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Federal Financial

Management Reform

Statement of
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Security
Committee on Government Operations
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

I am pleased to once again appear before you to discuss a vitally important challenge for the federal government--the need to reform federal financial management.

The number one fiscal problem facing the nation today is the federal budget deficit and how to reduce it. As the Congress and the next administration take on the difficult task of making the tough decisions necessary to reduce the deficit, they are and will be hampered by a federal financial management system that does not provide timely, reliable, and consistent information and that lacks fundamental internal controls.

On June 7, 1988, we testified before this Subcommittee on our proposals for fundamental changes to the budget structure and process as one element of the reform initiative. (See GAO/T-AFMD-88-13.) Today, I will focus on the other essential ingredients of financial management reform--the need to strengthen financial systems, internal controls, and financial reporting and to ensure financial management leadership in the federal government.

STRENGTHENING FEDERAL ACCOUNTABILITY

The federal government is the largest entity in the world. In programs ranging from the security and defense of the country to dealing with the problems of the poor, it touches the lives of all Americans. The federal government has an annual budget exceeding $1 trillion dollars and employs over 5 million civilian and military personnel. Its tens of billions of dollars of property, equipment, buildings, and facilities worldwide are unmatched.

Nevertheless, the government continues to rely on financial management systems that, despite improvement efforts over many years, are, frankly, second-rate. Decisionmakers at all levels of the federal government are not getting the financial information they need to help make policy and management decisions and to know the ultimate financial impact of those decisions. This information gap becomes especially critical as the government grapples with the deficit and is faced with difficult spending alternatives.

The basic structure of many of the current financial systems was laid out in World War II and built around vintage 1950 concepts, despite the major advances in computer and telecommunications technology. The systems are antiquated and in a general state of disrepair. Hundreds of millions of dollars have been spent each year on uncoordinated efforts to upgrade these systems. In the meantime, costly as they are to operate and maintain, the old systems do not produce complete, timely, and reliable financial data.

GAO is not alone in its concern about the condition of federal financial management. The President's report, Management of the United States Government--Fiscal Year 1989, states, "Once a leader in the early days of automation, the Government's financial systems and operations have eroded to the point that they do not meet generally accepted standards."

Another problem is that government agencies do not have the necessary internal controls to effectively operate programs and to safeguard the government's assets. Americans expect their government to be effective and efficient and, at all times, fully accountable for how public moneys are spent. Seemingly never ending reports of fraud, waste, abuse, and mismanagement, however, only serve to reinforce a perception that the federal government is poorly managed, with little or no financial control.

One picks up a newspaper and reads that the multibillion dollar Department of Defense procurement process is the target of a long-term investigation into possible criminal activity by Defense's own employees and its contractors--further indications of weaknesses in internal controls. This news is shortly followed by newspaper accounts of a government payment officer in another agency pleading guilty to embezzling $1.2 million.

Internal controls and accounting systems have been strengthened somewhat over the past several years, following the passage of the Federal Managers' Financial Integrity Act of 1982 under the leadership of this Subcommittee. But, serious, long-standing problems remain today, covering a broad range of government programs and operations and touching every major federal department and agency.[1] The internal control deficiencies have serious consequences. For example:

-- The Congress, in making multimillion and sometimes billion dollar program funding decisions, must rely on Selected Acquisition Reports that may not provide an accurate or timely reflection of program cost and schedule variances for major weapon systems.

-- Weaknesses in agencies' debt collection systems remain; and delinquencies in nontax debt owed the federal government have grown by 167 percent since 1981 to $32 billion at the beginning of fiscal year 1988. The amount of uncollectible debt owed to the federal government which should be written off may run into billions of dollars.

[1] Financial Integrity Act: Continuing Efforts Needed to Improve Internal Controls and Accounting Systems (GAO/AFMD-88-10, December 30, 1987).

-- Agencies paid almost 25 percent of their bills late, thereby incurring millions of dollars annually in interest penalties. They also paid a quarter of their bills too soon, thus costing the government at least $350 million in lost interest.

-- The Defense Department cannot account for hundreds of millions of dollars of advances made by foreign customers for weapon system purchases and has struggled to resolve this problem for 10 years.

-- Financial audits routinely uncover weak controls permitting things such as over $50 million in undetected fraudulent insurance claims at the Federal Crop Insurance Corporation, and, in the case of the Rural Telephone Bank, excessive rate charges to borrowers.

-- In their most recent reports required under the Financial Integrity Act, 17 of 18 agencies disclosed significant weaknesses in financial management and associated areas.

-- Since 1982, the Defense Department has received about $55 billion more for anticipated inflation than was warranted by the inflation that subsequently occurred. According to Defense, most of the inflation dividends were cut by congressional action, spent on additional defense programs, or lapsed and returned to Treasury. Because inflation funds have not been fully monitored and accounted for, exactly what happened to the total excess inflation funding cannot be determined.

NEED FOR COMPREHENSIVE REFORM

While the challenge is great, I believe that there are solutions. In 1985, we issued a report entitled, Managing the Cost of Government (GAO/AFMD-85-35 and 35A), which culminated a major study of the government's financial management practices. The report identified significant problems affecting the federal financial management structure, proposed a conceptual framework to guide improvement efforts, and provided an implementation strategy.

The past few years have witnessed a coalescing of opinion on the need for financial management reform, a number of initiatives to achieve this, and a strong, growing support for a legislative mandate. I believe three elements critical to the reform effort are:

-- centralized leadership in the executive branch that is responsible for developing and implementing a long-range, governmentwide plan to improve financial management systems and for reporting annually on the plan's progress;

-- corresponding financial management leadership in the major executive branch departments and agencies; and

-- annual preparation and audit of financial statements to foster accountability and system integrity.

Last year we drafted the "Federal Financial Management Improvement Act of 1987," legislation which would mandate these essential elements. A copy of the draft legislation is provided for the record. I am convinced that financial management reform legislation is needed. GAO studied centrally directed, governmentwide management improvements conducted in the 1970s and found that few initiatives had lasting impact.[2] Those few that did almost always had a legislative base. In our view, many of these initiatives would not have been so short-lived if there had been a legislative mandate to ensure that they would continue across successive administrations.

Organizations and the people who manage them naturally resist change. Reform initiatives, whether short-lived or

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[2] Selected Government-Wide Improvement Efforts--1970 to 1980 (GAO/GGD-83-69, August 8, 1983).

long-term represent change. Therefore, it is not surprising that administrative actions to improve operations are not fully successful, particularly when agency personnel perceive that there will be new directions from succeeding managers and the new administration. The existence of a legislative mandate would provide greater assurance that a financial management improvement effort would be realized.

Central and Continuing Leadership

Our draft legislation calls for establishing an Under Secretary of the Treasury for Federal Financial Management who would be the government's chief financial officer (CFO). This person would provide central focus to the long-range planning of improvements and oversight of agency financial management activities.

In July 1987, the Director of the Office of Management and Budget (OMB) administratively created the position of Chief Financial Officer for the federal government. The CFO was placed organizationally within OMB and was given responsibility to provide leadership, policy direction, and oversight to federal financial management. OMB's Associate Director for Management was named as CFO and continues to serve in both capacities.

Initially, the administration did not support the need for legislatively establishing the CFO position, but that view has changed. The President's 1989 management report calls for "legislation that will define and provide statutory underpinning for a permanent Chief Financial Officer structure throughout Government."

The next question is where to locate the CFO. Various proposals have been made. I favor the Department of the Treasury for several reasons.

-- Treasury can offer stability of leadership that cannot be expected in the Executive Office of the President.

-- Treasury has long-standing responsibilities and a historical mission for central financial and reporting functions. It establishes the financial reporting requirements that agencies must follow.

-- Treasury already has lead responsibility for agency financial management systems improvements, credit management, debt collection, and cash management.

-- Treasury has an organization, the Financial Management Service, whose mission is directly related to appropriate objectives for the CFO.

-- Treasury's primary mission is financial management, while OMB's primary focus is on budget matters.

I have testified previously against establishing the central financial management office in OMB or in any part of the Executive Office of the President. These organizations exist first and foremost to serve the President by helping him define, develop, and implement the policy agenda with which he was elected. Other responsibilities are inherently of secondary importance and unlikely to receive long-term attention and commitment. That is why efforts to graft on to OMB responsibility for routine management functions have consistently failed.

The President's Advisory Council on Executive Organization, commonly known as the Ash Council, recommended in 1970 the establishment of OMB as we know it today. The Council's Executive Secretary testified in 1986 that, had he to do it over, he would have created a management office separate from the budget office because of the secondary importance OMB has placed on management issues. Other people and organizations share this view that the current organization of OMB is not best suited to gaining comprehensive management improvements for the federal government. Recently, the National Academy of Public Administration issued a report calling for a long-term, governmentwide management reform and improvement program which could involve the creation of a separate Office of Federal Management.

In addition to OMB's natural focus on policy issues and the budget, I am concerned about the implications that frequent turnover in its top-level positions may have on OMB's ability to sustain important management initiatives. Recent support at OMB for financial management improvements demonstrates that when top-level management takes an active interest, progress can be made. However, the very fact that progress is dependent on who takes an interest demonstrates the tenuous position we face in improving financial management. If we look at the chain of command at OMB as it relates to financial management since 1981, we find there have been two directors, two deputy directors, and four associate directors for management (the incumbent also serving as the CFO). During a 7-year span in the 1970s, OMB had six different associate directors for management--an average of nearly one a year.

Several questions will remain unanswered until the new administration takes office. First, will there continue to be a CFO? If the position remains, how long will it take to fill this key financial management position? And how long will the new CFO remain in the position? Organizational instability can have profound effects on the line agencies throughout the executive branch as they try to implement policies and make improvements that are long-term by nature. This is why I believe strongly that we need to legislatively establish this position.

Our draft financial management improvement legislation would also require that the CFO develop a long-range, governmentwide financial management improvement plan. Trying to institute improvements without such a plan is like trying to build a house without a set of architect's drawings. An overall plan would generate greater confidence that the financial management system improvements would result in integrated systems for the government as well as provide information needed by individual agencies. Also, the planning process would reveal opportunities for (1) reducing the number of accounting systems by use of a cross-servicing arrangement where one agency performs financial services for other agencies, (2) eliminating redundant or antiquated systems, and (3) sharing system design among agencies to avoid the all too common problem of "reinventing the wheel." Finally, an overall plan would provide direction and continuity when leadership changes occur, centrally as well as at the agency level.

Agency Financial Management Leadership

The legislation we propose would require that the executive branch departments and agencies establish corresponding financial management leadership positions. Agency controllers, who would be career employees, would provide the continuity needed for improved agency financial management and support for the CFO. Agency controllers would be a conduit for policy and guidance from the CFO to the agencies and for financial reporting from the agencies to the CFO.

In November 1987, the CFO at OMB directed all departments and agencies to designate CFOs, and this has been done. OMB also established a CFO council comprised of CFOs from all departments, major agencies, and a representative for small agencies. I support the continuance of such a council because it provides the CFO with a circle of advisers on accounting and financial management policy and establishes a network to deal with problems and issues throughout government.

Financial Statements and Audits

A key element to financial management reform is strengthened and expanded financial reporting. Under our draft legislation, agencies would be required to prepare annual financial statements that are audited. I believe very strongly that audited financial statements serve a useful purpose and that the information benefits the Congress, managers, and the public. Financial statements provide a scorecard. Pulling numbers together for an agency, and subjecting them to the rigors of an independent audit, instills discipline in the financial systems and strengthens accountability.

Financial statement audits ensure that accounting transactions, accounting systems, financial statements, and financial reporting to Treasury, OMB, the public, and the Congress are properly linked. They provide an opportunity for an independent auditor--the agency inspector general, a public accounting firm, or GAO--to evaluate the adequacy of safeguards to protect resources entrusted to the agency and whether the agency accurately discloses the financial aspects of its operations. In my opinion, financial statements that are subjected to annual independent audits are also a first line of defense against fraud, waste, and abuse. It is more difficult to fight fraud, waste, and abuse without the discipline that audited financial statements provide.

We have made a start in this area. GAO has completed audits of the Veterans Administration[3] and the General Services Administration.[4] GAO financial audits are under way at the Department of Agriculture, the Department of the Air Force, and the Environmental Protection Agency. Inspectors general have

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[3]Financial Audit: Examination of the Veterans Administration's Financial Statements for Fiscal Year 1986 (GAO/AFMD-87-38, July 29, 1987).

[4]Financial Audit: Examination of GSA's Financial Statements for Fiscal Years 1986 and 1985 (GAO/AFMD-87-49, September 30, 1987).

completed financial audits at the Department of Labor and the Social Security Administration.

Federal government support for the preparation and audit of financial statements is not a new idea. In 1934, following the stock market crash, the Congress required audited financial statements for all publicly held corporations, and in 1984 the Congress enacted the Single Audit Act which requires financial statement audits of virtually all state and local governments. The Congress also requires financial statements and audits of federal government corporations and the Postal Service under the Government Corporation Control Act and other laws, and it required audited financial statements from New York City as a condition of financial guarantees during the 1970s.

I am not advocating business-type financial statements for federal departments and agencies. Rather, we are looking for the development of financial statements tailored specifically to the unique circumstances and requirements of the federal government.

Mr. Chairman, last year you raised questions about a number of accounting and financial reporting issues unique to the federal government which affect the preparation of financial statements. I am pleased to report that we are well along the way in a study of these and other significant accounting issues--each of which is an example of the unique situations that must be addressed by the federal government. We are developing an exposure draft of our proposed revised standards regarding these issues and will make it available to a wide range of groups to ensure the relevancy of the standards.

Also, we plan to send out for comment in the near future, a proposal which will establish a formal due process framework for establishing accounting standards for the federal government. This framework is necessary in order to ensure that GAO can reach out and obtain views and comments from all of those people who are interested in, or may be affected by, the accounting standards adopted.

THE STATE EXPERIENCE: LESSONS FOR THE FEDERAL GOVERNMENT

The federal government faces financial management problems over a broad front: systems, concepts, controls, accountability, reporting, leadership, and implementation. I would like now to step back in time because the federal government is not alone in having faced these issues. The government's current crisis is unique in its magnitude, but not in its problems. In the 1970s, the states faced a similar challenge, and it is widely held today that they are doing a much better financial management job than is being accomplished at the federal level.

The federal government's financial management and reporting practices today can be compared to the condition of New York City and State a decade ago. They made difficult decisions and instituted effective improvement actions, and so should the federal government. We need to continue surfacing problem areas, proposing approaches, gaining consensus, and implementing solutions.

Many state governments have made significant financial management improvements. In February 1988, the Texas Comptroller of Public Accounts issued the state's first financial report based on generally accepted accounting principles (GAAP), a practice being followed by other states to provide a more complete picture of their financial situation. The Comptroller General of South Carolina reported in May 1988 that, for the first time, the state could produce a balance sheet that conforms with GAAP. This occurred after more than a decade of projects to improve the state's financial accounting systems and reporting. Fiscal year 1987 marked the second consecutive year that Massachusetts produced general purpose financial statements, on both a budgetary and GAAP basis, that were subjected to an audit.

Florida has adopted a single accounting system which benefits management because the system (1) provides control and analysis of similar types of transactions, (2) permits timely reporting, and (3) permits an overall assessment of management stewardship of public resources. Virginia implemented over 12 major changes in accounting policies and supporting systems which permitted the state for the first time to publish its annual financial report for fiscal year 1986 in full conformance with standards. This improvement process resulted in operational benefits. For example, in 1982, Virginia did not have a central understanding of where fixed assets were, how old they were, and when they would have to be retired and replaced. Now the state has a system that contains that information. The state also lacked a system to tell state officials how many leases had been undertaken by state agencies, the nature of the leases, and whether they represented sound economic decisions. Now the state has a system that permits agencies and central officials to perform an economic analysis of all proposed leases and to prevent entering into leases that are too costly.

Clearly, the states are making progress and instituting financial management reforms which are resulting in more meaningful reporting and better financial management. The federal government needs to do the same.

In summary, at the federal level, we need to build on ongoing improvement initiatives, and I want to give credit to the many dedicated people in the agencies who have worked to strengthen their financial management systems and controls. But recognizing the size of the federal government and complexity of its operations, financial management reform is and will continue to be a long-term project. I will continue to emphasize GAO's work in this area, and I strongly urge passage of legislation to provide the impetus for further reform and the continuity of current initiatives.

Mr. Chairman, the leadership and work of this Subcommittee over many years in addressing problems such as those I have outlined today have been instrumental in improving government management and accountability. Significant legislative actions have taken place in a number of areas. We look forward to working with this Subcommittee in continuing this progress.

That concludes my formal remarks. I would be pleased to answer any questions that you or members of the Subcommittee may have at this time.