United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
9:30 a.m. EST
Thursday
July 23, 1987

The Federal Financial Management Reform Act of 1987

Statement of
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of the United States

Before the
Committee on Governmental Affairs
United States Senate

C39529 / 133524

GAO/T-AFMD-87-18

Mr. Chairman, I am here today to express my support of your efforts to bring about urgently needed improvements in federal financial management. The federal government's lack of effective financial management and accountability is being increasingly highlighted through our own reports as well as those made by agency heads under the Federal Managers' Financial Integrity Act and by the inspectors general. Recent reports are replete with examples of problems ranging from an inability to account for a half billion dollars of foreign military sales deposits to an inability to manage or report on the loans and accounts owed to our government. Billions of dollars are being spent on uncoordinated efforts to upgrade accounting and financial management systems, but these efforts have routinely failed to meet their objectives. I am concerned about our government's inability to effectively hold federal managers accountable for their financial activities, generally because we lack essential financial data.

I am also concerned about our continued reliance on antiquated systems that do not provide the information required for effective management, program, funding, and revenue-generating decisionmaking. We can no longer afford to rely on systems and concepts that do not provide the financial information and accountability needed by the Congress, federal managers, and the public.

Your proposed legislation, the "Federal Financial Management Reform Act of 1987," is an important step in addressing these long-standing problems. This legislation provides for the leadership needed to improve federal financial management, establishes a formalized planning process to guide the improvement efforts, and provides a legislative mandate for annual preparation and audit of agency financial statements, capstones necessary to ensure discipline and accountability in our financial systems.

As I stated in a recent letter to you, I believe that financial management reform is more likely to be successful if it has a legislative underpinning rather than being guided by uncoordinated, ad hoc initiatives. I believe such legislation should include

-- centralized financial management leadership that is responsible for developing and implementing a governmentwide improvement plan,

-- corresponding financial management leadership in executive branch departments and agencies, and

-- annual preparation and audit of agency and governmentwide financial statements.

Your proposed legislation provides for these vital elements. It provides for leadership by establishing an Under Secretary of the Treasury for Financial Management and chief financial officers in the 13 cabinet departments and 9 other departments and major agencies. It formalizes the planning process by requiring the under secretary to develop and implement a plan for improving federal financial management. Also, it promotes discipline and accountability by providing for audits of agency financial statements by GAO or other independent auditors. I believe, based on my experience and judgment, that this proposed legislation would significantly improve the operations of government and result in substantial savings.

NEED FOR A LEGISLATIVE MANDATE

I would like to spend a moment discussing the importance of providing a legislative mandate such as your proposed legislation for this much needed reform effort. In 1985, we issued a report entitled Managing the Cost of Government (GAO/AFMD-85-35 and 35A) on the need for comprehensive reform of federal financial management. We stressed that effective reform requires consistent and continuous effort and leadership.

The need for continuity and stability in management reform is not a new idea. In fact, GAO studied centrally directed, governmentwide management improvement programs conducted in the

1970's and found that few initiatives had lasting impact. I believe that many of these initiatives would not have been so short-lived if there had been a legislative mandate to ensure that they would continue in existence and be consistent across successive administrations.

Organizations and the people who manage them naturally resist change. Reform initiatives, whether short-lived or permanent, represent change. Therefore, it is not surprising that administrative actions to improve operations are not fully successful, particularly when agency personnel perceive that there will be new directions from succeeding managers. The existence of a legislative mandate would provide the needed assurance that an initiative's direction, and indeed its very existence, would be stable.

CENTRAL AND CONTINUING LEADERSHIP

Our 1985 report also stressed the need for consistent and continuing financial management leadership throughout the executive branch as another crucial element of the reform effort. As I testified in hearings before this committee earlier this year on improving federal management and accountability and last year on Senator Roth's bill, S.2230, our work has demonstrated the need for increased leadership and planning to strengthen federal management in general and federal financial management in particular. I continue to believe that if this reform effort is to be successful, a central office and position must be established in law and dedicated to planning, implementing, and overseeing the reform effort as well as providing the central and continuous leadership so desperately needed.

By establishing an Under Secretary of the Treasury for Financial Management, as is proposed in your legislation, the government would have the needed leadership and an office with a mandate to improve financial management. In addition, establishing agency chief financial officers, who should be career employees, goes hand in hand with the establishment of the governmentwide central office. Agency chief financial officers would provide the continuity needed for improved agency financial management and support for the central office. They would provide a conduit for policy and guidance from the under secretary to the agencies and for financial reporting from the agencies to the under secretary.

The next question is where to locate this central office. Various proposals have been made, but I believe that this bill offers a superior proposal by establishing the financial management leadership position within the Department of the Treasury. I believe Treasury can offer a stability of leadership that cannot be expected in the Executive Office of the President. Treasury already performs the central financial and reporting functions of the government and has lead responsibility for important financial management initiatives such as cash management and debt collection, as well as monitoring agency financial management systems improvement projects. Treasury also establishes financial reporting requirements that agencies must follow. Furthermore, Treasury has already established the Financial Management Service, which could directly support the under secretary's efforts.

The Office of Management and Budget (OMB) also recognizes the need for stronger leadership. In its fiscal year 1988 management report, OMB said that the establishment of a chief financial officer is a key measure in support of improvements in financial practices and systems. In fact, OMB has indicated that its current Associate Director for Management will become the first chief financial officer.

As I have said, I also strongly support the creation of a chief financial officer; however, I believe that the office should not be in OMB or in any part of the Executive Office of the President. I am concerned about OMB's historic lack of support for management activities in deference to budget responsibilities. Proponents of establishing a chief financial officer in OMB point out the potential for using the influence of budget decisions to gain agency cooperation and support for financial management activities. This linking of budget decisions to management improvements usually has not been the case. Furthermore, former government officials who were instrumental in establishing OMB said at hearings before this committee last year that, had they to do it over, they would have created a management office separate from the budget office because of the secondary importance OMB has placed on management issues.

In addition to OMB's natural focus on the budget, I am concerned about the frequent turnover in top-level positions. Recent support at OMB for financial improvements demonstrates that when someone takes an active interest, progress can be made. However, the very fact that progress is dependent on who takes an interest demonstrates the tenuous position we are in. If we look at the chain of command at OMB as it relates to financial management since 1981, we find there have been two directors, two deputy directors, and four Associate Directors for Management. What will happen when the senior financial official leaves OMB? How long will it take to find a replacement? And how long will the successor be on the job? How much time and attention can be focused on financial management? Will the pressure for improvements and policy directions be continued?

Such organizational instability can have profound effects on the line agencies throughout the executive branch as they try to implement policies established by a changing group of officials in OMB. This problem is compounded when you consider the managers in many departments and agencies without a central financial management leadership who must react to internal organizational instability as well.

LONG-RANGE PLANNING

Equally important to the success of the reform initiative is the need for the central leader to develop and implement a long-range, governmentwide plan to improve and operate federal financial management systems. Trying to institute improvements without such a plan is like trying to build a house without a set of architect's drawings.

An overall plan for executive branch financial management systems would generate greater confidence that the financial management system upgrades would result in integrated systems for the government as well as in information needed by individual agencies. Additionally, the planning process would reveal opportunities for (1) reducing the number of accounting systems by use of cross-servicing arrangements where one agency performs financial services for other agencies, (2) eliminating redundant or antiquated systems, and (3) sharing system designs among agencies to avoid the all too common problem of "reinventing the wheel." Finally, an overall, long-range plan would also provide a measure of direction and continuity when leadership changes, centrally as well as at the agency level.

FINANCIAL STATEMENTS AND AUDITS

As I have indicated, I believe the preparation and audit of agency financial statements is an integral part of improving financial management by promoting discipline and accountability. I strongly endorse your bill's requirement for the annual preparation and audit of agency financial statements. I recommend that the statements be prepared in accordance with the Comptroller General's accounting principles and standards and that audits be conducted in accordance with generally accepted government auditing standards.

Much can be gained by the preparation of agency statements and their subsequent audit. The process of preparing and auditing financial statements instills discipline in agency accounting and reporting systems because it establishes accountability. Financial statement audits ensure there is a proper link among accounting transactions, accounting systems, financial statements, and financial reporting to Treasury, OMB, the public, and the Congress. They provide an opportunity for an independent auditor--the agency inspector general, a public accounting firm, or GAO--to determine whether adequate safeguards are in place to protect resources entrusted to the agency and whether the agency accurately discloses the financial aspects of its operations.

With such sound reasons for performing financial audits, it is not surprising that the federal government has long mandated financial audits as a matter of public policy. Since 1934, publicly-traded companies have been required to have annual audits. In addition, financial audits were part of the conditions attached to assistance provided New York City during its fiscal crisis. Furthermore, governmental recipients of federal funds are required to have their financial statements audited under the provisions of the Single Audit Act sponsored by this committee.

I also believe that, ultimately, the under secretary should be required to develop governmentwide financial statements and that they be audited by GAO. Governmentwide financial statements would provide information not found in budgetary reports. Such information is useful for many purposes, such as improving cash management, planning capital replacement, and assessing the performance and financial position of the government. Taxpayers and others would be provided supplemental information regarding the financial position of the government that would be presented in a manner that could be understood by the average lay person. Publication of governmentwide statements would disclose the cumulative financial effects of decisions on the nation's resources and provide early warning signals of potential problems to policymakers.

GAO conducted a study in conjunction with the Auditor General of Canada to investigate the information needs of users of federal government financial information. Our report, the Federal Government Reporting Study (GAO/AFMD-86-30), identified several issues, such as how to define and value fixed assets and how to report on the Social Security system, that need to be resolved before the governmentwide statements can be published. We are currently working on addressing those issues; however, in the meantime, agency efforts to develop financial statements need not await resolution of these issues.

I cannot stress enough my strong belief in the importance of statutorily requiring the preparation and audit of agency, and ultimately governmentwide, financial statements on an annual basis and in accordance with generally accepted principles and standards.

BENEFITS OF FINANCIAL MANAGEMENT REFORMS

I believe the need to institute lasting financial management reform is widely recognized, but questions arise about whether, in times of budget austerity, the government can afford to make the improvements. In other words, can the proposed improvements demonstrate benefit/cost ratios that outweigh sound reasons for funding other budget priorities? I believe that we can't afford not to make the improvements because of the millions of dollars of unnecessary costs and losses in revenues to the government brought about by the absence of good financial information, adequate systems, coordinated systems upgrades, adequate internal controls, routine financial statements, and periodic financial audits.

First, I want to acknowledge that it is difficult to place a monetary value on timely, reliable financial information. It is also hard to estimate the benefits of making informed decisions or the costs of making bad decisions because sufficient information is not available. But let's look at the situation from another perspective. Can the government afford not to make the financial management improvements? How can the Congress decide the worth of a particular program if the full cost is not known? How can agency management evaluate performance without consistent financial information? How can agencies decide whether to continue performing commercial services or contract out without good cost information? How can we establish and demonstrate accountability to the public? Without timely, reliable information, the Congress and agency management are forced to make important decisions without full knowledge of the true costs of prior decisions. The credibility of the government is at risk when federal financial management failures all too frequently appear in national news. Failure to institute meaningful improvements will subject the government to ridicule.

There are numerous examples where better financial management systems and practices would save the government money. During an audit of the General Services Administration financial statements, we detected problems in billing for services that subsequently led to $8 million in collections. Our financial audit of the Federal Crop Insurance Corporation disclosed that lack of controls resulted in payment of improper claims in amounts that could ultimately run as high as $100 to $200 million. Hopefully, these problems will not occur again at these organizations. But, where else will we find similar problems? The emphasis on program execution--delivering services to beneficiaries, providing national security, or performing scientific research--often takes precedence over adequate safeguards and financial reporting.

We also believe that significant benefits could be achieved by upgrading systems. For example, the Internal Revenue Service (IRS) estimated that an automated financial system being developed will cost about $49 million and will provide $625 million in benefits over the life of the system, including $50 million annually in increased revenues. IRS projected a benefit-to-cost ratio of 12.7 to 1 for the project. Another agency has projected a 10-percent return on investment on a project to upgrade its personnel accounting system.

The benefit of adequate accounting and budgeting systems to the Congress is demonstrated by recent action concerning the Forest Service's fiscal year 1988 appropriation hearing. The House Appropriations Committee's Subcommittee on Interior and Related Agencies reported that inaccurate accounting over the years has led to inaccurate budgeting. Consequently, the Congress could not determine whether the funding for congressional goals has been excessive or deficient. Furthermore, the lack of such information denied the Congress the opportunity to make funding adjustments in succeeding years. The committee report said that if the accounting system being developed meets expectations, the committee could envision shifts in the budget in future years to more accurately reflect where the funds are actually being spent.

I could go on with numerous examples of problems and weaknesses in federal financial management practices and systems that result in substantial costs and losses of revenues to the government. We would be happy to supply additional examples for the record.

CONCLUSION

In summary, I believe that for financial management improvement to be effective and lasting, it must be legally mandated, it must be guided by a cohesive framework and plan under centralized leadership, and it must provide accountability and discipline of financial statements and the performance of annual financial audits. Your proposed legislation provides those essential elements, and I am convinced that such legislation would generate substantial savings to the government.

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This concludes my remarks. I would be pleased to answer any questions that you or members of the committee may have.