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FINANCIAL MANAGEMENT

CFO Act Is Achieving Meaningful Progress

Statement of Charles A. Bowsher
Comptroller General of the United States

GAO/T-AIMD-94-149

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the progress being made in implementing the Chief Financial Officers (CFO) Act. The CFO Act, sponsored by the full Committee, provides the blueprint for much-needed financial management reforms. The act's first 3 1/2 years represent a very successful start, and demonstrate the relevance of its provisions to improving government operations. The CFO Act and the more recent Government Performance and Results Act, which also was sponsored by the full Committee, together provide the legislative foundation for developing accurate and reliable cost information and performance data. Such information is essential if the executive branch and the Congress are to make informed decisions and move successfully toward a smaller more efficient government that focuses on accountability and managing for results.

The act's requirement for producing annual audited financial statements, in particular, is demonstrating its value in many important ways, including better highlighting the agencies' true financial conditions. Audited financial statements have also been integral to identifying management inefficiencies and weaknesses and highlighting gaps in safeguarding the government's assets and possible illegal acts. Additionally, the CFO Act financial audits have identified actual and potential savings of hundreds of millions of dollars.

Benefits such as these strongly support our belief that the act's requirement for agencywide audited financial statements should be expanded to all 23 CFO Act agencies, and to the government as a whole. We are encouraged by the House's passage of the provisions of H.R. 3400, the Government Reform and Savings Act of 1993, which included the requirement for agencywide audited financial statements for the government's 23 CFO Act agencies. However, we believe that there is a need to go one step further and require an audited governmentwide financial report that provides a consolidated picture of the federal government's financial condition.

Today, we will address each of the specific issues that you requested:

-- the value of financial statements and audits mandated by the act and the benefits of expanding the act's requirements;

-- costs and funding issues related to implementing the act and expanding its requirements;

-- the potential impact of future Office of Management and Budget (OMB) personnel cuts and OMB 2000 on the ability of OMB to carry out its responsibilities under the CFO Act;

-- the quality and timeliness of appointments to CFO Act-mandated positions; and

-- the ability of the Federal Accounting Standards Advisory Board to propose meaningful federal government accounting standards in a timely manner.

PROMOTING BETTER MANAGEMENT THROUGH AUDITED FINANCIAL STATEMENTS

First, I want to highlight just some of the benefits that have been realized by implementing the CFO Act. Since the act's passage in late 1990, we have seen significant progress in confronting serious financial management weaknesses. Audit coverage since fiscal year 1990 has increased from 30 to 60 percent of the government's budget authority. The act's requirement that entities prepare and have their financial statements audited annually is proving its value in several key ways.

Specifically, the CFO Act has resulted in:

-- significantly more accurate and useful information on the government's financial status and its operations;

-- a more in-depth understanding of the extent and pervasive nature of the internal control and financial management systems problems facing the government;

-- substantial savings of resources through recovery of funds due the government, and more efficient use of funds;

-- a better knowledge of the limited extent to which the Congress and program managers can rely on the financial information they receive; and

-- improvements in management's accountability for, and focus on, strong financial management especially the need for effective controls and systems.

More Accurate and Useful Information

A key benefit of CFO Act implementation is the emergence of a much clearer picture of agencies' financial condition. On the revenue side, our financial audits of the Internal Revenue Service (IRS) and the Customs Service concluded that the government does not have sufficient assurance that it is collecting all the money it is due, or that IRS is accurately accounting for the estimated $1.2 trillion it does receive. For example:

-- IRS's receivables have been historically overstated. According to IRS's books in fiscal year 1992, the government was owed $110 billion in delinquent taxes and could expect to collect about $30 billion of this amount. However, only about $65 billion was actually owed and, of that amount, IRS could expect to collect only about $19 billion. IRS took action to better measure receivables, and its fiscal year 1993 financial statements reported $71 billion as accounts receivable with $29 billion estimated as collectible.

-- The Customs Service cannot be reasonably assured that the $21.6 billion it reported as revenues for fiscal year 1993 includes all that it should have collected during the year. Custom's programs for inspecting goods did not provide reasonable assurance that (1) carriers, importers, and their agents complied with laws, and (2) the American people were protected from unsafe and illegal imported goods. This increases the risk that revenue may not have been identified and quotas and other legal restrictions may have been violated. Moreover, critical trade statistics may not be reliable. Acting to address this problem, the Customs Service reassessed its compliance strategies and began a program in 1993 intended to reliably measure the trade community's compliance.

Financial statement audits also have developed a much more realistic portrayal of the costs that the government can expect to incur as a result of its activities. They have highlighted hundreds of billions of dollars in liabilities and potential losses to the government not previously fully disclosed. For example:

-- The audit of the Office of Personnel Management's (OPM) fiscal year 1993 financial statements reported that the estimated liability for future payments to retired or terminated federal employees or their beneficiaries was $695 billion at September 30, 1993 ($318 billion was funded). Although this liability had been previously reported, the CFO audit report disclosed for the first time that if expected salary increases were factored into the model for calculating this liability, it could have been as much as $858 billion.

-- The Department of Veterans Affairs reported an unfunded estimated liability for veterans' compensation and pension benefits was $280 billion at September 30, 1993.

-- Liabilities of over $17 billion ($11 billion was funded) were also identified for the Department of Labor's Federal Employees' Compensation Act program at September 30, 1993.

-- An unfunded estimated $18 billion in potential future liabilities associated with hazardous waste disposal and cleanup at Army installations were disclosed in the fiscal year 1991 financial statements audit.

-- Large projected losses were reported at the Federal Housing Administration, with the fiscal year 1993 financial statements audit disclosing an estimated $13 billion loss reserve.

-- About $14 billion in liabilities (about $3 billion was funded) for loan defaults and interest subsidies were identified for the Department of Education's Federal Family Education Loan Program at September 30, 1993. These liabilities related to about $69 billion in outstanding guaranteed student loans.

-- An estimated $3 billion understatement in the Department of Education's Federal Family Education Loan Program's projected costs for fiscal years 1992 and 1993 were identified by GAO's fiscal year 1992 audit. Education has initiated efforts to have a contractor review some of its loan model assumptions used in projecting program costs. Education plans to make any needed changes to its assumptions based on the results of this review, which is expected to be completed during the summer of 1994.

This is the kind of information needed to make critical decisions on budgeting, tax policies, and the overall direction of government programs. Moreover, as Members of this Subcommittee can fully appreciate, after making extremely difficult budgetary decisions to curb the growth of the deficit, it is disheartening to find such efforts undermined by the unwelcome surprise of huge hidden costs. Although decisions on whether to record all of these potential costs in the budget need to be made on a case-by-case basis, full disclosure of these liabilities will help achieve more informed budget decisions on the costs and consequences of government programs and activities. Further, as a result of the act, much more attention has been given to financial management and systems problems by top officials of the government. In addition, agencies are developing procedures to deal with the issues and problems that the audits have highlighted.

Identifying Internal Control and Financial Management Systems Problems

Next, in addition to shedding light on the government's fiscal posture, audited financial statements have brought much needed discipline in pinpointing inefficiencies and weaknesses and in highlighting gaps in safeguarding the government's assets and possible illegal acts. For example:

-- The Army paid an estimated $7.8 million in improper military payroll payments. The Army's criminal investigators are pursuing cases against several individuals involved in the fraud or wrongdoing and, as of March 1994, Defense records show that recoveries have exceeded $1.7 million.

-- CFO Act mandated financial audits reported that the Department of Defense (DOD) did not match its disbursements with obligations. Having billions of dollars of "unmatched disbursements" substantially increases the risk that fraudulent or erroneous payments may have occurred without detection and that total disbursements may be exceeding appropriations and other legal limits. In response to these audits, DOD identified $19 billion in unmatched disbursements as problem transactions as of March 1993. Through its reconciliation efforts, DOD subsequently reported that it had reduced the amount of problem transactions from a DOD-wide total of $19 billion in March 1993, to $12.6 billion. However, on-going CFO audits are still raising concerns that unmatched disbursements may actually exceed amounts currently reported by DOD.

-- The fiscal year 1992 financial audit disclosed that the Department of Housing and Urban Development (HUD) needs to improve its oversight of $23 billion in grants and subsidy funds provided to program recipients. This oversight is essential to ensure that funds provided to recipients are in the proper amounts and are expended only on eligible tenants and activities and that recipients perform in accordance with applicable contracts.

-- The fiscal year 1992 and 1993 financial audits of OPM's health benefits, retirement, and life insurance programs revealed general control weaknesses with the data center's system security and disaster recovery plans. One OPM data processing center disaster recovery plan lacked information for ensuring continuation of benefit program operations that generate over $80 billion in annual revenues, produce payments of over $14 billion per year to health insurance carriers, and require thousands of annual changes and updates to annuity roll data.

-- CFO-mandated audits found that IRS, Customs, and the Department of Education did not adequately safeguard information and property. Specifically, adequate controls did not exist over (1) IRS taxpayer information, (2) tons of seized cocaine and heroin and millions of dollars in property and currency at Customs, and (3) Education's data files, computer programs, and system software related to its Federal Family Education Loan Program's general ledger system.

Substantial Savings of Resources

Third, CFO Act financial audits have also identified actual and potential savings of hundreds of millions of dollars. For instance:

-- To better manage its receivables, Customs reorganized its debt collection unit, formalized its collections procedures, and aggressively pursued collection of old receivables. According to Customs, this effort resulted in the collection of about $32 million of delinquent debt. This proactive collection approach has the potential for garnering hundreds of millions of dollars in additional collections.

-- The 1992 audit of HUD suggested that HUD reassess its approach to refinancing certain mortgages. Millions of dollars could be saved annually if the $3.2 billion in outstanding mortgage loans were refinanced at lower rates.

-- The Department of Education recovered $1.3 million that was incorrectly paid to two guaranty agencies which were identified as a result of the fiscal year 1992 financial audit of the Federal Family Education Loan Program.

Agencies also are benefitting by identifying resources that could be put to better use. For example, in August 1993, the President's Council on Integrity and Efficiency reported[1] the following.

-- The DOD Inspector General identified an estimated $200 million in invalid outstanding obligations related to DOD's fuel contracts. The report said these funds should have been deobligated and used for other necessary purposes.

-- Naval Audit Service fiscal year 1992 financial audits identified approximately $93.3 million in invalid Military Sealift Command obligations, and an estimated $51.1 million in invalid Navy Defense Business Operations Fund real property maintenance and repair obligations, which should have been deobligated and put to other uses.

-- The Army Audit Agency found that Army depot maintenance activities had an estimated $13.7 million in surplus funds accumulated through excessive charges to their customers. These excess funds are to be returned to the activities' customers in the form of lower costs for services.

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[1]Task Force on Improved Financial Management and Implementation of the Chief Financial Officers Act, PCIE, August 1993.

-- DOD identified over $204 million in potential savings from duplicate invoices, duplicate payments, and avoided interest.

Enhancing Accounting Information

Another result of financial audits is that they are identifying serious deficiencies in the information provided the Congress and program managers. We 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. For example:

-- A fiscal year 1992 audit of the Army disclosed that adjustments totaling almost $52 billion were needed to correct errors in reported financial data.

-- A fiscal year 1992 financial audit of the Department of Education's Federal Family Education Loan Program disclosed that a $1.1 billion adjustment, of which $433 million could not be supported, was reported to make the amount of cash reported at the beginning of the fiscal year coincide with Treasury's balance.

Highlighting Need for Financial Information Systems

Finally, CFO Act implementation focuses attention on management accountability and the need for sound financial information and systems. We have found information systems across the government to be in a serious state of disrepair. At least 16 of the 23 agencies covered by the CFO Act have documented problems related to their financial management systems. Across government, financial management systems are generally incompatible, costly to operate, and woefully out of date.

Significant cost savings can be realized by improving the federal government's ability to take advantage of today's technology. This technology offers unprecedented opportunities to improve the delivery of government services, reduce program costs, and enhance the quality and accessibility of information available to federal managers and the public.

Regrettably, the federal government has not yet taken full advantage of these opportunities. The result is wasted resources, a frustrated public unable to get quality service, and a government ill-prepared to measure and manage its affairs in an acceptable, business-like manner. Despite an estimated $200 billion invested in information management and systems in the last 12 years, there is little evidence of meaningful returns. Yet these investments are essential to improving these systems. In an environment where resources are shrinking while the demand for improved service is escalating, we must better utilize these funds so that we do not continue to spend such large amounts of money with such disappointing results.

Overcoming these persistent, long-standing problems will require both intensive efforts by the top levels of government and the agencies to institute new management practices. In addition, it will require legislation to reinforce the foundation for long-term success. Our study of best practices applied by leading private and public organizations indicated that the federal government lags behind in applying proven, contemporary management solutions.[2] This study outlines the fundamentals applied by top successful organizations that have produced demonstrated performance improvements through the effective use of information technology.

EXPANDING THE REQUIREMENT FOR AUDITED FINANCIAL STATEMENTS

It is critical that we make permanent and expand to all CFO Act agencies the act's requirement for agencywide audited financial statements. This is essential to continue financial management improvement progress under the CFO Act. Unless we achieve success here, agencies will continue to be hindered in their ability to control costs, evaluate performance, or adequately implement calls for broader management improvements.

The benefits that I outlined earlier have come from auditing about 60 percent of the government's budget authority and relatively few agencies on an overall basis. Currently, the CFO Act requires annual audited financial statements for revolving and trust funds and commercial operations of the 23 covered agencies. In addition, the act established a pilot program to test the viability of preparing and auditing financial statements for the entire operations of 10 major organizations. These pilots encompassed a range of government activities from the military services--Army and Air Force--to the revenue collection agencies--IRS and Customs--to cabinet departments such as HUD, Labor, Agriculture, and Veterans Affairs.

As a result of the act's limited scope, major segments of the federal government's operations have not had the benefit of a financial audit. In fiscal year 1993, this included:

-- about $85 billion appropriated to the Navy;

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

-- over $6 billion in Education's Pell grant programs;

-- more than $11 billion, or nearly 90 percent, of the Department of Justice's budget authority; and

-- over $16 billion, or about 62 percent, of Energy's annual obligations accounted for by its management and operating contractors.

To fill gaps such as these, we urge the Congress to expand the CFO Act's audited financial statement requirements. The Senate Committee on Governmental Affairs earlier this month reported a financial management reform bill, S. 2170, that would require CFO Act agencies to prepare agencywide audited financial statements. Our support for this legislation is based on the solid record of the CFO Act's pilots, which have been highly successful. Many benefits we have highlighted today and in previous testimonies have been generated from the pilot program. The Director of OMB agrees with this assessment and reported to the Congress last November that the pilot program has been successful.

In addition to OMB, the concept of financial audits is gaining support from agency leaders. For example, the IRS Commissioner expressed support for this concept last August in testimony before the full Committee. She stated that:

> "First and foremost, based on our experience with the recent GAO audit, we believe that all government agencies should prepare annual financial statements and have them audited. Our experience has been that the benefits of systematically identifying problems and measuring progress are truly significant. In addition, as I have stated earlier, the real value of audited financial statements is the comprehensive view they provide of the financial management issues that confront the IRS in effectively and efficiently running our operations."

We recently completed fiscal year 1993 financial statements audits at IRS, Customs, and Education and have been impressed by the commitment of these agencies to the CFO Act. Officials of these agencies have stated that the financial audits have been instrumental in helping them address significant financial management problems. For example, in comments on our 1993 audit, the Commissioner of Customs noted that the CFO Act audit had helped Customs identify solutions to serious financial management concerns and also helped develop a blueprint for sound management of resources for the future.

In addition, DOD officials are now showing real interest in addressing financial management weaknesses. In a February 1994 statement presenting DOD's fiscal year 1995 budget, the Secretary of Defense acknowledged "we need to reform our financial management. It is a mess, and it is costing us money we desperately need." DOD officials have stated that the savings possible through improved financial management was needed to sustain sufficient combat power.

Moreover, implementation of uniform requirements for audited financial statements has been a cornerstone of management improvement efforts of state and local governments and other countries. The state and local governments found that mandated annual audited financial statements were an important catalyst for achieving financial management improvements and producing quality information to assist decisionmaking, provide basic accountability, and track progress. Similarly, the success of other critical management reform initiatives, such as the Government Performance and Results Act of 1993, will rely heavily upon having accurate cost and financial data which only audits can ensure.

The CFO Act can be even more beneficial if audits are broadened beyond current guidance. In consultation with GAO, OMB also issued guidance on the form and content of federal financial statements and on auditing those statements. This guidance requires that auditors issue an opinion only on the financial statements to be augmented by reporting on the entity's (1) internal control structure and (2) compliance with laws and regulations. Because of the federal government's stewardship responsibilities to its citizens, this guidance emphasizes highlighting internal control problems and assessing how well organizations comply with applicable laws and regulations in delivering services to the American taxpayer.

Further, to help achieve the goals of the CFO Act, we believe the auditor should go beyond the existing audit guidance and determine the effects of any misstatements and internal control weaknesses on (1) the operations of the organizations and (2) the overall accuracy of other financial information--including budgetary and related program information--submitted to the Congress and other decisionmakers. In addition, unlike traditional private sector audits, we believe federal audits should identify the root causes of significant internal control weaknesses found and propose specific actions for correcting them, thus helping to improve operations and financial management.

Audited Governmentwide Financial Reports Needed

In addition to a permanent requirement for agency-level financial statements for all CFO Act agencies, we believe the time has come for an audited governmentwide financial report that would provide the Congress and the American public with a complete picture of where its government stands financially. The federal government is the world's largest financial operation. Yet, it operates without ever knowing its total financial picture--a situation that would be short-lived in either the state and local government environment or the private sector. While its mission is vastly different, the federal government also has a responsibility to provide meaningful governmentwide financial reports.

The administration's National Performance Review (NPR) calls for a consolidated annual report on the finances of the federal government and established 1997 as the first year to have the government's financial statements audited. In addition, NPR calls for Treasury to prepare another report by 1995--a simplified version of the consolidated statements--referred to as the "Annual Accountability Report to the Citizens"--for distribution to the public so that it receives an accounting of the monies spent and the effect on achieving goals.

With information that brings together in one place the results of operating each agency's program, decisionmakers would have the tools to (1) better understand the issues government faces and the implications of the decisions it makes, and (2) better manage scarce resources once those decisions are made. The government cannot be counted on to make sound decisions based on a financial information vacuum. To fill the void and make decisions in an informed manner, the right financial data must be in the hands of decisionmakers--the Congress and other top administration people--who are expected to make the hard choices affecting the lives and livelihoods of every American citizen.

In large part, the answer lies in having available agency-level financial statements, but the missing link continues to be financial statements that show a composite snapshot of financial results across government. Consolidated governmentwide financial statements would provide a wealth of critical information about government that is not available anywhere else and go well beyond what would be prepared if the requirement for financial statements were limited to agency-level reporting.

The American public wants to believe in our government and trust its decisions. In the taxpayers' eyes, there is no substitute for credibility and accountability. Reliable consolidated governmentwide financial reports that are easy to understand could provide the high-level credible information needed to help restore confidence in government.

These annual reports, which GAO would audit each year, would provide needed information to the Congress and the executive branch in assessing the government's financial status. It is most important that these reports be developed in a manner that assures that they are useful to the Congress and the executive branch and understandable by the public. Among the questions that could be answered by these reports would be whether the government's financial position improved or deteriorated over the period and whether future budgetary resources are likely to be sufficient to sustain public services and meet future obligations as they come due.

We believe it would be best for this requirement to be anchored in legislation. While administrative requirements to prepare annual financial statements go back to the 1950s, the legal force of the CFO Act, together with the interest of this Subcommittee, is what finally moved this effort ahead. We look forward to working with this Subcommittee as it considers such proposals. These actions are critical to once and for all provide the proper financial perspective to the Congress and the American public. Moreover, they are essential to rebuilding public confidence that the federal government can be accountable.

COSTS OF CFO ACT IMPLEMENTATION ARE SMALL WHEN COMPARED TO RESULTS

The CFOs and IGs have concluded that the benefits of preparing and auditing financial statements far outweigh the costs. Based primarily on OMB estimates, the total costs of the CFO Act requirement for the preparation and audit of financial statements for fiscal year 1992 was about $111 million, or only about .01 of 1 percent of total budget authority audited. In estimating these costs, OMB recognized the difficulties inherent in accumulating such costs:

> "First, the data in each agency generally come from different data bases. Second, the activities for the preparation and audit of financial statements for a fiscal year occur in that fiscal year and the next fiscal year. Third, much of the CFOs' costs to meet this statutory requirement are not new costs. CFOs are responsible for maintaining their agencies' financial data and preparing financial statements, regardless of the statutory requirement for audited financial statements."

Table 1 shows the costs of preparing fiscal year 1992 financial statements and performing the related financial statement audits for each of the 10 pilot agencies, and for over 150 revolving funds, trust funds, and commercial activities covered by the act. This information is not yet available for the fiscal year 1993 audits.

Table 1: Reported Costs of Preparing and Auditing CFO Act Financial Statements in Fiscal Year 1992

REPORTED COSTS OF PREPARING AND AUDITING CFO ACT FINANCIAL STATEMENTS IN FISCAL YEAR 1992

DEPARTMENT/AGENCY REPORTING ENTITY	AUDIT COSTS (in millions) Preparation **	Audit***	TOTAL AUDIT COSTS (in millions)
DEPARTMENTS/AGENCYWIDE PILOTS *			
HHS	$3.3	$2.8	$6.1
Defense	2.5	29.7	32.2
Agriculture	2.2	6.0	8.2
Veterans Affairs	0.7	2.2	2.9
Labor	1.2	5.3	6.5
HUD	3.9	1.9	5.8
Treasury	2.8	12.5	15.3
GSA	0.2	0.9	1.1
SUBTOTAL	16.8	61.3	78.1
15 Other Departments or Agencies	7.6	14.5	22.1
Total Direct Costs	24.4	75.8	100.2
Indirect Costs	5.9	5.0	10.9
TOTAL COSTS	$30.3	$80.8	$111.1

* The CFO Act mandates that 10 departments/agencies serve as "pilots". All but HHS, Defense, and Treasury were departmentwide audits. Within these Departments, the agencies audited included Social Security Administration, the Army, the Air Force, the Internal Revenue Service, and U.S. Customs Service, respectively.

** Source: The June 30, 1993 Council Operations Group Committee on Financial Statement Preparation and Audit Report

*** Source: The President's Council On Integrity and Efficiency August 1993 Report and the Office of Management and Budget's November 17, 1993 Report on the Preparation and Audit of Financial Statements

In the past, not all funds requested for preparation and audit of financial statements have been provided. We reported in December 1992[3] that the Congress appropriated about $57 million in funding for the preparation and audit of the fiscal year 1991 financial statements--about two-thirds of the amount requested by the administration. For fiscal years 1992 and 1993, while numerous financial audits were performed each year, agencies generally did not separately identify their funding needs for the preparation and audit of these financial statements.

There are additional facts to consider when analyzing audit costs. IGs often perform work that is similar to that done in a financial audit that could be incorporated into the audit, allowing this type of work to be deferred and in some instances eliminated. Also, in several instances, savings attributable to audit findings exceeded the costs of the audits. These savings and many other benefits produced by financial audits are the primary reasons that sufficient funding and strong support for audited financial statements are essential.

Costs of Individual Audits Are Expected to Decline

Historical audit experience in both the public and private sector shows that the costs of preparing and performing audits of federal financial statements should substantially decline in the future. The costs of conducting some audits has already declined based on recent reports by the IGs and CFOs. The President's Council on Integrity and Efficiency's August 1993 report by the IGs stated that

> "[T]he first year or two of an audit traditionally costs more than subsequent years because the auditor must obtain an understanding of the reporting entity's operations, identify the controls in place, and establish reliable beginning balances. Audit costs have already begun to decline for several audits initiated in fiscal years 1990 and 1991."

The costs of our recently completed fiscal year 1993 financial statement audits at IRS, Customs, and Education's Federal Family Education Loan Program declined by at least 40 percent from the fiscal year 1992 costs. For all three of these entities, fiscal year 1992 was the first year that the agencies prepared comprehensive financial statements. Other examples of cost savings in subsequent audits of federal agencies or programs follow.

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[3]Transition Series: Financial Management Issues (GAO/OCG-93-4TR, December 1992).

-- At Agriculture, an agency with several years audit experience, the IG planned to reduce 1993 audit costs by over $1 million from fiscal year 1992 audit costs.

-- The fiscal year 1992 audit costs at the Social Security Administration decreased by over $100,000 from fiscal year 1991 audit costs.

In addition, with regard to the costs of preparing financial statements, the CFO Council Operations Group reported to OMB in August 1993, that

> "[M]ost CFOs report that they expect financial statement costs to gradually decline as their agencies move further along the experience curve of preparing the statements."

This reduced cost should result from improved records and more capable personnel at the agencies. Some agencies have already had declines in their costs of preparing financial statements after the first year's efforts. For example, according to the PCIE report, the Department of Justice reported that the cost of preparing statements decreased from about $590,000 for fiscal year 1991 to about $272,000 for fiscal year 1992. In addition, officials at the Department of Veterans Affairs informed us that its costs of preparing financial statements amounted to $472,000 in fiscal year 1993. This represents a decline of more than 30 percent, from their fiscal year 1992 cost of $685,000.

OMB'S LEADERSHIP IMPORTANT TO CFO ACT'S SUCCESS

The role of OMB and its capacity to carry out its broad management mandate is critical to the success of CFO Act implementation. In compliance with the CFO Act, OMB (1) established positions for a Deputy Director for Management and a Controller to head its new Office of Federal Financial Management and (2) submitted combined government-wide financial management status reports and 5-year plans to the Congress in April 1992 and August 1993, respectively.

In March 1994, OMB announced a major reorganization, that is intended to more closely link OMB's management and budget functions. This reorganization was based on a management study called OMB 2000. The heart of the new organization consists of five new Resource Management Offices (RMOs) that are responsible for budget and management functions of their assigned agencies. These RMOs report to both the Deputy Director and the Deputy Director for Management. The new organization retains the three existing statutory offices: the Office of Information and Regulatory Affairs, the Office of Federal Procurement Policy, and the Office of Federal Financial Management (OFFM). The RMOs will be staffed by former members of the budget program divisions as well as some staff from the general management and statutory offices.

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. For example, because most of the cash/credit management function involved direct work with the agencies, the responsibility for this function was switched from OFFM to the RMOs.

There are potential benefits to better integrating OMB's budget and management functions. We stated in our OMB management report in 1989 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".[4] The CFO Act calls for integration of budget and financial management information, and NPR's report on improving financial management said that budget, program, and financial information should be fully integrated.

I am aware that concern has been expressed over reduced staff assigned to OFFM. However, the overall impact that the reorganization will have on CFO implementation, as well as other OMB responsibilities, will depend on how the reorganization is carried out. The reorganization was recently announced and the implementation initiated. The reorganization plan calls for training current OMB staff in broader management responsibilities and hiring new staff experienced in public sector program management. Consolidation of the budget and management functions at OMB has been tried before, but without success; the management function was neglected. This could happen again unless the OMB Director acts strongly to ensure that a proper balance between management and budget is maintained. We will monitor the reorganization implementation to assess its impact on the CFO Act and other OMB management responsibilities.

We continue to be concerned that the Deputy Director for Management and the Controller positions have not been filled. While the administration recently submitted a nomination for the Deputy Director for Management position, that position has been vacant for the past 6 months. The administration also urgently needs to appoint a highly qualified Controller to head OFFM. Since its creation in November 1990, this Controller position has been vacant over half of the time, including the past year. A strong Controller within OMB is critical to provide much-needed CFO Act leadership. The fact that these positions have been vacant has, in

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

our judgement, slowed the momentum for change that was building up and has hindered progress. Politically appointed leadership in these critical management and financial roles is vital.

KEY TO CFO IMPLEMENTATION IS WITHIN THE DEPARTMENTS AND AGENCIES

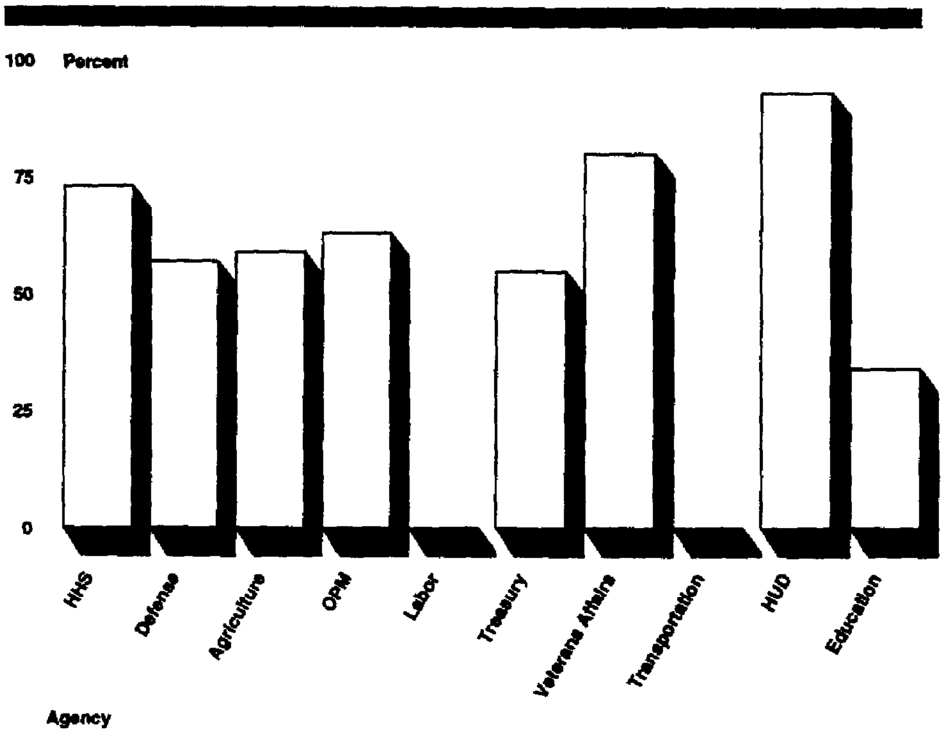
Although support from OMB is important to achieving success under the CFO Act, effective implementation at the department and agency level is essential. The administration must give high priority to financial reform, and be supportive of appointments of highly qualified CFOs. The act requires that CFOs "possess demonstrated ability in general management of, and knowledge of and extensive practical experience in financial management practices in large governmental or business entities." However, many CFO positions have been filled less than half the time, and those in Justice and Labor have never been filled. Appointment of highly qualified CFOs in all departments and agencies is fundamental to the success of the CFO Act.

CFO Appointments

The act provided for the appointment of chief financial officers with broad authorities in each CFO agency. The CFOs are to report to the agency head and are to be responsible for developing and maintaining integrated agency financial management systems and directing all aspects of agency financial management operations, including preparation of the agency's annual report to the agency head and OMB. In addition, we believe that the CFO should have budget formulation and execution responsibilities. However, CFOs at 3 of the 23 agencies covered by the act do not have budget formulation responsibilities.

Overall, since the CFO Act's enactment to June 1994, the 23 departments and agencies had CFOs only about half the time. Figure 1 shows the percent of time that the 10 pilot agencies covered by the act have had CFOs in place since the act's passage.

Figure 1: Percent of Time 10 Pilot Agencies Had CFO in Place—November 1990-June 1994



Source: Office of Management and Budget

Need for Qualified Financial Management Personnel

The need for qualified financial management personnel to carry out the act's requirements has been recognized by GAO, OMB, and the Congress. In our 1992 Financial Management Issues transition report, we pointed out that well-qualified financial management personnel were critical to carrying out the act's requirements[5]. In April 1992, OMB reported that well over half the agencies' CFOs believed that staff capabilities needed to be strengthened in the areas of financial systems, financial operations, and financial policy. Recognizing the limited opportunities to enlarge the size of existing staffs, CFOs must concentrate on training and other forms of continuing professional development for existing staffs. The full Committee's report accompanying the CFO Act said that 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.

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[5] Transition Series: Financial Management Issues (GAO/OGC-93-4TR, December 1992).

OMB has reported that a wide variety of training and continuing professional development opportunities have been provided for the CFO community and others who are or should be involved in financial management. For example:

-- Training has been offered on the form and content of financial statements for more than 800 CFO staff and others.

-- The Department of Treasury, the PCIE, and the Inspector General Auditor Training Institute have sponsored a variety of training programs including auditing agency financial statements for 325 auditors.

The CFO Council's Human Resources Committee is working with faculty and staff of the U.S. Department of Agriculture Graduate School and George Washington University's School of Business and Public Management to develop financial management curricula. In addition, since the act's passage, we have trained about 1,000 IG staff and other agency staff in performing financial audits.

We are concerned that an even higher level of training be provided. For example, we need to have courses with better technical content and a continuing education requirement should be imposed. Developing qualified financial management personnel is pivotal to effective CFO Act implementation.

FASAB MOVING FORWARD ON ACCOUNTING STANDARDS

In addition to actions taken directly by OMB and the departments and agencies, the Federal Accounting Standards Advisory Board (FASAB) established by OMB, the Treasury, and GAO,[6] has recently made significant strides to accelerate its standard setting process and is working toward the March 1995 NPR established deadline to issue a comprehensive set of federal financial standards. This is a short timeframe in comparison to the time it has taken other accounting standard setting groups to reach consensus.

Consistent with the CFO Act's objective of bringing about more effective financial management practices in the federal government, FASAB has initiated efforts to broaden the concept of financial

[6]The Board was established in October 1990 by a memorandum of understanding signed by the Secretary of the Treasury, the Director of OMB, and the Comptroller General. Its mission is to recommend accounting standards after considering the financial and budgetary needs of congressional oversight groups, executive agencies, and other users of federal financial information.

reporting to consider the needs of users who rely on financial information to make decisions. Specifically, in July 1993, FASAB issued a concept paper recommending a more comprehensive framework for agency financial reporting aimed at assisting users of federal financial information in determining how well the government is doing in terms of (1) whether funds were spent in accordance with applicable authority, (2) the operating performance of its programs, (3) its basic stewardship responsibilities, and (4) the status of its systems and controls.

The Board has also issued three statements of accounting standards recommending broader concepts of accountability in 16 separate areas.[7] In addition, it is currently developing a recommended cost accounting standard for the federal government. These efforts will be key not only to fully implementing the CFO Act, but also to measuring the true cost of government products and services, which will be necessary to implement the Government Performance and Results Act.

The September 1993 NPR report on financial management recommended an ambitious schedule for issuing cost accounting standards by December 31, 1994, and a comprehensive set of federal financial accounting standards by March 1995. As has been demonstrated by the private sector accounting standards boards (the Financial Accounting Standards Board and the Government Accounting Standards Board), standard setting is time-consuming and difficult. Despite the difficulties of this task, FASAB may be able to satisfy the NPR deadlines. I am cautiously optimistic that these deadlines can be substantially met to the extent that all needed standards will be proposed for public comment by Spring of 1995. I am confident the Board will be able to make substantial progress in this timeframe. Doing so, however, will require a high level of commitment on the part of FASAB members.

The standards to be proposed by FASAB are likely to satisfy the objectives of federal financial reporting identified at the beginning of its standard setting process. If they do so, the standards will provide the basis for reporting on operating performance and stewardship, and on the relationship of that information to the budget. There will be a number of controversial issues to resolve, including the definition of capital, which,

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[7]Statement for Recommended Accounting Standard No. 1, Accounting for Selected Assets and Liabilities, December 15, 1992; Statement of Recommended Accounting Standard No. 2, Accounting for Direct Loans and Loan Guarantees, July 15, 1993; Statement of Recommended Accounting Standard No. 3, Accounting for Inventory and Related Property, July 30, 1993.

under the terms of the CFO Act, may only be issued after a 45 day congressional review period.

While FASAB is working towards meeting the deadlines, the amount of progress achieved during the next several months will be telling. During this period, FASAB will be finalizing proposed standards for liabilities, physical assets, revenue, and cost accounting. The question is not only how quickly FASAB can come to agreement on the many controversial matters inherent in these difficult issues, but also what the reactions will be to the Exposure Drafts on these issues, which will be circulated widely for comment after the Board has reached agreement. Standard setting is a continuous and dynamic process. NPR has given the Board a challenge that we in GAO welcome, and we will work hard to support FASAB to develop these urgently needed standards.

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Mr. Chairman, this concludes my statement. We are at a critical juncture in our national government as we address the need for real management reform and the clear message from the American people that they want a smaller, more responsive government. I view the environment today as a tremendous opportunity for change and look forward to working with the Subcommittee as it strives for a better managed government. I will be glad to answer any questions that you or other members of the Subcommittee may have at this time.

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