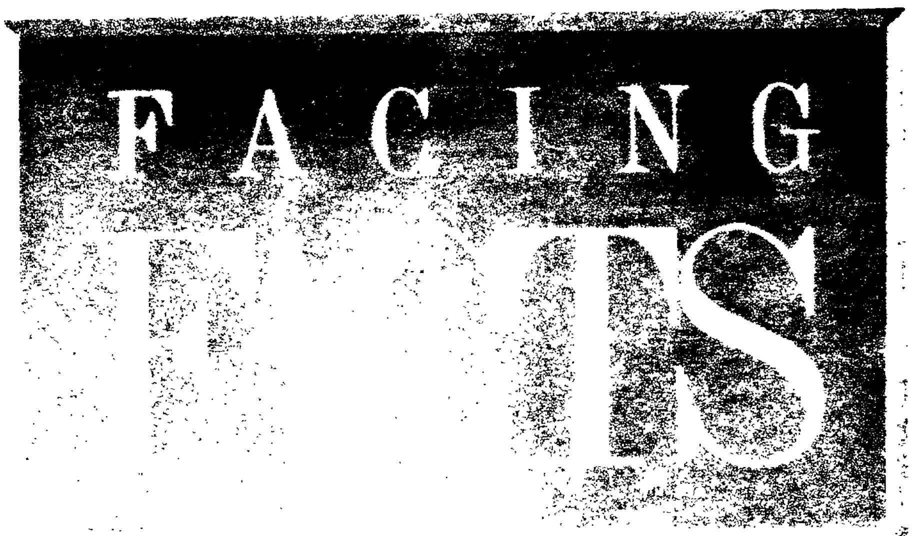
GAO

Comptroller General's
1989 Annual Report
United States
General Accounting Office



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A Message From the Comptroller General

This year's *Annual Report* is in some ways an extension of the series of 26 *Transition Reports* we prepared in November 1988 for the Congress and the incoming administration. Ranging from financial management to housing to transportation, the reports were designed to help policymakers focus on the major policy, management, and program issues now facing the government. We were pleased that Members, congressional staff, and incoming executive branch officials seemed to find the *Transition Reports* very useful; in a series of meetings with new cabinet heads, we found substantial agreement that the issues we raised were of great urgency for the nation.

One issue, in particular, stands out from the others, not only because it is the most difficult to resolve but because it so clearly cuts into our ability to resolve the others. That issue is the budget deficit.

"Facing Facts," the theme of this year's *Annual Report*, refers to the need to confront our most difficult problems and deal with them realistically. Nowhere is this need more immediate than in the budget. The debt burden is colossal—***$3 trillion***—and is increasing by about a quarter of a trillion dollars a year. Interest on the debt—$241 billion in fiscal year 1989—is our second-highest general fund expenditure, second only to defense and gaining fast. If defense spending goes down or just remains stable over the next few years while deficits continue to mount, the government will soon spend more on interest payments each year than on anything else.

As we have noted before and reiterate in the first section of this report, the official word is that the budget crisis is on the way to being solved. In fact, excluding the trust funds, the deficit is just as large today as when the Gramm-Rudman-Hollings deficit reduction process was begun in 1986. We can, indeed, solve the budget crisis, but to do so, we must recognize that it is a delusion to believe that the problem is already being solved.

Just as we must face the facts when it comes to the deficit, so must we begin to deal straightforwardly with other lingering problems that continue to drain us of resources we cannot afford to waste. Here are a few examples of where we are not facing the facts:

• We expect government to be accountable to the taxpayer, yet we allow federal agencies to operate without the basic internal controls and accounting systems necessary to run their programs and safeguard their assets. The scandal at the Department of Housing and Urban Development is a clear example of the dangers inherent when financial management is allowed to deteriorate.

• We pay a higher percentage of our Gross National Product for health care than any other industrialized nation—a price we cannot afford in a competitive world—yet leave millions of Americans without access to care.

• We spend billions attempting to design and install government computer systems necessary to meet current and future needs, yet wind up with systems that do not work.

• We have run a nuclear weapons complex so set on maintaining production that it brushed aside environmental and safety concerns. Now it is too contaminated and run-down to operate and has had to virtually cease production. It will require at least $100 billion to clean up.

None of these problems is what policymakers would call an "emerging issue." They have already emerged—and with a vengeance. The very fact that we come back to them again and again speaks to their seriousness and to the difficulty of resolving them. But the longer we delay, the more serious—and more costly—they will become.

THE PAST YEAR AT GAO

GAO's primary responsibility is to assist the Congress in its handling of the issues—to provide information and expertise and to point out areas in which improvements and cost savings can be accomplished. In 1989, we published 881 audit/evaluation reports, testified 217 times before congressional committees, and issued more than 3,800 legal decisions and opinions. We contributed to legislative and executive actions that resulted in about $8 billion in measurable financial benefits. The subjects we covered mirror the range of issues with which the Congress has been involved—or soon will be.

GAO reported on the Pentagon's five-year defense spending plan, the shortcomings of the B-1 bomber and the cost of the B-2 Stealth bomber, the balance of NATO and Warsaw Pact conventional forces, and the American military presence in Europe. Our staff traveled to El Salvador to report on the continuing conflict. We analyzed competition in the airline industry, the spread of AIDS, the concept of urban enterprise zones. We examined the treatment of the Social Security trust fund and underscored for the Congress the dangers of spending the trust fund on current government operations. We concluded general management reviews of the Office of Management and Budget and the Office of Personnel Management. We looked into information technology system failures at the Navy and elsewhere within the Department of Defense, and sponsored the first comprehensive symposium on information systems in government. We proposed a restructuring of the federal budget.

GAO not only reported on the potential costs of the budget crisis, the savings and loan rescue, and the cleanup of our nuclear weapons complex, but also alerted policymakers to other expenditures with which the nation will soon have to cope: an air traffic control system desperately in need of modernization at a cost of at least $25 billion; a crumbling infrastructure that includes 240,000 deficient bridges requiring $50 billion and highways requiring $300 billion over the next decade; run-down public housing that will cost $20 billion to repair; a prison system in need of $5 billion in new facilities; military installations where cleaning up hazardous wastes will cost $14 billion.

THE NEW CHALLENGES

Our work will continue to grow out of the spectrum of issues with which the government and the nation at large become involved. The United States finds itself in an increasingly competitive world, and will soon have to decide where to invest its resources to best promote the general welfare of its citizens and its standing among nations. This means reordering our priorities and reallocating our resources. With changes in East-West relations, it is likely that the competitive focus will move beyond military programs to other measures of national well-being: economic strength, agricultural productivity, technological innovation, education, health care, and the environment. There will be no shortage of challenges.

We can meet them all if we face them squarely. As for GAO, we will continue to examine the cost and effectiveness of federal programs on behalf of the Congress, to offer worthy policy options where we find them, and to urge improvement where we see the opportunity to do so.

Charles A. Bowsher

CHARLES A. BOWSHER
COMPTROLLER GENERAL OF THE UNITED STATES

THE PRICE OF THE DEBT

If federal deficits continue at their current rate, the national debt will rise by $1 trillion—to $4 trillion—in the next 4 years.

In 1975, interest payments on the public debt amounted to 13 percent of the general fund budget of the United States. In 1980, they totaled 17 percent. In 1989, they totaled 27 percent, or $241 billion. What this means, in other words, is that a quarter of the budget of the United States now buys *nothing*. It does not go to fight the war on drugs, or broaden educational opportunities for the young, or enhance the nation's security, or expand access to health care. It simply pays interest on a $3 trillion debt.

THE ENORMITY OF THE DEBT BURDEN

Just a decade and a half ago, the public debt stood at about $500 billion, one-sixth of what it is today. At the present rate of increase, it will soar by another $1 trillion—to $4 trillion—in just the next 4 years. Should we undergo a recession during this period, the loss of federal revenues will cause the debt to rise even faster.

This trend must not be allowed to continue. It drains us of resources we cannot afford to waste. It deprives our leaders of the flexibility to meet new challenges—in their response, for instance, to the emerging events in Eastern Europe. It inhibits their ability to initiate or expand needed programs, provide resources in times of emergency, or even maintain the level of investment in government necessary to provide the public with basic services. It affects our competitive position in the world, inhibiting, for example, investment in research and development. It forces the United States to borrow more from foreign lenders, which means that interest rates must be high to attract their capital. This, in turn, hinders the flexibility of policymakers to hold the value of the dollar at a low enough level to keep imports relatively expensive, make our export goods more attractive, and reduce our record trade deficits. In addition, Treasury securities sold to finance the debt soak up *trillions* in private savings that otherwise might be invested in American business and industry—in plant modernization and other activities that would lead to higher productivity and economic growth.

In one way or another, our growing public debt affects all of us. The lack of flexibility it imposes on the government affects the education of our children, our response to environmental challenges, and our ability to deal with such corrosive problems as drugs in our cities and housing for the poor and homeless. It hinders the ability of American industry to compete in world markets. In short, it costs us more than dollars. It costs us opportunities.

THE FACTS ABOUT THE DEBT

Public concern with the condition of our government's finances is more widespread than it once was, but still not what it should be. Perhaps this is because, by the government's own figures, the budget crisis has already begun to come under control. The deficit, $212 billion in 1985, was officially reported at $152 billion in 1989 and is supposed to shrink to $100 billion in fiscal year 1990 (the year that began Oct. 1, 1989). Under the Gramm-Rudman-Hollings (GRH) deficit reduction program, we are supposed to be on a course toward a balanced budget by 1993. In reality, however, we are not.

The official figures conceal the fact that the imbalance on the nontrust-fund side of the budget is actually larger today than in 1985, the year in which GRH was enacted. In 1985, the nontrust-fund deficit was $266 billion. In 1989, it was $276 billion.

How have the facts about the government's finances been concealed? By several means, including deficit projections that are based on overly optimistic economic forecasts and accounting gimmicks—such as moving paydays from one fiscal year to another—that are an embarrassment to all involved. But what most distorts the deficit picture is the merging of the operations of federal trust funds with expenditures for the rest of the government.

The Social Security trust fund now operates at a surplus of $53 billion a year, soon to exceed $100 billion a year. When the Congress decided in 1983 to raise payroll taxes, its intent was to build a trust fund to finance investments to support the retirement of the baby boomers in the next century. Instead, the Social Security trust fund—along with other federal trust funds whose surpluses amount to $71 billion a year—is being spent *right now* to run the government. For purposes of meeting GRH deficit reduction targets, the trust fund surpluses are counted against the federal operating deficit. The bottom line of this "unified" budget shows a shrinking overall deficit. But if we exclude the trust funds, it is apparent that the government is operating at a loss at least $124 billion greater than the official figures indicate.

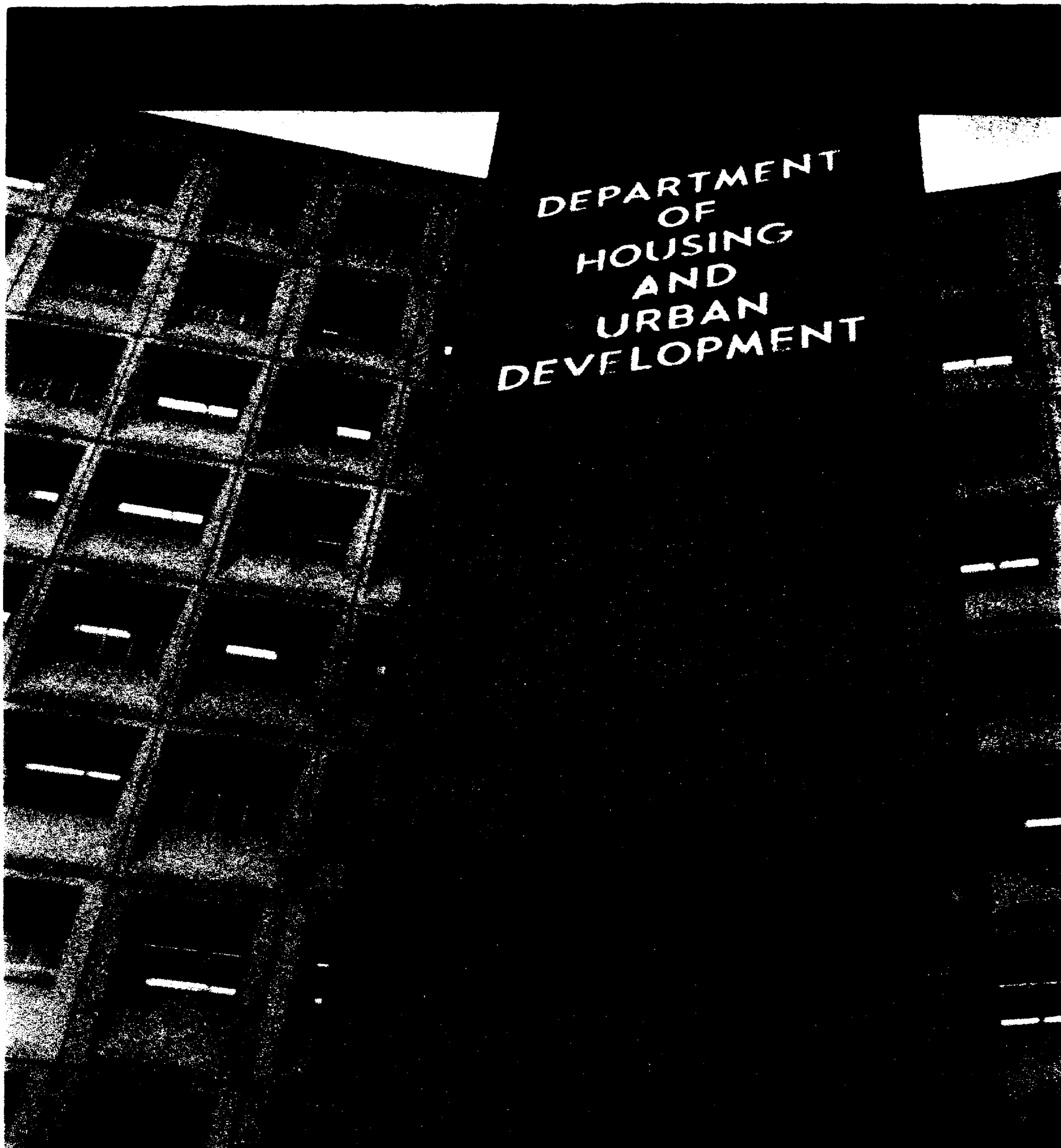
We are supposed to be making progress on the deficit. We are not. It is time to face this fact, and to act upon it.

A RESPONSIBILITY TO THOSE WHO FOLLOW US

The deficit problem can be solved. But the first step is to acknowledge, at long last, that without major changes in our spending and taxing policies, the problem will continue to grow. When we rely on optimistic forecasts and budgetary chicanery to create the appearance of a lower deficit, we only fool ourselves. And when we use the growing surpluses in the Social Security and other trust funds to offset the government's operating deficit, we only obscure the fact that the operating deficit is growing, too.

This year, GAO once again recommended against the use of trickery in budget making, and set forth an extensive proposal for restructuring the unified budget to reveal what's really going on—that is, to include separate subtotals for Social Security and other trust activities. Further, it would provide sections and subtotals for the government's business-type activities and investment activities.

GAO has also reiterated the need for a comprehensive, bipartisan budget strategy. Consensus and tough decisions are required if we are to straighten out our troubled finances and free ourselves to meet the enormous opportunities the times present us. Coming generations should not be deprived of these opportunities due to our negligence. They should not have to pay the price for our inability to get our financial house in order. For their sake as well as our own, we must begin to spend and tax more wisely. Doing so is our only means of returning the nation to fiscal health. ■



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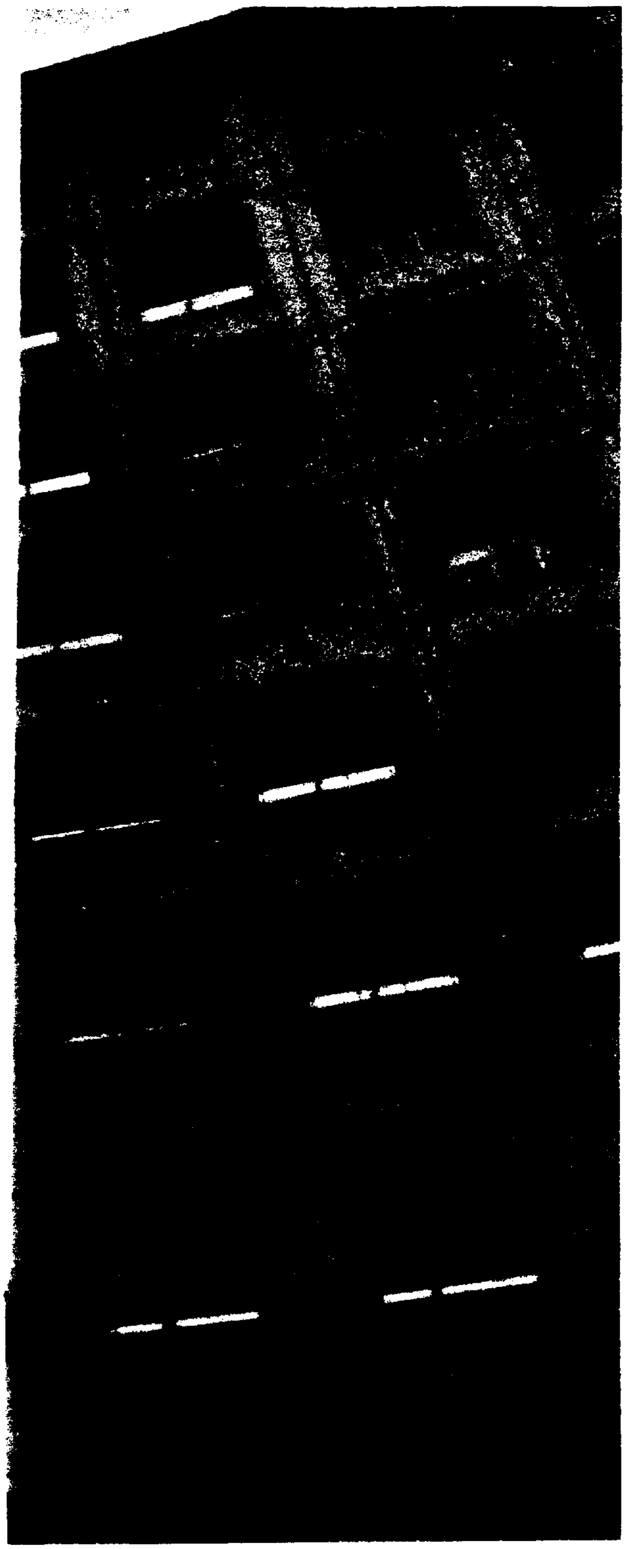

The disclosure this year of widespread abuses at the Department of Housing and Urban Development (HUD)—mismanagement, theft, favoritism, and influence peddling involving billions of taxpayer dollars—brought home an ugly fact: The U.S. government does not currently have the internal control systems necessary to effectively operate its programs and safeguard its assets. The problem is systemic. It is by no means confined to HUD, and the abuses at HUD are by no means the only ones that may eventually come to light.

Scandals like HUD's make big news. But what makes them possible is a situation less "newsworthy" but more far-reaching than any particular case of wrongdoing or mismanagement. Weak internal controls and second-rate accounting systems allow these incidents to happen. In 1987, for instance, HUD reported in its annual Financial Integrity Act report that inadequate controls in the property disposition process provided the potential for closing agents to manipulate or otherwise take funds for their own use. In 1989, a closing agent nicknamed "Robin HUD" testified that she had done just that.

Internal control weaknesses can lead to enormous losses; uncollected taxes, for example, now exceed $60 billion.

If the nation wants to prevent future scandals such as those at HUD, it must improve accountability from one end of the government to the other. The Federal Managers' Financial Integrity Act of 1982 (FIA) was passed with this very goal in mind. Yet, 7 years later, as GAO prepared its fourth report on the efforts of the 18 largest federal agencies to implement the act, it found that they still were falling far short of the mark. Annual FIA reports are required of all executive agencies. The latest reports reviewed by GAO—those for 1988—point out unresolved internal control and accounting system weaknesses over a broad range of functions and across all phases of government operations. The breakdown by category appears in the accompanying table. But while the numbers in the table reflect the proportion of agencies reporting internal control and accounting system weaknesses, they do not tell the whole story, because they do not reveal how costly these weaknesses can be.

Here are some examples:

- Fiscal year 1988 delinquent debts and taxes owed to the government amounted to about $89 billion. The Internal Revenue Service has seen its delinquent accounts receivable balance grow to about $60 billion—more than three times what it was in 1981.
- From 1980 to 1988, the value of unneeded secondary inventory items at the Department of Defense almost tripled, from $10 billion to $29 billion.
- In 1987, GAO reported that, in 1985 alone, Medicare paid at least $527 million in hospital costs that should have been paid by other insurers. In a November 1988 follow-up report, GAO noted that the Health Care Financing Administration, which runs Medicare, still had not acted on GAO's recommendations to strengthen internal controls.

The ongoing self-evaluations called for by FIA provide an early-warning system to alert agencies and the Congress to weaknesses that require correction. But, as

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at HUD, the warnings have not been heeded as well as they should. The uneasy question is: How many more HUDs are out there?

GAO'S RECOMMENDATIONS

The fourth major GAO report on FIA implementation was issued in November 1989. It urged the Director of the Office of Management and Budget (OMB) to ensure that agencies implement the July 1989 recommendations of the Internal Control Interagency Coordination Council, which included linking the FIA internal control review and reporting process to the budget; identifying, in annual reports, agency actions taken to correct weaknesses; and validating that corrective actions have been accomplished and are effective. GAO also recommended that OMB increase its oversight of federal agencies to ensure that they are effectively implementing the act.

In the same report, GAO urged the Congress to hold annual hearings on the actions of the 18 major federal agencies to evaluate their systems, correct the material weaknesses identified, and ensure that similar problems will not recur. Agency FIA reports, plans for actions to correct material internal control and accounting system weaknesses, and financial statements provide information that congressional committees can use when planning and conducting annual oversight hearings.

GAO also reiterated the need for legislation to establish a new approach to federal financial management, featuring the creation of a Chief Financial Officer of the United States whose responsibilities would include developing a long-range financial management improvement plan for the government, chief financial officers in each major agency, and a requirement for the annual preparation and audit of agency financial statements.

GAO'S PROGRAM

For its part, GAO is intensifying efforts to help the Congress and the agencies identify those "high-risk" programs whose internal control and accounting system weaknesses are most likely to result in material losses. These efforts will include:

- Identifying the major areas GAO believes to be most vulnerable;
- Focusing, in conjunction with agency managers and inspectors general, on the causes of serious long-standing weaknesses in order to develop approaches to solving them;
- Monitoring agency corrective actions and reporting the results to the appropriate congressional committees; and
- Recommending legislative action to ensure that corrective actions are taken.

Management deficiencies, program abuses, and illegal activities cost American taxpayers billions of dollars and undermine their confidence in government. This situation would be unacceptable under any circumstances, but it becomes a matter of utmost urgency when major problems loom and every dollar counts. ■

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With the passage last summer of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Congress has acted to resolve the nation's problem savings and loans and protect insured depositors. The 33-year cost of this legislation will exceed $250 billion, of which an estimated $139 billion will be taxpayer funds. This amounts to $2,100 for every family in the United States, and the price may go higher.

Earlier action would have cost less. But more disconcerting is that there probably need never have been an S&L crisis at all, had many S&Ls not abused the new powers granted them in the early 1980s, had oversight of the industry kept pace with the new powers, and had regulators acted sooner to shut down failed S&Ls. Today, an estimated 600 of the nation's 2,900 S&Ls must be closed or assisted.

We are faced now with the task of implementing FIRREA successfully. But we also need to ensure that other insurance and credit assistance programs backed by the government do not eventually, like the S&Ls, wind up on the taxpayer's doorstep.

The S&L deposit insurance fund, which started the 1980s with reserves of $5.8 billion, ended 1988 with a $75 billion deficit.

TOUGH QUESTIONS STILL FACE US

FIRREA provides funds to resolve the S&L crisis and protect insured depositors, limits the investment powers of S&Ls, increases regulation of the industry, and improves supervisory tools. The Federal Home Loan Bank Board, of which the Federal Savings and Loan Insurance Corporation (FSLIC) was a part, has been abolished. Its functions have been assumed by several new federal entities. The Office of Thrift Supervision within the Department of the Treasury becomes the S&L industry regulator. The Resolution Trust Corporation (RTC), managed by the Federal Deposit Insurance Corporation (FDIC), will act on failed S&Ls. And FDIC, long the insurer of the nation's banks, now assumes the insurance function for S&Ls as well.

So the mechanism to rescue the S&L industry is in place. But with it come some difficult questions:

• Can regulators and the industry rise to the occasion? RTC and FDIC have tough jobs ahead of them. S&Ls with more than $260 billion in assets will have to be dealt with; a cleanup of such unprecedented magnitude carries the potential for conflict and abuse. In addition, FDIC must tackle its new duties while still fulfilling its old responsibilities for the banking industry. As for the S&Ls themselves, they will have no easy time trying to meet new capital requirements and adjusting to the new legislative restrictions on their investment powers.

• How do we deal with the "moral hazard" problem of deposit insurance that, although necessary, allows managers of financial institutions to invest depositors' money, reaping the rewards of success themselves while handing taxpayers the price of failure?

• How do we prevent the problems of S&Ls from reappearing elsewhere in the financial services industry or other sectors of the American economy?

OTHER FEDERAL INSURANCE AND CREDIT ASSISTANCE PROGRAMS

The entire S&L experience raises another, potentially larger, question: that of the government's exposure to risk under other programs that may not be operating under the rigorous controls they deserve.

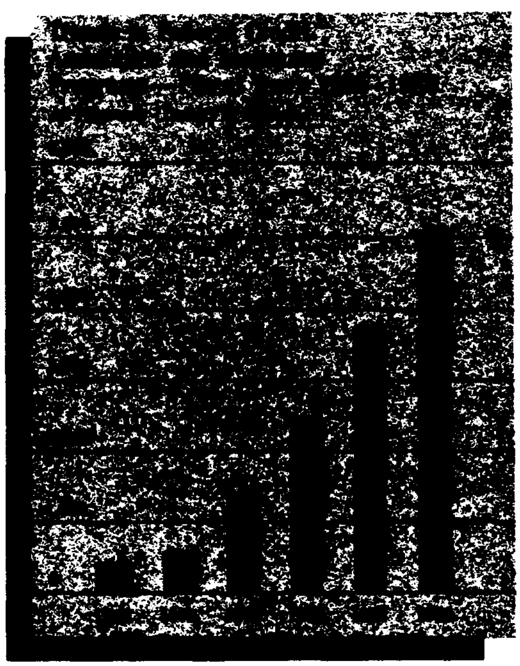
Just as the deposits in S&Ls were, and continue to be, backed by the "full faith and credit of the United States," a number of other insurance and credit assistance programs exist, each backed either explicitly or implicitly by the federal government. Each requires sound oversight, accounting, and financial reporting if we are to avoid repeating the S&L disaster.

These programs involve direct federal loans that by 1988 totaled $222 billion; privately held, federally guaranteed loans of $550 billion; loans by such government-sponsored enterprises (GSEs) as the Federal National Mortgage Association (Fannie Mae) and the Student Loan Marketing Association (Sallie Mae) of $666 billion; and insurance commitments, such as those covering bank deposits and pension benefits, of $3.6 trillion. The total: $5 trillion, or about a year's Gross National Product. While it should be emphasized that the government will face the obligation of making good on credit defaults or insurance guarantees in only a small percentage of this $5 trillion exposure, the risk for very substantial loss is real. In fact, covering the government's deposit insurance obligations for failed S&Ls is only the most dramatic example to date. During 1985 and 1986, for instance, the Farm Credit System (a GSE) lost $4.6 billion, which resulted in government guarantees and subsidized debt to enable the system to remain solvent. GAO anticipates additional tens of billions of dollars in future losses in other programs.

More troubling is the fact that the government does not know today the full magnitude of the losses already incurred. And as a result of deficiencies in financial management systems at some of the agencies administering these programs, it is not prepared to foresee the losses that may occur down the road.

Reporting in November 1989 on government insurance and credit assistance programs, GAO urged that their accounting and financial reporting problems be resolved and that financial statement audits be required of all of them. This would help ensure that actual losses are revealed as they occur, and help identify internal control improvements or policy changes that might reduce or prevent future losses. The report also urged that the estimated costs of these programs be reflected in the federal budget in the year in which the Congress makes the commitments that will result in future outlays. Finally, the report reiterated GAO's longstanding recommendation that the Congress establish a Chief Financial Officer of the United States, with equivalent positions in the executive agencies, to provide the organizational structure and discipline needed to help ensure the integrity and completeness of reported financial information.

As the Congress and regulatory entities tackle these issues, they will continue to rely on GAO for accurate and objective information. Through its legislatively mandated reports on such matters as deposit insurance reform, the risks facing GSEs, and the financial condition of the credit union industry, along with its annual financial audits of the deposit insurance funds and RTC and other work, GAO will continue to provide timely information not only on the progress and problems of the S&L rescue but on ways to avoid similar crises in the future. ■



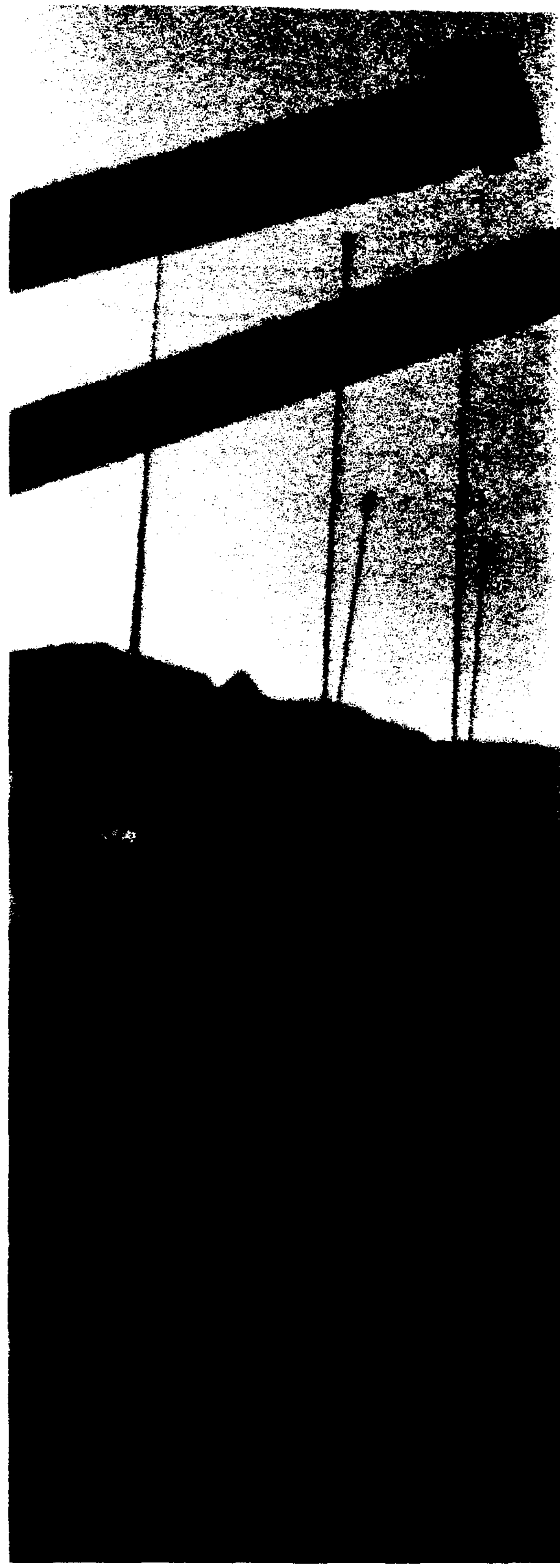
PLANNING FOR THE NATION'S DEFENSE

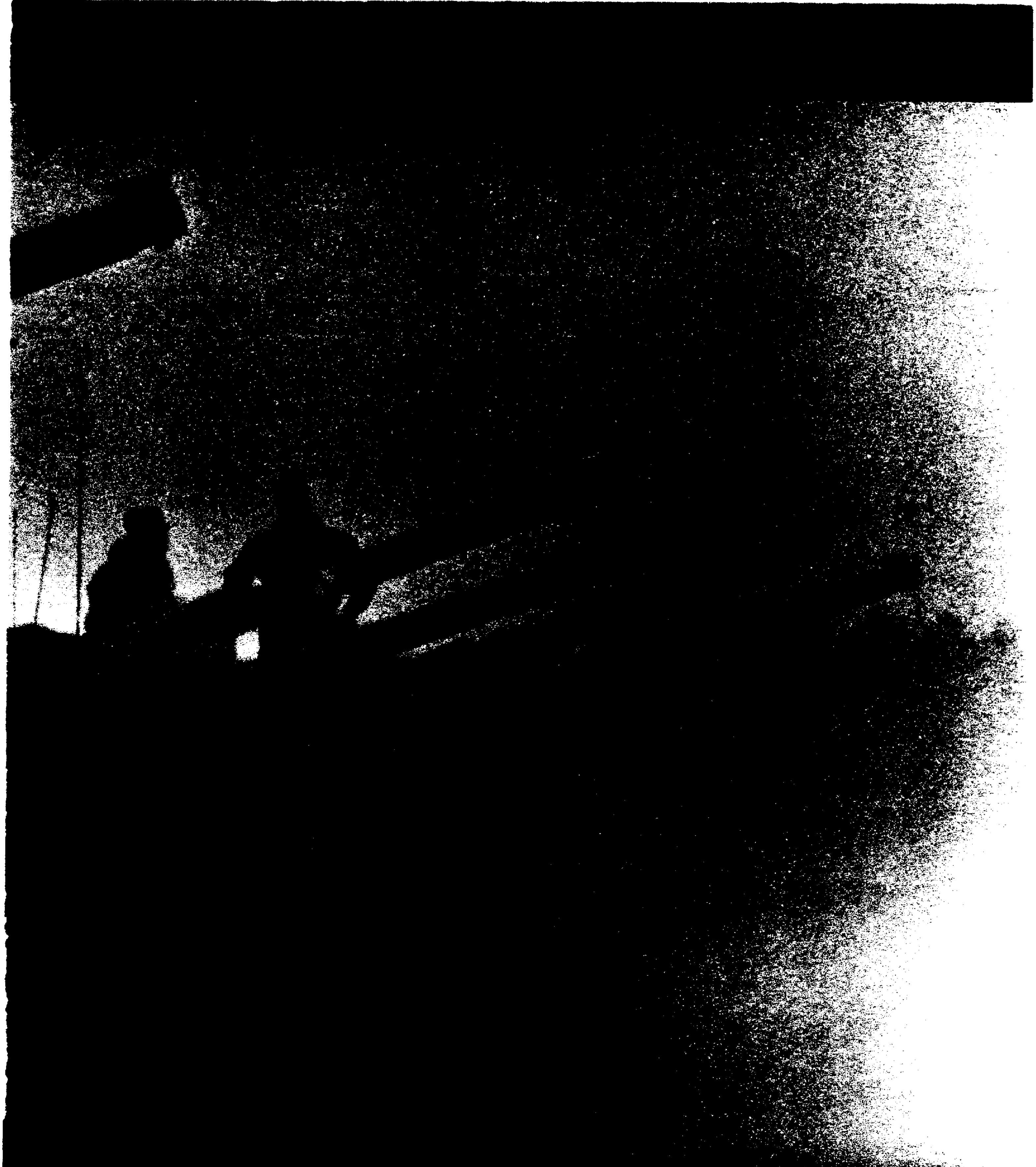
The Pentagon's 1990 5-year spending plan may exceed actual funding by at least $147 billion.

During the 1980s, the United States spent almost two and a half trillion dollars on defense. This past May, GAO testified on what the nation got for its money. "The increases in defense spending have clearly resulted in gains in overall military capability," GAO told the Senate Armed Services Committee. "However, these gains were not as great as they could have been for the money spent."

GAO reported that both the overall quality of our military personnel and our force readiness had been improved and that new and more capable weapon systems had been added to our arsenal. Sustainability—that is, the capacity of our forces to fulfill their commitments during wartime—had also been improved, although to a lesser extent.

A major reason more was not achieved is that defense decisionmakers have not planned realistically for funding and national security needs. Between 1980 and 1985, the defense budget doubled. Then two developments occurred that changed the world in which the Pentagon operates: soaring federal budget deficits put the squeeze on all spending—defense included—and progress in arms control negotiations and overall improvements in U.S.-Soviet relations brought about a general questioning of the Soviet threat.





"Acknowledging the financial constraints, and then setting funding priorities to best meet our national security goals, is the only route to realistic planning and stable budget levels."

The Department of Defense (DOD), however, assuming that the second half of the 1980s would be an extension of the first, prepared a 1986 5-year defense spending plan that exceeded actual funding by $561.4 billion. By then, DOD had more weapons either planned or under development than could be produced economically or supported once they were in place. As defense appropriations leveled off, adjusting to each year's new realities forced DOD into a game of catch-up: piecemeal decision-making, program funding instability, costly stretch-outs, and program terminations.

TOUGH CHOICES

DOD has begun adjusting to changing times. Its 5-year spending plans have been reduced by $374.9 billion since 1986. But GAO determined that the 1990 5-year plan as submitted in April 1989 was still unrealistic in its expectations. It included expenditures of $45 billion that did not appear in the President's budget. It understated the likely impact of inflation by nearly $48 billion. And it anticipated that the Congress would provide funds to cover inflation plus 1 percent real growth in both 1991 and 1992 and inflation plus 2 percent real growth in both 1993 and 1994. The plan made no provision for the growing probability of no real growth, which would force an additional $54 billion in cuts.

Add up these GAO estimates, and it appears that DOD will be forced to reduce its 1990 5-year defense spending plan by at least an additional $147 billion. Furthermore, it should be remembered that the plan was submitted before the recent developments in Eastern Europe. Clearly, the Pentagon faces some tough choices.

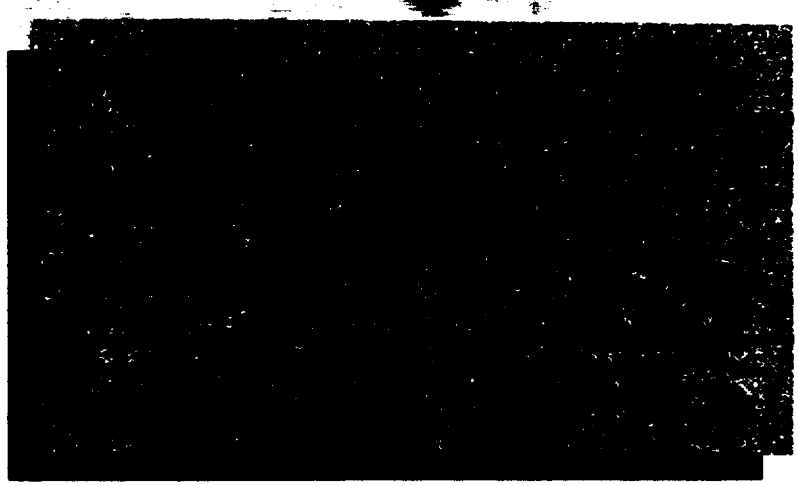
"Choices" means cuts and trade-offs among programs. Making the right long-term decisions will require a reexamination of some of the major elements of our national defense: the affordability and operational needs and capabilities of the "big-ticket" weapon systems, the level of our commitments in Europe and elsewhere, the requirements in both size and structure of our active forces, and the appropriateness of our war-fighting strategies and traditional service missions in a changing world environment.

The uninsured pose an especially troubling problem. Some do not have access even to the most basic services. One recent study found that children born to mothers without insurance faced a 30-percent greater likelihood of illness or death than those born to mothers with insurance. As GAO reported this year, hospitals with heart transplant programs have established financial criteria for admission; many patients are denied admission for financial reasons.

Even among the insured, major gaps in coverage can cause individuals to forgo needed care or to be wiped out by catastrophic medical expenses. For instance, GAO reported that for lack of coverage, families of children with chronic illnesses often have difficulty obtaining vital support services. GAO also reported on the gaps in coverage created by restrictions and limitations in many long-term-care insurance policies.

Access to care clearly entails more than just insurance coverage. Those with problems obtaining access face many barriers in addition to financial ones. For example, in an evaluation of the availability of health care at the Texas-Mexico border, GAO found that most counties had physician shortages and that several rural counties also lacked health facilities and emergency services. GAO also reported that AIDS patients face serious problems in obtaining services—especially nursing home and community-based care—due to shortages in capacity or lack of insurance. GAO is studying such key issues as the access of Medicaid recipients to nursing homes and the roles of nonprofit and for-profit hospitals in providing care to individuals who cannot pay.

Overall, access to health care will not improve without some control of health care costs. Yet not only have past cost control measures failed, some have



made access even more difficult. For example, the traditional way of financing indigent health care—that is, by shifting these costs to insured patients—has become more difficult now that insurance buyers have adopted more prudent buying strategies to control their own rising costs. Many states are trying to control their escalating Medicaid budgets while improving access to care, but in doing this, find that hard trade-offs are inevitable. For example, Oregon's plan to limit coverage to a list of "priority" services in order to extend benefits to more of the poor would improve access for some people and worsen it for others.

THE SYSTEM MUST BE SEEN AS A WHOLE

GAO believes that a major reason past efforts to control costs and improve access have not worked is that they have focused on separate parts of our decentralized health care system and have not recognized that the various problems and delivery subsystems are interrelated. Partial solutions, such as mandating employer-provided health insurance and increasing Medicaid eligibility, may eliminate financial barriers to care, but at the same time jeopardize jobs and increase overall spending on health care. Indeed, even if all Americans had health coverage, there is no assurance that services would be used appropriately, that they would be available, or that costs would not continue to rise.

We are spending more than ever on a health care system that is still insufficient to the needs of many Americans. Controlling costs and improving access nationwide may require the development of a comprehensive strategy, drawing upon public and private sectors alike. An imposing challenge, to be sure. But the enormity of the problem may demand it. ■

Bringing Order to Government Information Systems

For decades, the federal government has sought to harness information technology in hopes of modernizing operations and improving service to the public. The promise of computer technology is substantial; the performance of federal agencies in putting it to use has been a disappointment. Again and again, government information systems have not lived up to their advance billing. They are developed late, they fail to work as planned, and they cost millions—even hundreds of millions—more than expected.

The causes behind these problems are complex, but more often than not it has been faulty management, not faulty technology, that has led to failure. Agencies try to develop systems without clearly defining their functions. They set unrealistic goals, underestimate costs, and defer the tough decisions. The results, in missed benefits and misspent money, are to be found throughout the federal government.

Not one major government computer system reviewed by GAO has come in under budget or on time.

LACK OF PLANNING

The Federal Aviation Administration, for example, has struggled for years to modernize its air traffic control system. Yet the agency still lacks the information systems it will need to manage its future work load. Even now, air traffic controllers work with outmoded equipment that too often fails to provide them with critical airspace safety data.

Because of poor planning at the Social Security Administration (SSA), the public will have to wait years for a modern information system to meet the demands of the 1990s. At the Internal Revenue Service (IRS), where scenes such as the one in the Philadelphia Service Center (pictured) are not uncommon, a failure to specify appropriate development requirements has left in operation an antiquated tax return processing system whose design dates back 25 years.

As GAO has pointed out, neither SSA nor IRS has a clear strategic plan for linking its various information initiatives into a coherent system. The Congress has been left to wonder where each agency is going with information management, how long it will take to get there, and what the ultimate costs will be.

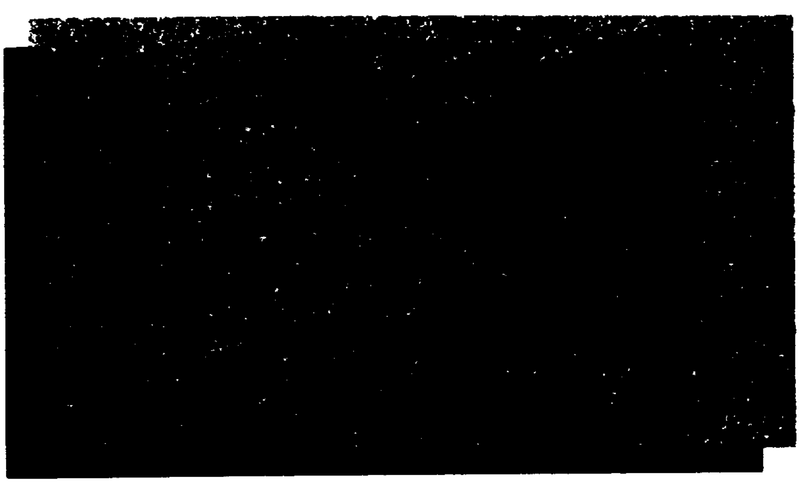
"An estimated 31 million Americans lack health insurance, millions more are underinsured, and many do not have adequate access to care."

made access even more difficult. For example, the traditional way of financing indigent health care—that is, by shifting these costs to insured patients—has become more difficult now that insurance buyers have adopted more prudent buying strategies to control their own rising costs. Many states are trying to control their escalating Medicaid budgets while improving access to care, but in doing this, find that hard trade-offs are inevitable. For example, Oregon's plan to limit coverage to a list of "priority" services in order to extend benefits to more of the poor would improve access for some people and worsen it for others.

THE SYSTEM MUST BE SEEN AS A WHOLE

GAO believes that a major reason past efforts to control costs and improve access have not worked is that they have focused on separate parts of our decentralized health care system and have not recognized that the various problems and delivery subsystems are interrelated. Partial solutions, such as mandating employer-provided health insurance and increasing Medicaid eligibility, may eliminate financial barriers to care, but at the same time jeopardize jobs and increase overall spending on health care. Indeed, even if all Americans had health coverage, there is no assurance that services would be used appropriately, that they would be available, or that costs would not continue to rise.

We are spending more than ever on a health care system that is still insufficient to the needs of many Americans. Controlling costs and improving access nationwide may require the development of a comprehensive strategy, drawing upon public and private sectors alike. An imposing challenge, to be sure. But the enormity of the problem may demand it. ■



"Agencies try to develop systems without clearly defining their function. They set unrealistic goals, underestimate costs, and defer the tough decisions. The results, in missed benefits and misspent money, are to be found throughout the federal government."

The military has had its share of problems, too. Cost estimates for the Navy's Standard Automated Financial System shot up as new requirements were added haphazardly. The estimates started at $33 million and moved to $479 million before the project was terminated entirely. The funds spent by then totaled $230 million.

The Air Force's aircraft supply system automation project is 4 years behind schedule and is expected to overrun the original $715 million cost estimate by nearly 40 percent. And after 8 years and $775 million, a modern replacement for the North American Aerospace Defense Command (NORAD) is still years away.

VISION AND COMMITMENT

The government's future information management systems—especially those for defense—will be far more massive and complex than the ones already in trouble today. Their costs will make the current $17 billion annual systems expenditure look relatively small. By the year 2000, when an estimated 75 percent of public transactions will be handled electronically, federal agencies will have no choice but to keep up.

Recognizing the scope of the problem and the need to draw together ideas from all quarters, GAO held a symposium this year called "Meeting the Government's Technology Challenge." It was the first gathering of leaders from industry, the executive branch, and the Congress designed to explore ways of charting a wiser course of action in this area. Several points emerged from the discussions:

- The key to integrating information technology into any federal agency is the vision and commitment of agency leaders. They must clearly define their agencies' information needs and work with the Congress to meet them.
- In partnership with the Congress, agencies should explore ways of bringing continuity to systems development, such as developing long-term strategies that can transcend personnel changes, and using advisory groups to provide consistent institutional memory.

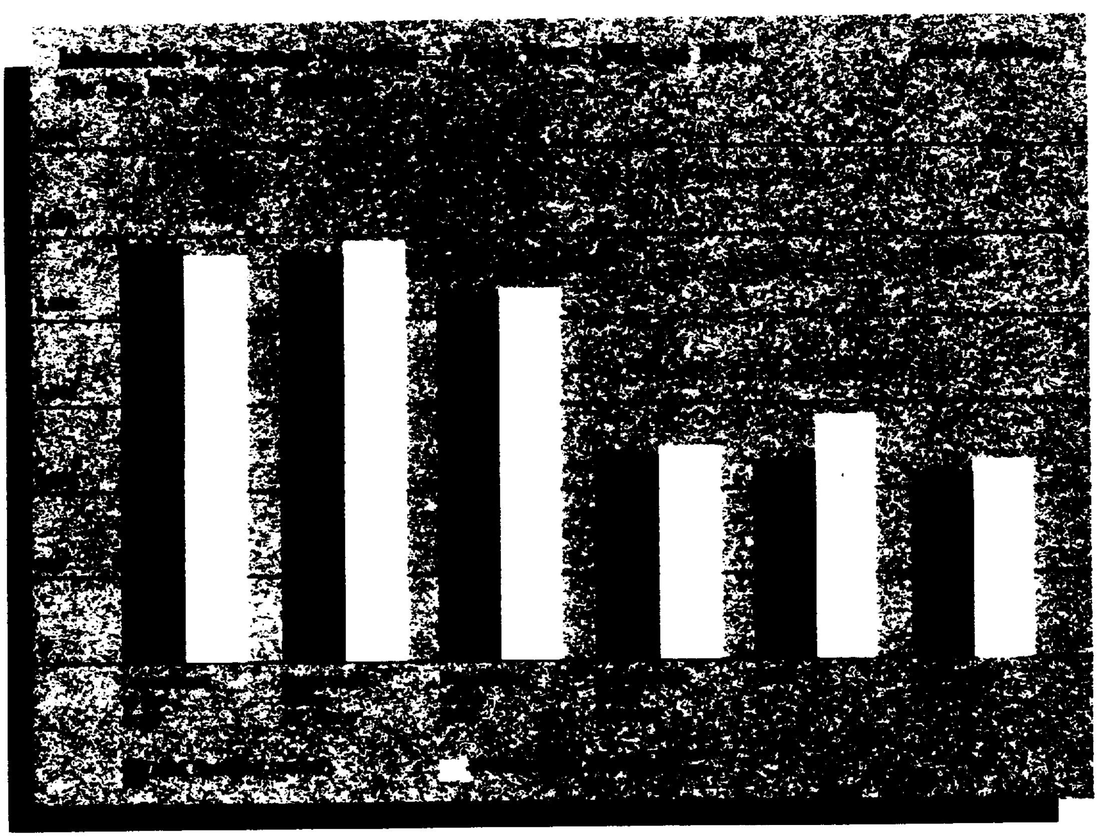
• Instead of simply automating old ways of doing business, agencies need to learn what technology has to offer—how it can help them accomplish their basic missions more effectively.

• Agency leaders need to surround themselves with the best advice available. They should make better use of advisory panels composed of government, industry, and academic experts, and form alliances with other federal agencies to find solutions to their common problems.

• Agencies must have the right people on the job. Agencies need both to devise creative ways of recruiting more technical expertise and to retrain their existing staff in what is a rapidly developing field.

NO TIME FOR CATCHING UP

Clearly, both the technology and the need to apply it will not wait for the federal government to catch up. System development problems are severe and growing worse. Vast sums are being spent on financial, human services, and defense information systems that fail to perform properly. Taxpayers are not receiving the benefits promised by system developers. And federal managers are not getting the programmatic and financial information they need to make sound decisions and better serve the public. The longer the government takes to bring some order to the development of information management systems, the worse—and more costly—these problems will become. ■



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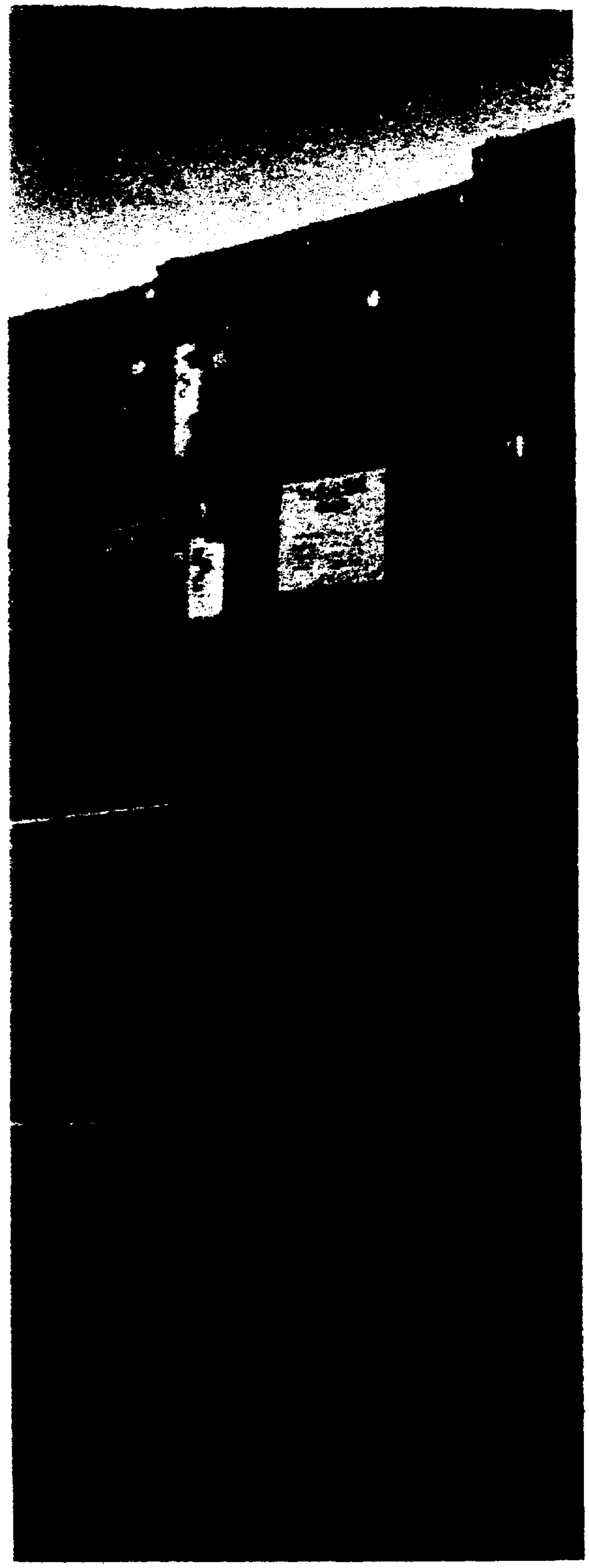
THE NUCLEAR CLEANUP

The United States began making nuclear weapons in the 1940s. In the years that followed, managers of nuclear arms facilities emphasized production almost to the exclusion of environmental and safety considerations. Over the past couple of years, many of the nation's nuclear weapons facilities have had to be shut down, too dangerous to operate. Today, we are faced with radioactive and other contamination that, according GAO's estimate, may cost as much as $65 billion to clean up, and we may never know the total cost in health and environmental damage. To modernize and improve safety at the facilities and bring them into compliance with environmental laws may cost an additional $90 billion. The production of nuclear weapons—which underlay the neglect of health and environmental concerns in the first place—has had to be put on hold.

Through more than 60 reports and testimonies over the past 10 years, GAO has been instrumental in focusing congressional and public attention on the Department of Energy's (DOE) management of the nation's nuclear weapons complex. DOE was not quick to concede that the complex was facing serious, mounting problems, and actively resisted outside scrutiny.



"The issue facing the nuclear weapons complex is one of finding the technological answers; of putting them into operation; and of summoning the money, effort, and resolve to make up for years of neglect."

Recent events have underscored the severity of DOE's situation: the forced shutdown of many of its facilities nationwide, including the nuclear weapons production reactors at its Savannah River, South Carolina, plant; the excessive—and previously unreported—releases of radioactive contaminants at its Fernald, Ohio, plant; and concern over possibly illegal waste disposal at DOE's Rocky Flats, Colorado, facility.

A LONG-STANDING PROBLEM

If a single theme underlay the growth of problems in the nuclear weapons complex, it was the lack of responsible management: too much decentralization, lack of internal controls, and insufficient independent external or internal oversight. Operations were kept secret, facilities were allowed to deteriorate, state-of-the-art safety technology went underused.

In August 1989, DOE for the first time issued a comprehensive 5-year plan to correct the environmental problems in the nuclear weapons complex and bring all operations into compliance with environmental laws. The plan sets a 30-year goal to have the problems resolved. It is an important first step. But, as GAO pointed out as recently as November 1989, DOE still does not know the extent of contamination at many of its facilities and, in fact, is not certain that it has identified all contaminated sites. Nor has the agency characterized all the contaminated sites by type and quantity of contaminant—a process to which current technology is inadequate and for which we may have to wait years. Only after the sites have been characterized can DOE develop specific, detailed plans to clean them up.

The keys to the 5-year plan's success will be a continuing commitment to its full implementation at DOE and its adequate funding by the Congress. GAO will continue to inform the Congress of DOE's efforts to modernize the nation's nuclear weapons complex and resolve the waste management and cleanup problems.

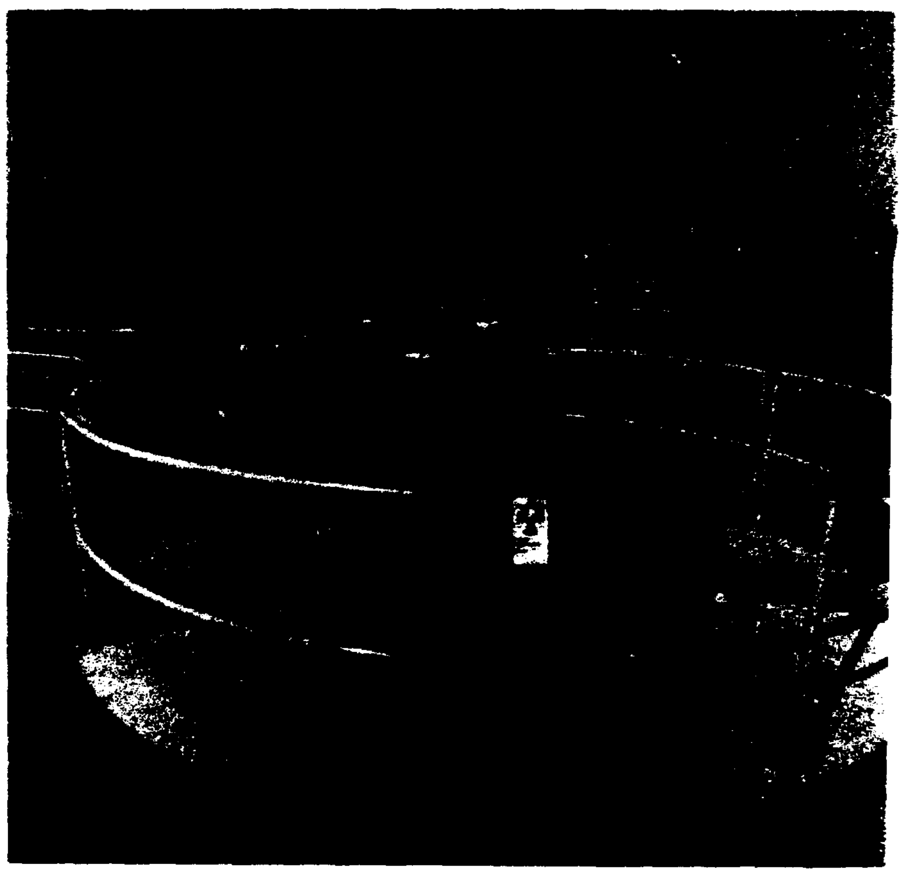
TIMING, TECHNOLOGY, AND POLITICS

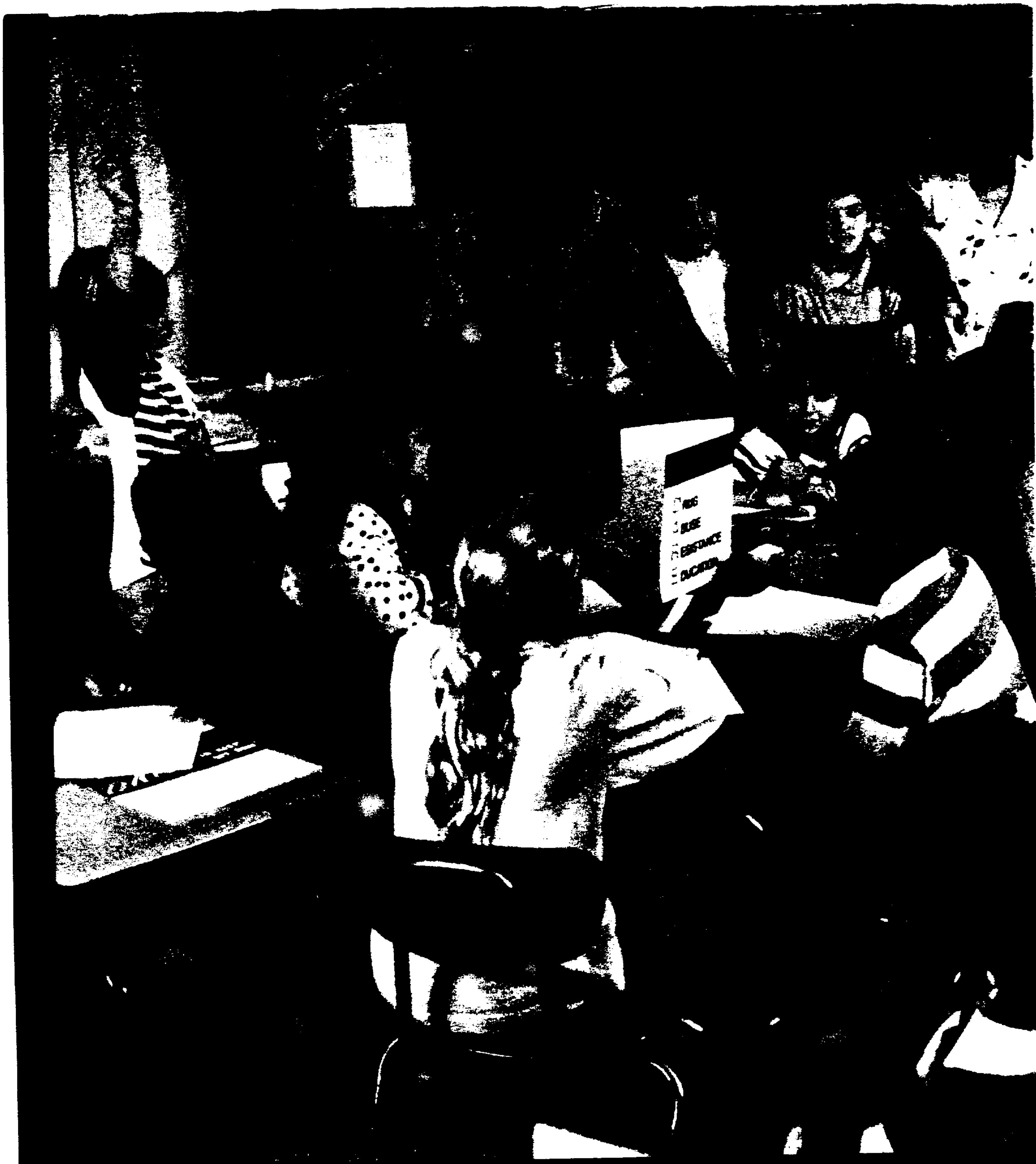
However strong DOE's new resolve may be, its cleanup program faces problems in timing, technology, and politics. For example, millions of cubic meters of *low-level* radioactive wastes are currently stored around the nation in stacked barrels or in open trenches awaiting permanent disposal. The agency's Waste Isolation Pilot Plant (WIPP) in New Mexico, designed to dispose of *mid-level* nuclear weapons plant contaminants called transuranic wastes, is not yet operational; DOE is still about 5 years away from demonstrating that the facility can meet environmental standards. Political opposition has been strong in Nevada, where DOE is exploring Yucca Mountain as a disposal site for *high-level* nuclear wastes of the sort produced not just by nuclear weapons facilities but also—and more extensively—by commercial nuclear power plants.

EARNING THE PUBLIC'S CONFIDENCE

The disposal of waste materials produced by commercial nuclear power plants is an unresolved issue on which the future of nuclear power may hinge. The fate of the commercial nuclear industry—the maintenance of what amounts to 20 percent of the nation's current electricity generating capacity and perhaps a larger share in the future—rests in large measure on DOE's ability to demonstrate to the public that nuclear wastes can be disposed of without posing a hazard to health and the environment.

The problem with environmental cleanup, as with the operation of nuclear weapons facilities and the disposal of the wastes they generate, is largely a technological one—one that was not addressed in the rush to put nuclear technology to use. Because DOE emphasized production, the technology for cleaning up or stabilizing radioactive contamination is years away from development. The issue is now one of finding the technological answers; of putting them into operation; and of summoning the money, effort, and resolve to make up for years of neglect. ■





"The enduring dilemma is that the drug war costs money and money is scarce. Trade offs will be necessary between the lengthy list of possible improvements in prevention, treatment, research, and education programs on the one hand, and law enforcement and international drug control programs on the other."

So urgent have been the nation's efforts to resolve the problem of illegal drugs that we often speak of the "drug war." Most of our resources in this war have been devoted to fighting the most conspicuous enemy: the drug suppliers. In 1988, for instance, the federal government applied $1 billion to demand reduction—treatment of drug addicts, research into the causes and characteristics of drug abuse and addiction, and prevention of drug abuse through education. But three times that amount went to supply reduction: domestic investigations and prosecutions of drug traffickers, attempts to interdict drugs being smuggled into the country, and international drug control.

Economists estimate the total cost of illegal drugs to American society at more than $60 billion annually.

Yet the fact remains that the war continues: The federal antidrug strategy has not worked. Illicit drug production in foreign countries remains at high levels, with plentiful supplies available for export to the United States. Only a fraction of the drugs smuggled into the country are intercepted. And the enormous profits available through drug trafficking continue to attract an endless stream of entrepreneurs who know opportunity when they see it.

If federal antidrug measures indeed constitute a kind of war, for years it has been a fragmented and uncoordinated campaign without much in the way of oversight or leadership. But with the establishment of a Director of National Drug Control Policy (the "drug czar") in 1988, the Congress established a single position accountable for planning and coordinating federal drug control strategy and policy. This was a step GAO had long advocated.

The President's National Drug Control Strategy, developed by the Director of National Drug Control Policy and unveiled in September 1989, still gives high priority to law enforcement efforts to reduce the supply of drugs. But it places emphasis on reducing demand as well—both by calling for penalizing drug users and by increasing funding for treatment and prevention programs.

The enduring dilemma, however, is that the drug war costs money and money is scarce. Trade-offs will be necessary between the lengthy list of possible improvements in prevention, treatment, research, and education programs on the one hand, and law enforcement and international drug control programs on the other. For example, the nation's criminal justice system at all levels—federal, state, and local—is already strained to the breaking point. Drug-related crime and violence are overwhelming police departments, courts, and prisons. Yet criminal justice system problems cannot be addressed in isolation from other facets of the drug war: Spending more on prisons, for instance, may mean that less money is available for drug treatment and prevention programs.

That the nation is fighting a "war" should not lead us to ignore the need for long-term programs that address the social and economic conditions that provide fertile ground for drug abuse. Poor Americans and members of racial minorities are among those at greatest risk. Even restoring law and order to our drug-plagued inner cities and providing treatment for drug users and addicts will have little permanent effect if we cannot help inner-city residents find decent jobs and the access to good education, housing, and health care that most Americans already enjoy.

GAO'S INVOLVEMENT

At present, GAO's work includes evaluations of both short-term efforts on the immediate impacts of the drug crisis and longer-term programs with the potential to alleviate the problem over time. GAO is addressing efforts to reduce the supply of drugs, including domestic drug law enforcement, drug interdiction, and international drug control programs; the role of the military and national intelligence community in the drug war; and efforts to reduce the demand for illegal drugs, including prevention and treatment programs. As part of its future work, GAO will examine the long-term efforts needed to address the social and economic conditions contributing to the nation's drug problem, including early childhood intervention programs. One goal of GAO's future work will be to evaluate the effectiveness of the National Drug Control Strategy and the success of the Director of National Drug Control Policy in planning, implementing, and coordinating the strategy's components. Among GAO's objectives will be to determine which antidrug policies and programs are effective and how antidrug policies and programs can be improved. GAO will focus, as well, on improving measures of drug program effectiveness so that the Congress and the administration can make the best possible decisions with scarce resources. ■

GAO OPERATIONS

INTERNAL CONTROLS

GAO maintains a system of internal controls over its operations. The system is designed to provide reasonable assurance, at an appropriate cost, that GAO's assets are protected, that transactions are properly executed and recorded, and that operations are conducted in accordance with established policies and procedures.

RESULTS FROM FINANCIAL INTEGRITY REVIEWS

GAO is firmly committed to the spirit and intent of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. GAO has instituted a series of steps to ensure compliance with the act's objectives. Those steps include

• a top level internal control advisory committee to provide policy oversight, review work progress, and provide guidance in meeting the FMFIA objectives,

• a management control plan to guide GAO's FMFIA efforts and ensure that internal controls throughout the organization are evaluated,

• a requirement that all GAO units test selected internal controls as part of their annual FMFIA self-assessments, and

• a quality review system which evaluates adherence to GAO's auditing and reporting standards, policies, and procedures.

As a result of those steps, GAO's internal controls have been strengthened and operational improvements made in several areas. GAO recently completed projects relating to the accountability and control of property, physical security of property and space, and the planning, executing, and reporting on the results of specific assignments. For 1989, GAO's self-assessments and internal audit program provide reasonable assurance that GAO's internal controls comply with the internal control objectives of FMFIA.

GAO is currently reviewing its accounting system. To date, nothing has come to GAO's attention to indicate that the system does not conform in all material aspects with the principles, standards, and related requirements contained in title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies. However, certain areas in the system needing improvement were identified during the audits of the financial statements. GAO has an effort underway to bring about those improvements.

Ira Goldstein

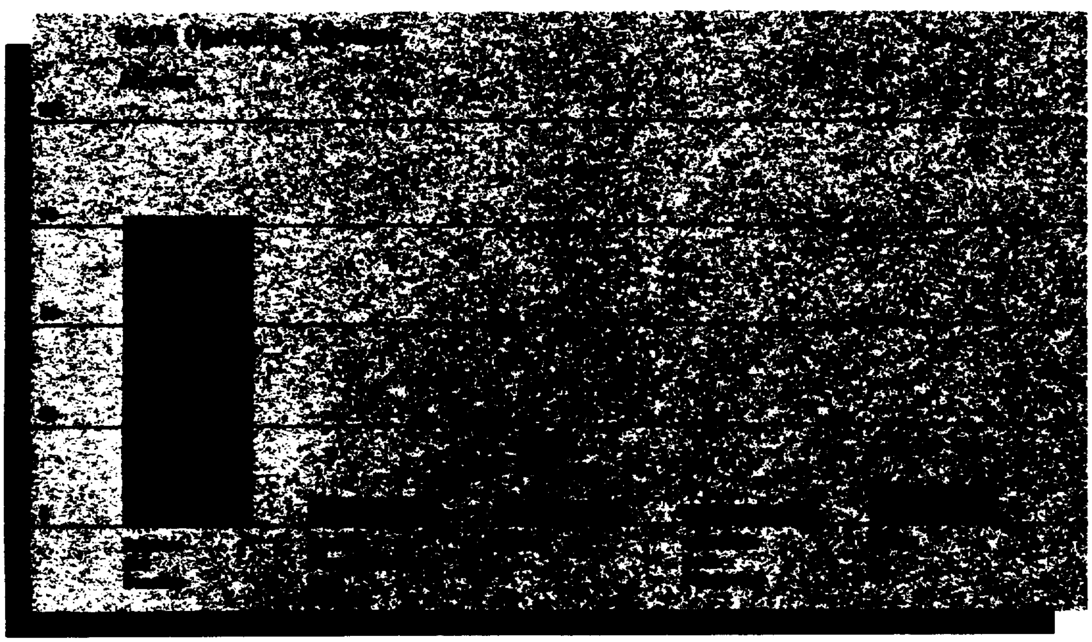
Assistant Comptroller General
for Operations

FINANCIAL RESOURCES AND OPERATING EXPENSES

The accompanying financial statements summarize the financial position of GAO, disclose the cost of operations during fiscal years 1989 and 1988, and present all significant sources and uses of resources during the 2 fiscal years.

The cost of operating GAO during fiscal years 1989 and 1988 amounted to about $339 million and $327 million, respectively. Over 99 percent of its operations were financed through appropriations from the Congress. The remainder came from reimbursements from other government agencies. The percentage of operating expenses financed by appropriations has been about the same over the last five years.

During fiscal year 1989, expenses for salaries and related costs totaled $258 million and constituted about 76 percent of GAO's total operating expenses. This supported a staffing level of 5,061 full-time equivalent staff-years, most of which were employed in carrying out GAO's audit and evaluation activities. This staffing level has remained relatively constant during the past decade.



REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENTS

Comptroller General of the United States

We have audited the accompanying statements of financial position of the General Accounting Office, an agency of the legislative branch of the government of the United States of America, as of September 30, 1989 and 1988 and the related statements of operations and financing sources and of changes in financial position for the years then ended. These financial statements are the responsibility of the General Accounting Office's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the *Government Auditing Standards* issued by the Comptroller General. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Also, in accordance with those standards and as an integral part of our examination, we issued separate reports that describe the scope of our review and findings related to internal accounting controls and compliance with laws and regulations. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements audited by us present fairly, in all material respects, the financial position of the General Accounting Office at September 30, 1989 and 1988 and the results of operations and the changes in its financial position for the years then ended in conformity with generally accepted accounting principles as prescribed in title 2 of the General Accounting Office's *Policy and Procedures Manual for Guidance of Federal Agencies*.

Price Waterhouse

Washington, DC
January 19, 1990

U.S. GENERAL ACCOUNTING OFFICE
STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1989 AND 1988

Dollars in Thousands	1989	1988
Assets		
Funds with U.S. Treasury	$46,769	$37,224
Future appropriations due	24,201	22,936
Travel and other advances	1,144	1,082
Accounts receivable	2,406	2,235
Supplies inventory	465	485
Building and land, net of $626 accumulated depreciation	16,229	0
Improvements to the building, net of $537 accumulated depreciation	2,168	0
Furniture and equipment, net of $8,111 and $6,840 accumulated depreciation, respectively	8,298	9,354
Total Assets	**$101,680**	**$73,316**
Liabilities		
Salaries and benefits	$15,575	$16,167
Employee travel	1,882	1,482
Accounts payable	8,439	7,843
Other liabilities	4,186	3,533
Accrued annual leave	22,979	21,846
Total Liabilities	**$53,061**	**$50,871**
Net Assets	**$48,619**	**$22,445**

The accompanying notes are an integral part of the financial statements.

U.S. GENERAL ACCOUNTING OFFICE
STATEMENT OF OPERATIONS AND FINANCING SOURCES
FOR FISCAL YEARS ENDED SEPTEMBER 30, 1989 AND 1988

Dollars in Thousands	1989	1988
Operating Expenses		
Salaries and benefits	$258,241	$244,387
External training	1,586	1,263
Travel	17,377	15,731
Rent, communications and utilities	21,401	36,092
Computer and other ADP services	12,730	9,937
Other contract services	15,361	10,754
Supplies and materials	4,825	3,055
Printing and document copying	2,833	3,116
Depreciation	3,719	2,459
Other	1,388	453
Total Operating Expenses	**$339,461**	**$327,247**
Financing Sources		
Appropriations expended	$336,743	$325,929
Funds to be provided by future appropriations	1,265	575
Rents, reimbursable audits and other reimbursable services	10,129	2,870
Less amounts remittable to U.S. Treasury	(8,676)	(2,127)
Total Financing Sources	**$339,461**	**$327,247**

The accompanying notes are an integral part of the financial statements.

U.S. GENERAL ACCOUNTING OFFICE
STATEMENT OF CHANGES IN FINANCIAL POSITION
AS OF SEPTEMBER 30, 1989 AND 1988

Dollars in Thousands	1989	1988
Sources of Funds		
Appropriations and other financing sources	$339,461	$327,247
Increase in receivables, advances, and future appropriations due	(1,498)	(1,097)
Decrease in supplies inventory	20	106
Increase in liabilities	2,190	5,764
Total Sources of Funds	**$340,173**	**$332,020**
Funds Used in Operations		
Operating expenses	$339,461	$327,247
Less expenses not requiring funds:		
Depreciation and amortization	(3,719)	(2,459)
Loss on disposal of capital assets	(380)	(90)
Total Funds Used in Operations	**$335,362**	**$324,698**
Other (Sources) and Uses of Funds		
Increase in net assets	$(26,174)	$(1,230)
Transfer of building and land	16,855	0
Acquisition of other capital assets	4,585	4,424
Net Other (Sources) and Uses of Funds	**$(4,734)**	**$3,194**
Total Uses of Funds	**$330,628**	**$327,892**
Increase in Funds with U.S. Treasury	**$9,545**	**$4,128**
Funds with U.S. Treasury:		
Beginning of year	37,224	33,096
End of year	**$46,769**	**$37,224**

The accompanying notes are an integral part of the financial statements.

Note 1. The Entity

The accompanying financial statements present the financial activity of the General Accounting Office (GAO), an agency of the U.S. Government. The activity presented relates to the execution of the GAO's congressionally approved budget and, as such, does not include the effects of centrally administered assets and liabilities related to the federal government as a whole, such as borrowings, which may in part be attributable to GAO.

Note 2. Summary of Significant Accounting Policies

A. Basis of Accounting

The Statement of Financial Position, Statement of Operations and Financing Sources, and Statement of Changes in Financial Position are presented in accordance with generally accepted accounting principles as prescribed in title 2 of GAO's *Policy and Procedures Manual for Guidance of Federal Agencies*. These principles differ from budgetary reporting principles. The differences relate principally to the capitalization and depreciation of buildings, improvements, furniture and equipment and the recognition of other long-term assets and liabilities in the accompanying financial statements. Also, for financial statement purposes, budgetary appropriations are realized as a financing source as accrued expenses are recognized.

B. Accounts Receivable

GAO's accounts receivable are due principally from federal government corporations and other federal agencies for audit and other reimbursable services. They are recorded, when appropriate, net of allowance for amounts that may not be collectible.

C. Fixed Assets

The GAO's headquarters building in Washington, D.C. is depreciated over 25 years. Furniture and equipment costing more than $5,000 are capitalized and depreciated. Bulk purchases of lesser-value items that aggregate more than $100,000 are also capitalized. Depreciation is calculated on a straightline basis over the estimated useful life of the property, which ranges from 5 to 20 years. Improvements to the GAO headquarters building and other leased office space costing $5,000 or more are capitalized and amortized over 5 years. Library and other resource materials are depreciated over 10 years.

D. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. The accrued leave liability is principally long-term in nature. Sick leave and other types of leave are expensed as leave is taken.

Note 3. Reconciliation to Budgetary Accrued Expenditures

The following schedule reconciles operating expenses, as included in the Statement of Operations and Financing Sources, to budgetary expenditures. This reconciliation is presented to facilitate an understanding of the relationship and differences between information presented in the financial statements and budgetary information.

Dollars in Thousands	1989	1988
Total operating expenses as included in Statement of Operations and Financing Sources	$339,461	$327,247
Expenses financed by charges to agencies and retained by the GAO	(1,453)	(743)
Increase in annual leave and retirement benefit expenses recognized in financial statements but not in budgetary expenditures	(1,265)	(575)
Net effect of capitalizing assets in the financial statements which are recognized as expenditures for budgetary purposes	468	1,296
Total Budgetary Accrued Expenditures	$337,211	$327,225

Note 4. Funds With U.S. Treasury

GAO does not maintain cash in commercial bank accounts. Rather, its receipts and disbursements are processed by the U.S. Treasury. The balance of funds with the U.S. Treasury represents appropriated funds that are available to pay current liabilities and finance authorized purchase commitments relative to goods or services which have not been received.

Note 5. Future Appropriations Due

The balance of future appropriations due represents the aggregate of amounts that will be included in future years' appropriations to finance congressionally authorized long-term liabilities (annual leave and retirement benefits for Comptrollers General), which are financed (funds appropriated) in the year payment is required.

Note 6. GAO Building

Public Law 100-545 transferred control of the General Accounting Office building and land in Washington, D.C., from the General Services Administration to GAO, effective October 28, 1988 without a monetary exchange. The depreciated value of the building at the time of transfer was $16,855,000. GAO recorded the building as an asset at this value and a corresponding amount was included in net assets.

The fair value of the building and land is considered to be significantly higher than the recorded value by both GAO and the transferer. For the purpose of determining the cost effectiveness of additional improvements and changes to the building, GAO plans to obtain an estimate of the fair market value of the building and the land during the next fiscal year.

Rental expense for space occupied in the GAO building is included in total operating expenses for the year ended September 30, 1988. Since the GAO no longer pays rent to the GSA for the GAO building, there is no such expense in fiscal year 1989. However, significant depreciation and maintenance expenses relating to the building are included in total operating expenses for the year ended September 30, 1989.

GAO is responsible for collecting rent from tenants of the GAO building and transferring these funds to Treasury. GAO does not have the use of the funds. Rents collected and transferred to Treasury for the year ended September 30, 1989 were $6,093,000.

Note 7. Leases

A. Operating Leases

GAO leases additional office space from the General Services Administration and the State Department and has entered into various other operating leases for office communication and ADP equipment. These leases are cancelable without penalty. Lease costs for office space and equipment for fiscal years 1989 and 1988 amounted to approximately $15,500,000 and $30,250,000, respectively. The decrease in fiscal year 1989 was primarily due to the elimination of rent paid prior to the transfer of the GAO building and land from GSA to GAO, effective October 28, 1988.

B. Capital Leases

GAO has entered into several noncancelable capital leases under which the ownership of the equipment covered under the leases transfers to GAO when the leases expire. Lease payments of approximately $947,000 remained to be paid on these leases as of September 30, 1989. When GAO enters into these leases, the value of the future lease payments is capitalized and recorded as a liability.

Note 8. Retirement Benefits

All permanent employees participate in the contributory Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS) which became effective January 1, 1987. Temporary employees and employees participating in FERS are covered under the Federal Insurance Contributions Act (FICA). GAO makes matching contributions to the CSRS, FERS, and FICA and matches employee contributions to the savings component of FERS up to 5 percent of basic pay but has no liability for future payments to employees under these programs. GAO's costs associated with its employee retirement programs during fiscal years 1989 and 1988 amounted to approximately $25,250,000 and $22,850,000, respectively.

Comptrollers General and their surviving beneficiaries who qualify and so elect are paid retirement benefits by GAO under a separate program. These benefits are funded from current year appropriations. Since GAO is responsible for future payments under this program, the estimated present value of future payments is included in future appropriations due and other liabilities. The estimated present value of future payments was $1,222,000 as of September 30, 1989 and $1,090,000 as of September 30, 1988.

Note 9. Net Assets

GAO operates in a fashion that does not require permanent capital, and its operations are not expected to generate an operating surplus or deficit. The composition of net assets is as follows:

Dollars in Thousands	1989	1988
Building and land	$16,229	$ 0
Other capitalized assets	9,983	9,310
Purchase commitments	22,407	13,135
Total Net Assets	**$48,619**	**$22,445**

The GAO building and land were transferred to GAO by GSA (note 6). The increase in net assets from fiscal year 1988 to 1989 related to purchase commitments is attributable to an increase in outstanding undelivered orders from September 30, 1988 to September 30, 1989.

Note 10. Contingent Liabilities

GAO has certain claims and lawsuits pending against it. Where claims are expected to result in payments, and the payment amounts can be reasonably estimated, appropriate provision has been included in the accompanying financial statements. In the opinion of management and legal counsel, the resolution of other claims and lawsuits will not materially affect the financial position or operations of GAO.

Note 11. Trust and Other Governmentwide Functions

GAO is responsible for conducting three trust functions for the federal government: (1) collecting delinquent claims receivables; (2) administering Davis-Bacon Act receipts and payments, and (3) administering assets of Americans who die abroad.

GAO is accountable to the Congress and the public for the proper administration of the assets held in the trusts. During fiscal year 1989 GAO completed transferring all delinquent claims to the agencies from which the claims originated. There will be no further activity in this trust function in future years. Trust assets under administration by GAO aggregated approximately $4,356,000 on September 30, 1989. These assets are related to Davis-Bacon Act funds and the estates of Americans who die abroad; they are not the assets of GAO or the federal government and are held for distribution to appropriate claimants. During fiscal year 1989 receipts and disbursements in these funds amounted to $1,250,000 and $1,037,000, respectively. Since these trust assets and related liabilities are not assets and liabilities of GAO, they are not included in the accompanying financial statements.

In addition to the trust activities, GAO is also responsible for authorizing the payment of certain adjudicated and administratively settled claims against the federal government from a special appropriation. During fiscal years 1989 and 1988, GAO authorized approximately $519,000,000 and $1,424,000,000 respectively, in claims for payment from this special appropriation.

Report of Independent Accountants on Internal Controls

Comptroller General of the United States:

We have audited the financial statements of the General Accounting Office (GAO) as of and for the year ended September 30, 1989, and have issued our report thereon dated January 19, 1990. We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

GAO's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that (1) obligations and costs are incurred in compliance with applicable laws, (2) funds, property, and assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenses applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the entity's assets. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For purposes of this report, we have classified the significant policies and procedures relative to GAO's internal control structure in the following categories:

- Treasury and appropriations
- Revenues and receivables
- Travel expenses
- Payables and disbursements
- Payroll and employee advances
- Property and inventory
- Comptroller General's retirement plan
- Trust functions

For all categories listed above, we obtained an understanding of the design of relevant policies and procedures which comprise the control structure, determined whether they have been placed in operation, and assessed control risk.

A material weakness is a reportable condition in which the design or operation of specific elements of the internal control structure do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be a material weakness as defined above. However, we noted certain matters involving the internal control structure and its operation that we have reported to management in a separate letter.

This report is intended for the information of GAO's management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Price Waterhouse

Washington, DC
January 19, 1990

Report of Independent Accountants on Compliance with Laws and Regulations

Comptroller General of the United States:

We have audited the financial statements of the General Accounting Office (GAO) as of and for the year ended September 30, 1989, and have issued our report thereon dated January 19, 1990. We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Assuring compliance with laws and regulations applicable to the GAO is the responsibility of GAO's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of GAO's compliance with provisions of applicable laws and regulations, noncompliance with which could have a material effect on the financial statements of the GAO. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, GAO complied, in all material respects, with the provisions of the laws and regulations referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that GAO had not complied, in all material respects, with those provisions.

This report is intended for the information of GAO's management. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Price Waterhouse

Washington, DC
January 19, 1990

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