, cost, and performance data or support the preparation of required financial reports. Further, systems that account for related information, such as inventory and purchasing systems, are not integrated. These problems diminish not only an agency's ability to prepare auditable financial statements, but, more importantly, the reliability, usefulness, and availability of all agency financial data. As a result, inadequate systems decrease an agency's ability to measure and manage the cost of its programs, efficiently carry out its operations, and protect the assets and resources for which it is responsible.

Because of these problems, the CFO Council has designated financial management systems as its number one area of emphasis. The need for this high priority 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, managers do not have reliable, timely financial data throughout the year to help manage effectively.

Agencies reported that only 29 percent of their financial management systems were part of the single integrated financial management system that the CFO Act requires each agency to establish. For example, DOD reported that it had over 250 financial management systems in operation but that only 8 percent of these systems were part of the department's single integrated system. Further, agencies reported that only 33 percent of their core financial systems comply with the Joint Financial Management Improvement Program's (JFMIP)[8] Core Financial System Requirements, as required by OMB, and only 46 percent of their systems comply with individual agency data standards.

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[8]JFMIP is a joint cooperative undertaking of OMB, GAO, the Department of the Treasury, and the Office of Personnel Management to improve financial management operations throughout the government.

Efforts to Improve Information Technology Management

The continuing poor condition of agency financial systems is a symptom of a much broader issue--the federal government's overall inability to effectively manage its investments in information technology. Many agency system development projects have been poorly planned and managed and, as a result, have cost much more than anticipated and have not provided intended benefits.

There is a growing recognition throughout government 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[9] on the best information management practices of leading organizations has been enthusiastically received, and several agencies are actively attempting to implement its tenets, which focus on strategic information management. We testified before this Subcommittee on the key practices outlined in this guide.[10]

We have developed several tools to assist agencies in taking a strategic view of their information resource management practices and maximizing their information technology (IT) investments. Our Strategic Information Management (SIM) Self-Assessment Toolkit,[11] for example, has been used by several agencies, including IRS and HUD, to take the important initial step of assessing their own practices. Additionally, we are currently working with OMB to finalize its Information Technology (IT) Investment Guide, which is intended to provide agency managers a systematic and objective means of reducing the risk and maximizing the return associated with planned IT investments.

Further, the Congress is taking steps to improve federal IT management. Earlier this year, the Congress passed amendments to the Paperwork Reduction Act, which the President signed into law on May 22, 1995. The amendments are intended to improve the management of IT resources and institute stronger controls over IT investments. Other legislative proposals to strengthen leadership and accountability for managing and improving systems are being considered. These proposals include ideas such as establishing Chief Information Officers in federal agencies and changing system planning and acquisition practices.

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

[10]Managing for Results: Steps for Strengthening Federal Management (GAO/T-GGD/AIMD-95-158, May 9, 1995).

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

Financial System Improvement Efforts

In addition to general IT management improvement initiatives, there are improvement efforts specifically aimed at financial systems that are either underway or needed. For example, over the past few years, available guidance on financial system design standards has been expanded and improved. This should help agencies ensure that their new or redesigned systems perform required accounting functions and produced needed data.

In particular, JFMIP is developing a set of Federal Financial Management System Requirements, which provide guidance in determining the functions that agency systems should be able to perform. Since 1988, JFMIP has issued guidance on a number of areas, including general ledger systems, personnel and payroll systems, and inventory systems. In the fall, JFMIP plans to issue guidance on cost accounting systems, which will help to implement the cost accounting standards recently issued by FASAB.

Also, in January 1995, JFMIP published a model for establishing and maintaining integrated financial management systems to support management and federal program delivery. This document, entitled Framework for Federal Financial Management Systems, is an important step in providing the guidance agencies need. GAO is developing detailed system review guides to assist agency managers and auditors in implementing and assessing agency compliance with federal guidance, including the JFMIP criteria.

When implementing improved system design criteria, agencies need to take a fresh look at their financial operations to determine how they can best take advantage of information technology to increase efficiency. Operational improvement gains resulting from such reengineering efforts can result in savings that help offset new system costs. Also, it is essential that agencies upgrade and make the most of the financial system expertise available within federal agencies and take full advantage of private sector expertise.

One way to maximize agency expertise would be to expand the practice of cross-servicing, where one agency provides financial management software and processing support to another agency. According to OMB, 16 of the 24 CFO Act agencies currently engage in some type of cross-servicing, covering approximately 20 percent of personnel/payroll systems and 6 percent of travel systems. We believe that this practice could be expanded significantly.

Also, agencies could pool their resources to establish interagency centers for managing financial system development projects. Establishing centralized, governmentwide computer operations centers or establishing private/public sector partnerships to resolve major problems and test innovations, would be other possibilities. Such practices could result in systems being developed faster by fewer personnel and could facilitate accounting for and managing the cost of system development and operations.

Further, in light of the government's long-standing poor track record in systems development, it may be appropriate to consider contracting with private businesses to take over large segments of federal automated operations. Many private firms have turned to this practice, known as "outsourcing," because it allows them to concentrate on their core businesses and improve customer service rather than expending effort on their information technology infrastructure. Costs may be lower because (1) they are, in effect, shared with the vendor's other customers, (2) the number of computer support staff can be dramatically reduced, (3) vendors may do the job better because computer service is their primary business, and (4) state-of-the-art technology could be acquired faster.

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 to implement the routine controls needed to keep these data reliable, such as reconciliations to identify, research, and resolve discrepancies. Such efforts will improve the reliability of current financial reports and help ensure that data transferred to new systems are reliable.

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Through the CFO Act, the Congress has set the foundation to provide much needed accountability and gain financial control of government operations. Over the 5 years since the act's passage, important progress has been made and the CFO Act's provisions have begun to take root. This momentum needs to be sustained and enhanced. Much more needs to be done to fully achieve the act's financial management reform goals and attain the type of accountability and effective management the American taxpayers expect and deserve. We look forward to working with the Subcommittee and others to help make the CFO Act's goals a reality.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions.

AGENCIES REQUIRED TO HAVE ANNUAL AUDITED FINANCIAL STATEMENTS ($ in billions)

Agency/Department	1994 Outlays	Percent of Total	1994 Gross Budget Authority	Percent of Total
HHS	278.9	17.6	370.4	17.4
Defense	299.0	18.9	408.0	19.1
Treasury	307.6	19.4	340.2	15.9
SSA	345.8	21.8	360.1	16.9
Agriculture	60.8	3.8	89.6	4.2
Labor	37.0	2.3	48.9	2.3
OPM	38.6	2.4	79.1	3.7
Veterans Affairs	37.4	2.4	43.1	2.0
Transportation	37.2	2.3	47.1	2.2
Education	24.7	1.6	33.6	1.6
HUD	25.8	1.6	36.5	1.7
Energy	17.8	1.1	24.9	1.2
NASA	13.7	0.9	15.3	0.7
Justice	10.0	0.6	13.3	0.6
Interior	6.9	0.4	11.2	0.5
EPA	5.9	0.4	7.0	0.3
AID	2.5	0.2	6.5	0.3
State	5.7	0.4	6.9	0.3
FEMA	4.2	0.3	6.9	0.3
Commerce	2.9	0.2	5.4	0.3
NSF	2.6	0.2	3.2	0.2
SBA	0.8	0.1	3.5	0.2
GSA	0.3	0.0	10.2	0.5
NRC	0.05	0.0	.5	0.02
Total CFO Entities	1,566.15	98.8	1,971.63	92.3
Non-CFO Entities	18.23	1.2	163.55	7.7
Total Government	1,584.38	100.0	2,135.18	100.0

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