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**Federal Internal Control and  
Financial Management Systems  
Remain Weak and Obsolete**

Statement of  
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Before the  
Committee on Governmental Affairs  
United States Senate



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Mr. Chairman and Members of the Committee:

I am pleased to be here today to provide GAO's perspective on the condition of internal control and financial management systems in the federal government.

In January of this year, I brought to this Committee the message that the government faces major problems that are growing and that will not be easily or quickly resolved. At that time, I discussed the seriousness of the budget deficit and problems in key government operations such as the nuclear weapons complex and the Internal Revenue Service (IRS).

Unfortunately, my assessment of almost one year ago still holds true. The seemingly never ending disclosures of fraud, waste, abuse, and mismanagement in federal programs continue to paint the picture of a government unable to manage its programs, protect its assets, or provide taxpayers with the effective and economical services they expect and deserve. One has only to pick up the newspaper to read about scandals in Defense procurement activities or the debacle at the Department of Housing and Urban Development (HUD) which have cost us billions of dollars and further undermine confidence in government. As demonstrated in the report we are releasing today, entitled Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses (GAO/AFMD-90-10), the problems that exist are not limited to a few agencies or a few programs; rather, all of the major agencies have serious problems.

MANY PROBLEMS ARE KNOWN

BUT REMAIN UNCORRECTED

Agencies essentially know what their major problems and vulnerabilities are. Unfortunately, time and time again we find situations where agencies and auditors have identified problems, yet the corrective actions taken, if any, are ineffective, and the problems remain uncorrected for years. The following examples illustrate this point.

- Federal credit assistance and insurance programs have increased from \$400 billion to over \$5 trillion in the past 2 decades. As a result of deficiencies in financial management systems and inconsistencies in the application of accounting principles by agencies administering these programs, many agencies have understated their current losses. The recognized losses from these programs over the past several years total in the \$200 billion range. These losses have already significantly impacted the federal deficit. We anticipate additional tens of billions of dollars in future losses in other programs.
  
- Federal agencies are spending billions of dollars developing and acquiring automated systems and are experiencing massive problems in the process. Design

flaws, misjudgments in requirements, and poor program management caused the Navy to halt installation of a new automated management information system after spending an estimated \$230 million over 9 years to develop the system. Unfortunately, the Navy's experience is not uncommon.

- The basic structures of many present federal financial management systems were designed during the World War II time period. Financial reports resulting from these systems provide a flood of data but little reliable operational and cost information that is essential to monitor programs, anticipate overruns, and provide bases for program and budget planning.
  
- HUD's financial management and accounting systems cannot provide basic accountability and control over program funds, a problem that has plagued the Department for many years and that is, unfortunately, not confined to HUD. Our recent financial audit of the Federal Housing Administration (FHA) showed that while FHA's financial reports showed losses of \$858 million for fiscal year 1988, in fact, the losses were \$4.2 billion, or almost five times greater than management's best information showed them to be.

-- The lack of accurate receivables information has inhibited IRS' efforts to collect its receivables, which have grown to more than \$50 billion.

FINANCIAL INTEGRITY ACT EFFORTS HAVE  
NOT ACHIEVED THEIR INTENDED RESULTS

What must be done to eliminate these problems or at least reduce their impact? Sound internal control and financial management systems are essential to the effective and economical operation and management of any program. They are absolutely critical in times of high budget deficits, ever increasing debt ceilings, and a continuing erosion of the public's confidence in the government's ability to manage its programs. In 1982, the Congress passed the Federal Managers' Financial Integrity Act in an attempt to strengthen agency internal control and financial management systems by requiring agency self-evaluations of those systems and annual reports to the President and the Congress on the condition of the systems. While agencies have identified and reported correcting many system weaknesses, these efforts have clearly not produced the results intended by the Congress when it passed the act.

It is evident, based on examinations of the system problems that agencies have reported in their annual Financial Integrity Act reports and that GAO and federal audit organizations have

identified in their audit reports, that

- the government does not currently have the internal control and accounting systems necessary to effectively operate many of its programs and safeguard its assets;
- many weaknesses are long-standing and have resulted in billions of dollars of losses and wasteful spending;
- major government scandals and system breakdowns serve to reinforce the public's perception that the federal government is poorly managed, with little or no control over its activities; and
- top-level officials must provide leadership if this situation is to ever change.

ACTIONS NEEDED TO STRENGTHEN  
CONTROLS AND ACCOUNTING SYSTEMS

I believe that intensified oversight by the Congress and by the Office of Management and Budget (OMB) are needed to help ensure more effective internal controls and financial management systems in government programs. In addition, the agencies can take actions to strengthen their Financial Integrity Act programs and increase the usefulness of the annual reports they issue.

In July 1989, the Internal Control Interagency Coordination Council, an organization composed of representatives from all the major agencies, OMB, and GAO issued a report that recommended several actions to improve federal implementation of the Financial Integrity Act. These include

- linking the Financial Integrity Act internal control review and reporting process to the budget;
- providing for and promoting senior management involvement in the internal control process;
- identifying, in annual reports, agency actions to correct weaknesses; and
- validating that corrective actions have been accomplished and were effective.

I endorse these recommendations and urge OMB to take prompt action to ensure that agencies implement them. OMB has increased its attention to major problems within agencies and has taken actions to ensure that these problems receive high-level priority attention within the agencies. It has identified high risk areas in each of the 16 largest federal agencies and plans oversight of agency actions to correct problems in these areas.

While I am encouraged by the steps it has taken, OMB is only a part of the solution, and my optimism is somewhat guarded. Mr. Chairman, I would like to read some excerpts from an article entitled "The Stench at FHA" to illustrate a point.

"FHA has approved marginal or hopeless projects, let promoters milk them . . . and then abandon them. And while FHA has sat dumbly by, other promoters have gone from city to city defaulting on project after project. It has permitted still others to default on loans but continue to collect rents for up to five years. . . . In the last 30 months, the GAO has submitted to Congress 11 reports indicting FHA for derelictions ranging from misrepresentations of its income to slovenly neglect of its own foreclosed property."

That quotation is similar to many others written over the past several months. However, there is one significant difference. It is taken from an April 1966 Reader's Digest article. Unless something more is done to correct agency internal control and financial management system weaknesses, major losses of federal funds and the collateral incidents of fraud and abuse will continue. My concern is that 20 years from now, there may be another Comptroller General giving testimony on the government's failure to manage its programs and resources.



The Financial Integrity Act report we are releasing today recommends several actions that should result in stronger internal control and financial management systems throughout the government.

First, we believe that the Congress can significantly contribute to effective corrective action through its oversight role. Through the authorizing, appropriations, and oversight committees, it should hold annual hearings using Financial Integrity Act reports, plans for corrective actions, and audited agency financial statements as the focal point in the process of reviewing agency actions to correct internal control and accounting system weaknesses. Such hearings could help assure the Congress that corrective measures are actually implemented. Unfortunately, the Congress increasingly finds that it has too little time for oversight activities because budgeting has become an endless, repetitive cycle that takes priority. We have recommended actions to streamline the budget process.<sup>1</sup>

Next, the widespread occurrence and significant dollar and programmatic impact of federal accounting system weaknesses, in particular, highlight the need for a new approach to federal

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<sup>1</sup>Managing the Cost of Government: Proposals for Reforming Federal Budgeting Practices (GAO/AFMD-90-1, October 1989).

financial management. I have long been a strong advocate of legislation which would

- establish a chief financial officer structure for the federal government, with counterpart chief financial officers in each of the major agencies, and
- require the annual preparation and audit of agency financial statements.

Until such legislation is passed, OMB and Treasury, working with the administratively appointed chief financial officers in the federal agencies, should be charged with developing and maintaining long-range plans which tie management systems together, much as an architect's drawings provide a guide to the construction of a building. Such a planning effort would ensure that agencies look more than one year ahead in determining future financial system needs and in coordinating their plans. Besides upgrading out-dated financial management systems, long-range planning would be a catalyst to needed standardization of accounting systems and increased use of shared services among agencies. For example, a number of federal agencies--including GAO--now use the Department of Agriculture's National Finance Center in New Orleans to handle payroll and other accounting needs. Such expanded coordination and sharing could minimize the

government's operating costs and increase the comparability of information.

One point needs to be stressed here: it will take a substantial monetary investment to acquire the systems that are needed and to train personnel to operate them. In an era of severe budget restraint, there may be a temptation to take shortcuts to hold down these costs. I strongly believe, however, that new systems will ultimately pay for themselves. The payoff will come not only in terms of better efficiency and prevention of loss from fraud, waste, abuse, and mismanagement, but also in greater confidence in the integrity of government operations and program decisions.

The annual preparation and audit of financial statements will provide the cornerstone to the reforms that we seek. It is fair to say that without the demands imposed by a requirement to prepare accurate financial statements, the underlying financial management systems will be weak. In these situations, the subsystems do not provide information needed to properly manage the agency or protect its funds and other assets from losses of all kinds--including waste, fraud, and abuse. I cannot overstate the deplorable condition of financial management systems in the government. The agencies know how to spend the money you provide, but they now cannot effectively manage its use because they lack the most basic financial management systems. I think that forcing agencies to

prepare accurate financial statements will provide a very strong incentive to get their financial management systems in order.

For years, the federal government has insisted that publicly traded companies, as well as state and local governments, submit their financial statements to the scrutiny of an independent audit. The federal government should do no less. Annual audits promote discipline in the recording and processing of data simply because people know that the information is subject to scrutiny. The improved quality of the financial information enables agencies to place greater reliance upon it in making decisions and monitoring implementation of programs. Furthermore, audits undoubtedly result in strengthened internal controls. In the case of FHA, although independent auditors were unable to render an opinion on the fiscal year 1988 financial statements, the audit identified losses about five times greater than those reported by the agency. Instead of having a surplus, the program has a \$3 billion deficit.

Implementing the recommendations cited in our report is critical in order to realize the purposes of the Financial Integrity Act, to bring about meaningful financial reform, to enable the government to reestablish accountability for federal programs and assets, and to regain the confidence of the American public.

GAO IS INTENSIFYING ITS INTERNAL CONTROL  
AND ACCOUNTING SYSTEM EFFORTS

For our part, I have directed GAO to intensify its efforts to help the Congress and the agencies identify those programs with critical weaknesses in their internal control and financial management systems that are most likely to result in material losses. This program will initially include

- identifying the major areas we believe to be most vulnerable;
- focusing, in conjunction with efforts of agency management and the inspectors general, on the root causes of serious long-standing weaknesses to develop approaches to solve the problems;
- monitoring agency corrective actions and reporting the results to the appropriate congressional committees; and
- recommending the legislative action necessary to ensure that corrective measures are implemented.

The legislative and executive branches of government must form a partnership, with the common goal of achieving effective and economical federal programs and sound financial management systems.

We cannot merely think in terms of tomorrow, waiting for something to happen. The poor state of internal controls and financial management systems demands that we think and act today.

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Mr. Chairman, this concludes my formal statement. I want to thank you and former Committee Chairman Roth for your continuing support of financial management reform legislation, and I will be happy to answer any questions you or members of the Committee may have.