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STATEMENT OF
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BEFORE THE

HOUSE GOVERNMENT OPERATIONS COMMITTEE

ON

"IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT OF 1982"

Mr. Chairman and members of the committee, I am pleased to appear before you to discuss first year efforts to implement the Federal Managers' Financial Integrity Act of 1982. The goal of this legislation--to help reduce fraud, waste and abuse and improve management of federal government operations--is one we all share.

This act provides for the first time the needed discipline on a government-wide basis to identify and remedy longstanding internal control and accounting systems problems that hamper effectiveness and accountability, cost the taxpayer potentially billions of dollars, and erode the public's confidence in its government. The act perpetuates the concept first embodied in the Accounting and Auditing Act of 1950, that primary responsibility for adequate systems of control and accounting rests with management. The Congress has taken a major step forward by requiring for the first time that management report annually on the status of their internal control and accounting systems, and by holding managers publicly accountable for correction of weaknesses.

Assuring successful implementation of the Financial Integrity Act is one of GAO's top priorities. As a result, we undertook a comprehensive review of efforts to implement the act at 22 federal departments and agencies (Chart 1), which together account for over 95 percent of all federal expenditures. We are issuing individual reports to each of the agencies included in our review, and plan to issue an overall report next month. I would like to share with you some of our observations on the first year implementation of the act.

PROGRESS IN FIRST YEAR

To provide the framework for implementation of the act, GAO issued standards for agencies to use in establishing their internal control systems, and the Office of Management and Budget (OMB) established guidelines for agencies to use in evaluating, improving, and reporting on their internal control systems.

Our review has shown that agencies made a good start in this first year to put in place the elements recommended by OMB's guidelines, and have demonstrated a management commitment to implementing the act. There has been involvement by top management in the agencies and in OMB, and an unusual degree of cooperation between the agencies, OMB, the IGs, and GAO.

Agencies have made progress in assessing the vulnerability of their internal control and accounting systems and have submitted the year end reports required by the law. They are establishing a systematic process to evaluate, improve, and report on their systems, and we see an increased awareness of the need for good internal control and accounting systems by federal managers. The first year effort was a learning experience and much remains to be done to fully implement the evaluation process established by OMB to comply with the act. Nevertheless, agencies' first year reports under the act did disclose material internal control and accounting systems problems that need prompt attention.

MATERIAL WEAKNESSES REPORTED

I would like to spend a few minutes, not to criticize the agencies who have been forthright in disclosing material weaknesses, but rather to point out the nature and type of problems which today exist, covering the spectrum of government functions, programs, and accounting systems. Many of the material weaknesses identified in the agencies' first year reports are of a longstanding nature, and have been the subject of prior GAO and Inspector General reports. Before getting into the problems, I would like to note that six of the agencies included in our first year review were in the Department of Defense, which issued a consolidated report for all of its operations. Therefore, while our review covered 22 agencies, for purposes of discussing reported weaknesses, I will be talking about 17 agency reports.

Reported material weaknesses can be generally categorized into 8 areas (Chart 2):

First, accounting and financial management systems. Sixteen agencies reported material weaknesses in this area in their first annual report to the President and the Congress. The

Department of State, for example, reported that its Departmental accounting systems are weak, and is now developing new world-wide systems for general budgeting and accounting, and real estate, property and cost accounting. HUD reported that its systems are cumbersome, costly to change or enhance, error prone, and difficult to control; and GSA stated that one of its major accounting systems did not provide timely, accurate, or reliable reports to users, thus requiring a duplicate system. The Interior Department reported material weaknesses in its multi-billion dollar oil and gas royalty program, and the Department of Defense identified a wide range of financial management problems including weaknesses in the $15 billion a year foreign military sales program.

Prior GAO reports confirm the existence and longstanding nature of these weaknesses. For example, both GAO and HUD's IG have issued a series of reports over the years, pointing out that HUD accounting systems had received little attention or the funding necessary to keep them timely, accurate, or sufficiently automated to meet the agency's needs. We have issued numerous reports dating back 25 years addressing problems in accounting for oil and gas royalties, and over the past decade have issued over 40 reports citing problems in financial management of Defense's Foreign Military Sales Program which have cost the government hundreds of millions of dollars.

Second, eligibility and entitlements for which eight agencies reported material weaknesses. For example, the Department of

Agriculture reported that it needs to increase the detection and collection of overissuances in its $11 billion Food Stamp program. GAO previously found the need for greater efforts to recover costs of food stamps obtained through errors or fraud, and noted in a report issued last year that of $2 billion in food stamp overissuances over a 2 year period only $20 million, or 1 cent of each overissued dollar, was subsequently recovered. The net drain on program resources could have provided benefits to about 1.7 million needy people for 2 years. The Veterans Administration reported that it did not have adequate control over who received services under its medical care programs. In this regard, we previously reported that the Veterans Administration, by not maintaining a central control file of individuals determined to be ineligible for VA benefits, had incurred $15 million in costs for ineligible beneficiaries.

Third, grant, loan, and debt collection management, where 12 agencies reported material weaknesses. For example, the Commerce Department's first year report cited material weaknesses in the management of the Economic Development Administration's business grants and loans. This is confirmed by a February 1984 Commerce IG report, which disclosed that approximately $465 million, or 46 percent, of the $1 billion business loan portfolio is delinquent or in default. Billions of dollars are at stake in the debt collection area. HUD and Agriculture, which reported $1.4 billion and $3.2 billion of delinquent debt, respectively, at the beginning of fiscal year 1983, and have longstanding debt collection problems which have been reported on by GAO, cited material weaknesses in debt collection in their first year Integrity Act reports.

Fourth, 14 agencies reported procurement weaknesses. The Department of Defense, whose procurement appropriation was $86 billion, for fiscal year 1984, cited several procurement weaknesses in its first year report. Included were disclosures of ineffective controls over spare parts procurement, the cost growth rate in weapon system procurement, lack of competition and sources for supplies, and inadequate verification procedures for material shipments. Audits by GAO, DOD's IG, and the military service internal auditors have all confirmed the need for improvement in the Defense procurement program. The public becomes properly concerned by reports of Defense paying excessive amounts for some of its spare parts.

Fifth, property management where 13 agencies reported material weaknesses. The General Services Administration, the government's largest property manager, reported material weaknesses with its $800 million annual leasing program. In this regard, last year we reported that GSA incurred $16 million in overpayments, overcharges, waste, and improper accounting attributable to control weaknesses in leasing office space, nonrecurring reimburseable work, and investments in operating equipment. Justice reported it lacked adequate internal control for millions of dollars of seized assets. Justice seizes assets such as yachts, airplanes, expensive foreign automobiles, and a wide range of legitimate businesses. GAO and Justice's internal auditors previously reported problems in this area, particularly in custody and disposition of seized property. Among the problems were the deterioration of the assets before being sold; vehicles sold for only 58 percent of their seizure value, boats for 43 percent, and aircraft for only 35 percent of seizure value. DOD also reported that its controls over property need strengthening, and that the lack of these controls has adversely impacted on the management of all property whether held by DOD or furnished to contractors.

Sixth, automated data processing. Ten agencies reported material weaknesses in this area. The agencies we reviewed have over one hundred major automated systems which control billions of dollars of assets, receipts, and expenditures; $329 billion in income security payments; $600 billion in revenues from tax administration; and over $68 billion in salary and benefits for active and retired military personnel. Further, many of these systems perform a critical role in federal operations, such as air traffic control, and military command control and communications.

A frequent problem agencies reported was system security, including protecting automated information, and controlling the automated resources that process, maintain, and disseminate it. For example, the Department of Health and Human Services reported 19 material weaknesses in the automated data processing area, including contingency planning in the event that the Social Security Administration's ADP facility was destroyed or became inoperative for an extended period of time. GAO reported in 1980 that Federal agencies have failed to practice effective risk management and have not developed adequate ADP systems to maintain continuity of operation in emergency situations.

The seventh category of reported weakness, cash management, is one in which 13 agencies reported material weaknesses. For example, HUD reported a material weakness in the use of lump sum drawdowns in connection with its Community Development Block Grant Program, which may result in grantees drawing amounts in excess of realistic needs and in excess interest costs incurred by the Treasury. The HUD IG had previously questioned over $42 million in costs associated with the drawdowns because of excessive drawdowns and ineffective and inefficient use of the drawdown funds. Also, two agencies (Defense and the Veterans Administration) reported the need to improve controls to assure that payments are made more timely (not early or late) as required by the Prompt Payment Act.

Finally, 10 agencies reported problems in personnel and organizational management. Problems such as misclassifying personnel and poor position management practices cause the Government to incur unnecessary costs. Agencies also reported problems in training and hiring of employees as well as organizational problems. The Administrator of GSA reported that managing people in an orderly business-like way is prevented by the "labyrinths and catacombs" of Federal personnel systems.

Also, in its report to the Secretary of Defense, the Army identified special forces recruiting procedures as an agency material weakness. They reported that individuals were enrolled in the program even though they could not pass the Army's physical fitness test.

IMPROVEMENTS NEEDED IN SECOND YEAR EFFORTS

While there was progress in the first year, our review identified a number of problems with agencies' implementation of the act--problems that one would expect in a new program. We worked closely with the agencies, and have made suggestions to help correct problems with individual agency implementation efforts. We made suggestions to help assure that all organizations, functions, and programs are subject to the evaluation process.

For example, we found that all agency operations were not included in the evaluation process at ~~Commerce and Treasury. Commerce excluded their field offices, and at~~ Treasury, the IRS did not include all of their data centers and the Bureau of Government Financial Operations did not include 8 regional disbursing office accounting systems which annually account for over $600 billion in disbursements. Treasury also excluded the $13 billion Exchange Stablization Fund because they believe the fund is not subject to the act. We disagree.

We also made several other suggestions to strengthen agencies' second year efforts to implement the act; including the need to (1) prepare adequate documentation, (2) better train managers to implement the process, (3) more thoroughly consider ADP controls in agency evaluations, and (4) increase efforts to evaluate accounting systems. Generally, agencies have agreed to correct the problems we noted as part of their second year implementation efforts.

Our review identified reporting criteria and ADP as areas where we plan to work with OMB. A clear, consistent understanding of what is meant by the terms "material weakness" and "reasonable assurance" is key to assuring that agency reports to the Congress on the status of their control systems are complete and accurate. The act provides for agencies to report on whether their internal control systems provide reasonable assurance that the three statutory objectives are met. The act also provides for the agency report to identify the material weaknesses involved and describe the plans for corrective action. We perceive that in the first year agencies were somewhat uncertain as to the application of these terms in preparing their yearend reports, and noted some inconsistencies between agencies. While reporting should improve as agencies gain more experience under the act, we believe additional guidance would be helpful.

In the automated data processing area, we found that even though ten agencies did report material weaknesses, generally agencies did not give full consideration to the controls over their automated systems such as controls over computer software development and data processing center operations. In some cases they did not review all their ADP activities. Because of the dependence on and pervasiveness of automated systems in the Federal Government, it is important that agencies receive guidance that will assure that evaluations of internal controls over ADP resources and systems are both comprehensive and consistent.

Implementation of the act remains a high priority in GAO, and we are now planning a review of agencies' second year efforts. They must begin developing well thoughtout, comprehensive plans to correct material weaknesses identified. Correction of the problems that have and will be identified represents the "bottom-line" of the act. The Congress, and in particular this committee which was instrumental in the passage of the act, demonstrated great wisdom in requiring agency management to report annually on the state of their internal control and accounting systems, and detail plans to correct identified problems. This provides needed accountability and discipline.

As I indicated earlier, many of the weaknesses identified to date are longstanding and cannot be treated on a piecemeal and partial basis as has been the case in the past. The problems that gave rise to passage of the act did not develop overnight, and the solutions will not be easy. It will take a sustained, high priority commitment. While our first year review concentrated on agency efforts to establish a process to implement the act, our second year review will focus more on agency actions to address the weaknesses identified, and whether their reports to the Congress are accurate and complete. OMB plans to continue its commitment to this effort in the second year, and the continued involvement of the Inspectors General (IG) is also critical. The IG's, by virtue of their experience and expertise, represent a valuable resource that agency management needs to use to a great extent in the future in evaluating their internal control and accounting systems.

BUILDING A MODERN FINANCIAL MANAGEMENT STRUCTURE

This leads me to some additional proposals I have on improving financial management in the federal government. The first year's implementation of the Financial Integrity Act, in highlighting the magnitude and seriousness of the government's financial management problems, underlines the urgent need for broad reform.

The government needs to make a major effort to rebuild its financial management structure. The federal government's basic approach to financial management is obsolete and inefficient. We rely on outdated accounting and management information concepts, systems and structures which are not designed to provide the information needed by managers, policy officials and the Congress. For example, the flood of information from our financial reports provides little of the reliable cost data essential for effective policy making and program management. The long history of unreliable and inconsistent weapons system cost estimates is a case in point.

The overburdened and complex budget process, in the executive branch, as well as in the Congress, is another dimension of the problem. Despite the complexity of that process, it is incomplete in its coverage and fails to deal adequately with such central issues as the level of capital investment.

These problems with the basic structure of financial management, and others too numerous to mention, cannot be solved in piecemeal fashion. The problems are too intertwined for that approach. In my judgment, successful reform will require a comprehensive, long-term, integrated approach. The effort should be government-wide in scope, serving the needs of both the Congress and the executive branch, by ensuring that consistent data are available across agency and department lines. The effort should stress four key elements.

1. Strengthened Accounting, Auditing, and Reporting. Effective financial management must start with complete, consistent, and timely information. Government financial systems must be designed to produce such information, and its reliability must be assured through effective auditing procedures.

2. Improved Planning and Programming. Many of the most pressing national issues cannot be adequately considered using a narrow, short-term focus. A modern financial management system should include a structured process for considering those issues, one that focuses attention on major issues, identifies alternative courses of action, and analyzes the issue's probable future consequences. The process must assure that alternatives are accurately and completely costed on the basis of data from the integrated accounting systems.

3. Streamlined Budget Process. To be effective, the federal budget process must focus on budget choices, be made more manageable and integrated with the planning, programming, and accounting phases of financial management. Reform is needed in both the Congress and the executive branch. The budget process should exclude any unnecessary repetition, detail and obstacles to action.

4. Systematic Measurement of Performance. Effective management of resources requires examining the results of government activities as well as their costs. An integrated and disciplined financial management system that provides consistent data on cost and performance is essential to help both the Congress and the executive branch assess the efficiency and effectiveness of government operations.

Taken together, these elements form the conceptual foundation of a new financial management structure of which successful implementation of the Financial Integrity Act is an important first step.

In building a new financial management structure, we think that discussion and debate are needed on the nature and extent of our financial management problems. This, in turn, should lead to consensus on the need for reform and the general direction it should take.

We believe that the debate and the effort to develop consensus might best be initiated through a series of congressional hearings. This is the approach which has always provided major financial management reform, from the Budget and Accounting Act of 1921, through the Congressional Budget Act of 1974, to the Financial Integrity Act. Our assessment of the problems and our ideas on how we might proceed are discussed much more extensively in a two volume report which we provided you in draft form. I appreciate the opportunity to meet with you and Representative Horton to begin a dialogue on our proposals and plans to schedule similar meetings with other members of the committee and the Congress and the executive branch. We plan to release the final version of our report when we are satisfied we have obtained a wide range of informed views on the draft. We hope this report will stimulate widespread discussion of these issues, leading to the concensus which will be needed if reform is to be successful.

We look forward to continuing to work closely with this Committee in this important area where we share substantial interest and concern. I would like to thank you Mr. Chairman and the members of this Committee for holding these oversight hearings. I believe annual hearings on the Financial Integrity Act are vital to assuring full implementation of the act, and provide a forum to address the additional financial management reforms we believe are necessary.

This concludes my statement. I would be happy to respond to any questions you or the other members may have.

CHART 1

FEDERAL DEPARTMENTS AND AGENCIES GAO REVIEWED

Defense Department 1/

1. Office of the Secretary
2. Department of Air Force
3. Department of Army
4. Department of Navy
5. Defense Logistics Agency
6. Defense Mapping Agency

Other Agencies

7. General Services Administration
8. National Aeronautics & Space Administration
9. Small Business Administration

0. Veterans Administration

Civil Departments

11. Department of Agriculture
12. Department of Commerce
13. Department of Education
14. Department of Energy
15. Department of Health & Human Services
16. Department of Housing and Urban Development
17. Department of Interior
18. Department of Justice
19. Department of Labor
20. Department of State
21. Department of Transportation
22. Department of Treasury

/While the Department of Defense issued one overall report to Congress and the President, GAO reviewed and issued separate reports on six Defense components.

<u>CHART 2</u>

<u>CATEGORIES OF REPORTED MATERIAL WEAKNESSES (AS OF DEC. [illegible], 1983)</u>

AGENCY	Automated Data Processing	Eligibility and Entitlement	Accounting/Financial Management Systems	Grant, Loan & Debt Collection, Management	Personnel and Organizational Management	Procurement	Property Management	Cash Management
Agriculture	X	X	X	X	X	X	X	X
Commerce		X	X	X			X	
Defense[1]	X		X	X		X	X	X
Education		X	X	X	X	X		X
Energy			X			X	X	
GSA	X		X		X	X	X	X
HHS	X		X	X	X	X	X	X
HUD		X	X	X	X	X		X
Interior	X	X	X	X	X	X	X	X
Justice			X	X	X	X	X	X
Labor	X	X	X	X		X	X	X
NASA		DID NOT REPORT ANY MATERIAL WEAKNESSES						
SBA	X	X	X	X	X	X		X
STATE			X		X	X	X	X
Transportation	X		X	X		X	X	X
Treasury	X		X				X	
VA	X	X	X	X	X	X	X	X
TOTAL	10	8	16	12	10	14	13	13

[1] Six Department of Defense agencies (Department of Defense, Army, Navy, Air Force, Defense Logistics Agency and Defense Mapping Agency) were included in one report to the Congress and the President.