United States Government Accountability Office

TRANSFORMATION OF THE FEDERAL GOVERNMENT *and the Accountability Profession*

GAO
Accountability * Integrity * Reliability

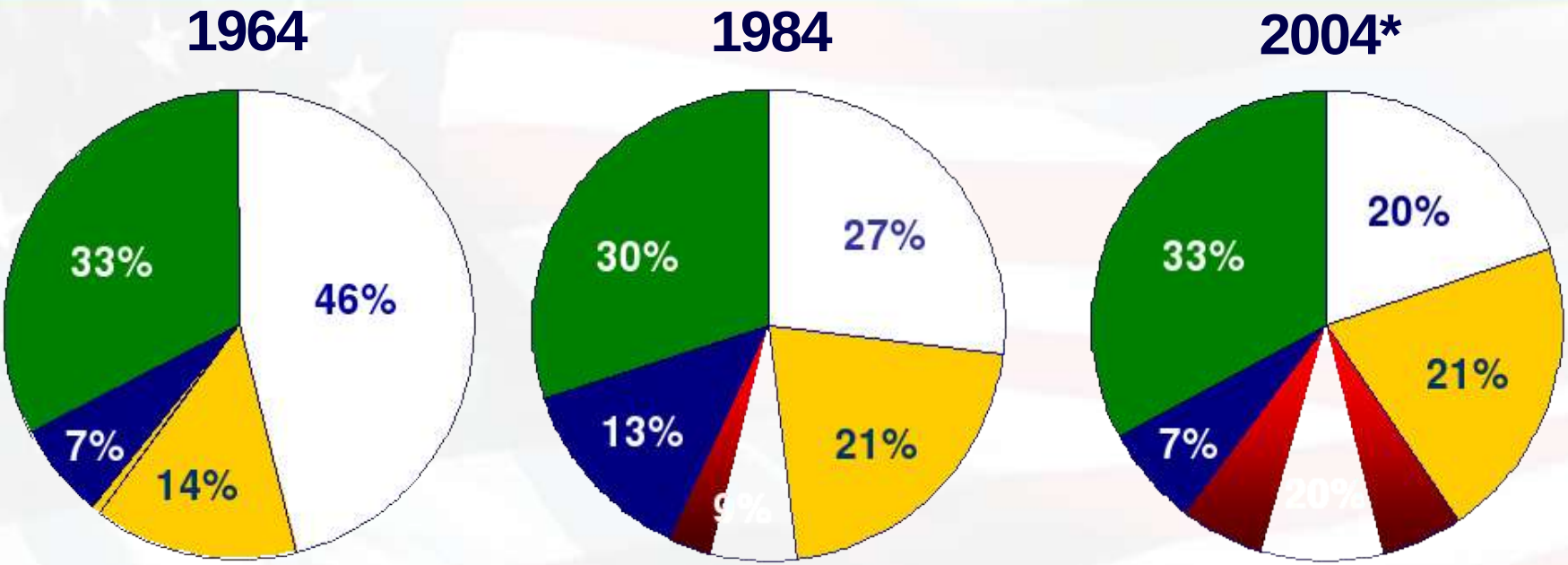
The Honorable
David M. Walker
Comptroller General
of the United States

Northern Illinois
University,
DeKalb, Illinois,
September 29, 2004

The Case for Change

- **Government is on a "burning platform," and the status quo way of doing business is unacceptable for a variety of reasons, including:**
  - Past fiscal trends and significant long-range challenges
  - Rising public expectations for demonstrable results and enhanced responsiveness
  - Selected trends and challenges having no boundaries
  - Additional resource demands due to recent terrorism events in the United States
  - Government performance/accountability and high risk challenges, including the lack of effective human capital strategies

Composition of Federal Spending



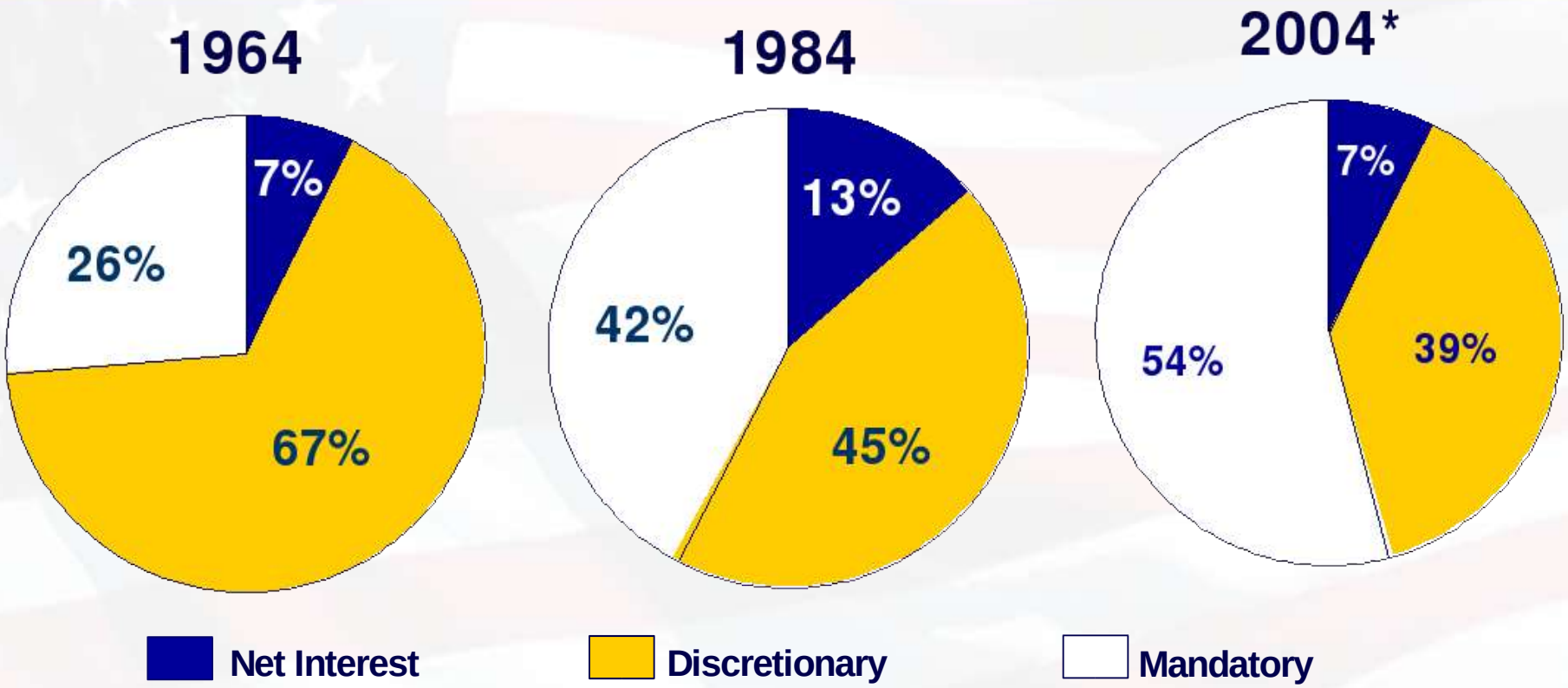
Defense
Net interest
Social Security
All other spending
Medicare & Medicaid

*Current services estimate.

Note: Numbers may not add to 100 percent due to rounding.

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



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Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Selected Fiscal Exposures: Sources and Examples

(End of 2003)[a]

Type	Example (dollars in billions)
Explicit Liabilities	Publicly held debt ($3,913) Military and civilian pension and post-retirement health ($2,857) Veterans benefits payable ($955) Environmental and disposal liabilities ($250) Loan guarantees ($35)
Explicit Financial commitments	Undelivered orders ($596) Long-term leases ($47)
Financial contingencies	Unadjudicated claims ($9) Pension Benefit Guaranty Corporation ($86) Other national insurance programs ($7) Government corporations e.g., Ginnie Mae
Exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts ($2,859)[b] Future Social Security benefit payments ($3,699)[c] Future Medicare Part A benefit payments ($8,236)[c] Future Medicare Part B benefit payments ($11,416)[c] Future Medicare Part D benefit payments ($8,119) [c] Life cycle cost including deferred and future maintenance and operating costs (amount unknown) Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

[a] All figures are for end of fiscal year 2003, except Social Security and Medicare estimates, which are end of calendar year 2003.

[b] This amount includes $774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

[c] Figures for Social Security and Medicare are net of debt held by the trust funds ($1,531 billion for Social Security, $256 billion for Medicare Part A, and $24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be $10.4 trillion, $21.8 trillion for Medicare Part A, $23.2 trillion for Medicare Part B, and $16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

Updated 3/30/04.

Another Way to Think About These Numbers

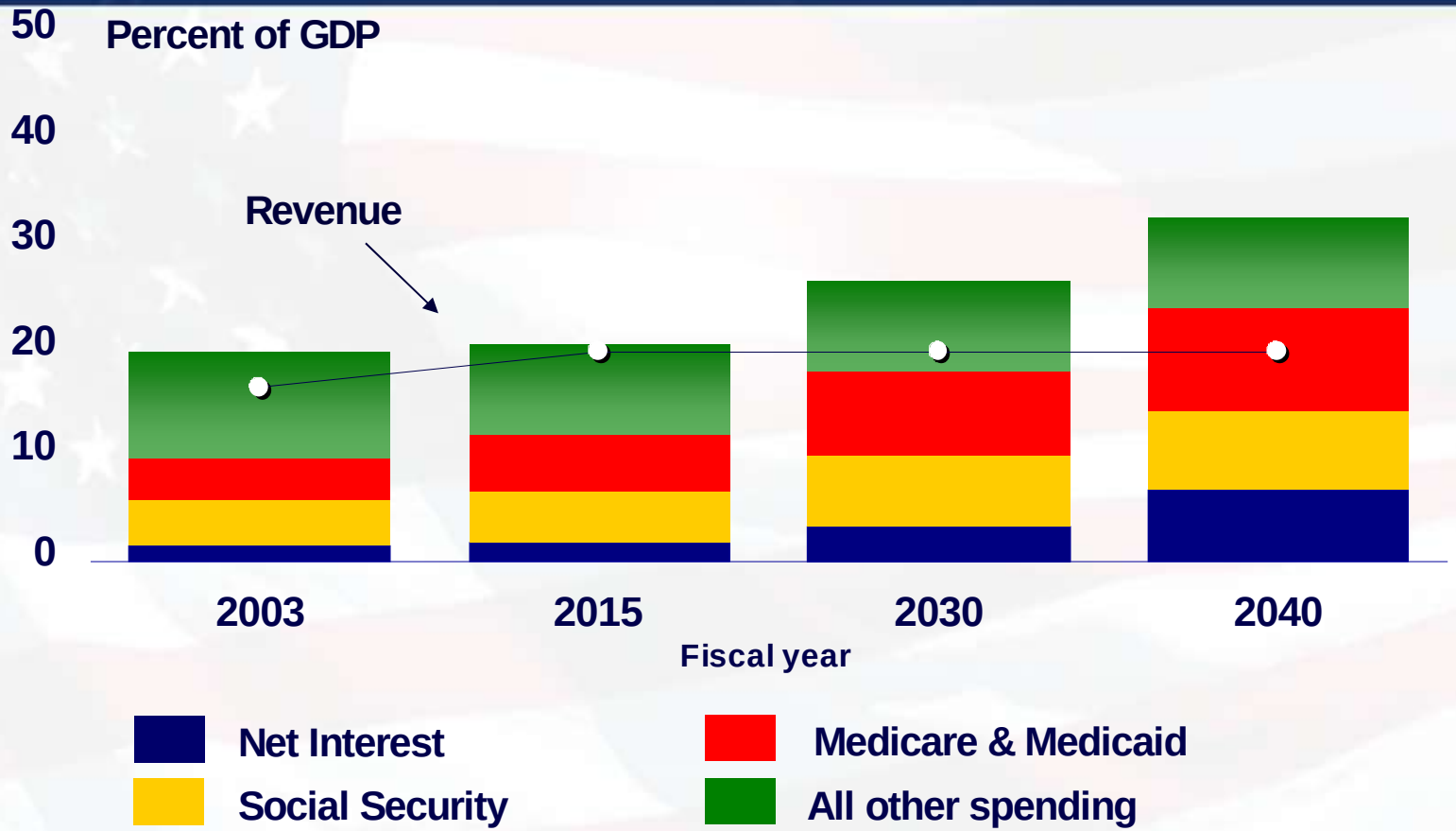
<u>As of the End of FY 03</u>

- Debt held by the public—$3.9T
- Trust fund debt—$2.9T
- Gross debt—$6.8T
- Gross debt per person—about $24,000
- If we add everything on the previous slide that is not included in gross debt, the burden per person rises to over $140,000. Alternatively, it amounts to a total unfunded burden of more than $40 trillion in current dollars, which is about 18 times the current annual federal budget or more than 3 ½ times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare.

Composition of Spending as a Share of GDP

Under Baseline Extended

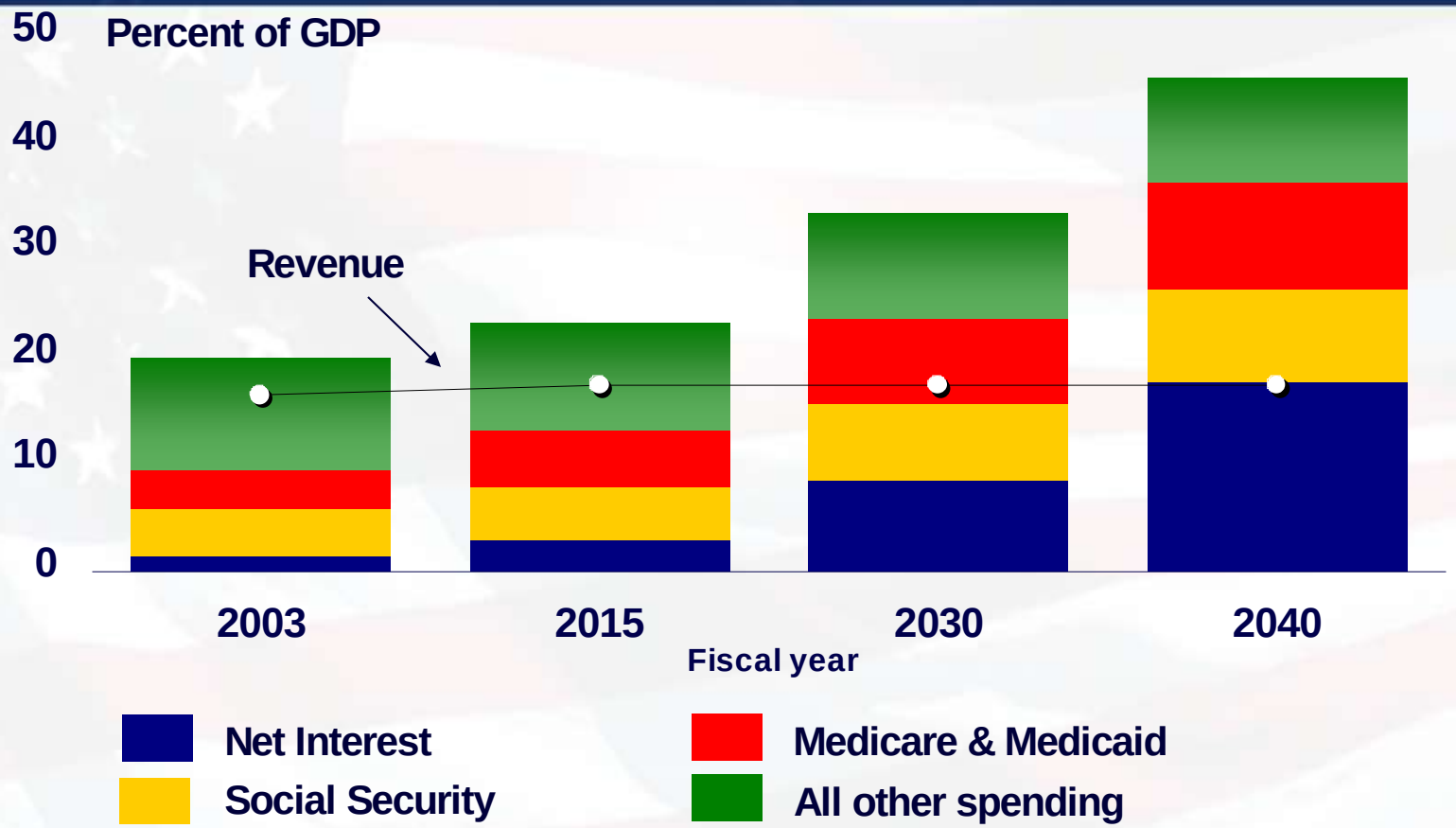


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant. Budgetary effects due to passage of the Working Families Tax Relief Act of 2004 are not reflected in this simulation.

Source: GAO's September 2004 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP After 2004 and All Expiring Tax Provisions Are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's September 2004 analysis.

Current Fiscal Policy Is Unsustainable

- **The "Status Quo" is Not an Option**
  - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
  - GAO's simulations show that balancing the budget in 2040 could require actions as large as
    - Cutting total federal spending by about 60 percent or
    - Raising taxes to about 2.5 times today's level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
  - During the 1990s, the economy grew at an average 3.2 percent per year.
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
  - Less change would be needed, and there would be more time to make adjustments.
  - The miracle of compounding would work with us rather than against us.
  - Our demographic changes will serve to make reform more difficult over time.

We Need a Multifaceted Approach to Close the Long-Term Fiscal Gap

Policy:

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise our tax policy and enforcement programs

Operations:

- Reassess and revise how the government does business (e.g., management, planning and operational issues)
- Consider who should provide government services (e.g., sourcing strategy)

Long-term Fiscal Challenges Demand New Metrics, Mechanisms, and Processes

- Accounting and reporting policies for trust funds, Social Security, Medicare, Veterans benefits, among other things, need to be reviewed and revised.
- The current budget time horizon [2-year, 5-year, 10-year] does not capture many long-term costs—e.g. Social Security, Medicare, pension insurance—and other major tax and spending provisions
- Cash and obligations-based budgeting is misleading for insurance and some benefit programs
- Budget controls have expired—and we need to go beyond "holding the line" to "changing the base" in spending and tax policies

Improved Metrics, Measures and Processes: Some Ideas

- Provide information on long-term costs of major spending and tax proposals before they are voted on, including showing long-term costs even for proposals that sunset
- Establish an OMB annual report on fiscal exposures, including appropriate measures and how to address them
- Consider fiscal targets, triggers, sunset provisions and points of order with focus on limiting growth of long-term commitments
- Move to accrual budgeting for employee pension, retiree health; disclose “risk assumed” [missing premium] for insurance
- Reinstitute budget controls (caps & PAYGO)

Selected GAO-Related Activities

- Speeches and Outreach Efforts
- Financial Literacy Efforts
- CG Forums
- High Risk Update Report
- 21st Century Challenges Report
- Various Congressional Consultation and Assistance Efforts
- Public Education Assistance
- Constructive engagement efforts (e.g., best practices guides, self assessment tools, benchmarking statistics)
- Leading by example

Trans FORMATION

Webster's definition

An act, process, or instance of change in structure appearance, or character

A conversion, revolution, makeover, alteration, or renovation

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Transformation is about CREATING the future rather than PERFECTING the past.

Effective HUMAN CAPITAL strategy is key to any SUCCESSFUL transformation effort

Transformation Has Different Dimensions

DOD	DHS	U. S. Postal Service	IRS	DOE	NASA

Human Capital Strategy

Financial Management

Information Technology

Sourcing Strategy

Disability Programs

Real Property Management

Note: All of the above are on GAO's High Risk List to one extent or the other.

GAO's High Risk List

High Risk Areas	Designated High Risk
Addressing Challenges in Broad-based Transformations	
Protecting Information Systems Supporting the Federal Government and The Nation's Critical Infrastructures	1997
Strategic Human Capital Management*	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook*	2001
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs*	2003
Federal Real Property*	2003
Ensuring Major Technology Investments Improve Services	
FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995
Providing Basic Financial Accountability	
DOD Financial Management	1995
IRS Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999
Reducing Inordinate Program Management Risks	
Medicare Program*	1990
Collection of Unpaid Taxes	1990
DOD Inventory Management	1990
Student Financial Aid Programs	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Earned Income Credit Noncompliance	1995
DOD Support Infrastructure Management	1997
Medicaid Program*	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program*	2003
Managing Large Procurement Operations More Efficiently	
DOD Weapon Systems Acquisition	1990
Department of Energy Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992

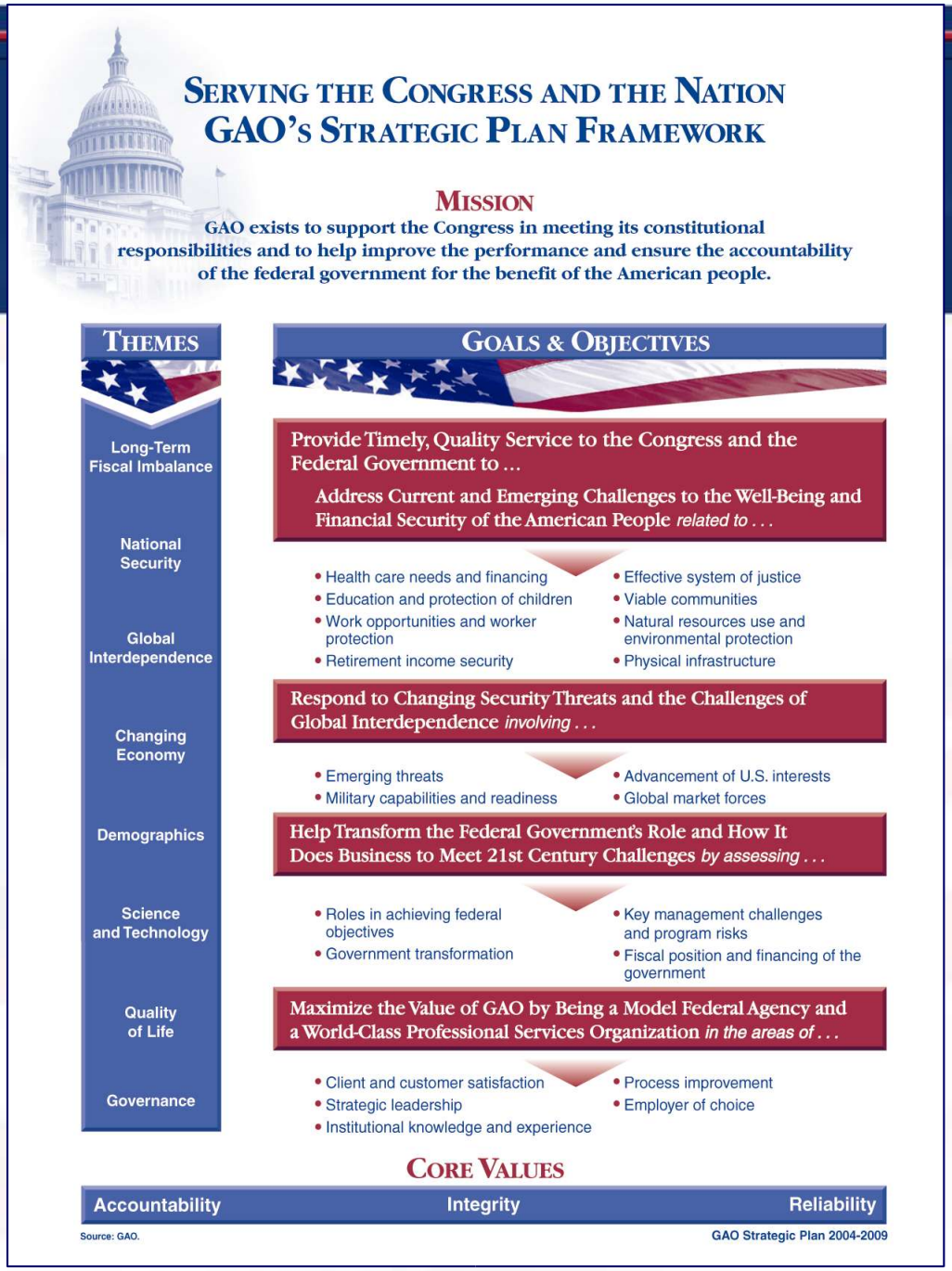
*Additional authorizing legislation is likely to be required as one element of addressing this high risk area.

Key Transformation Elements

- People
- Process
- Partnerships
- Technology
- Environment

The most important of the five is **PEOPLE —** an agency's human capital.

GAO's Strategic Plan



Selected Success Measures

- Results
- Clients/customers
- People
- Partnerships

Annual Performance Measures
(1998 and 2003)

	Actual	
Performance measure	**FY 1998**	**FY 2003**
Financial benefits (billions)	$19.7	$35.4
Other benefits	537	1043
Past recommendations implemented	69%	82%
Return on investment (ROI)	58:1	78:1
Financial benefits per employee (millions)	$6.1	$10.8
Timeliness	93%	97%

GAO: Leading by Example

(Change, Performance, and Human Capital Management)

- Mission and vision clarification
- Core values: accountability, integrity, reliability
- Strategic planning
- Organizational realignment
- Definitions of success
- Multi-tasking and matrix management
- Procurement, contracting, and acquisition
- Human capital
- Information technology
- Knowledge management
- Financial management
- Client service/external agency relations and protocols
- Enhanced products and services
- Constructive engagement with agencies
- Partnering with other accountability and “good government”organizations

How GAO Has Addressed Its Human Capital Challenges

Administrative

- HQ realignment & field office restructuring
- Self-assessment checklist
- Human capital profile
- Workforce & succession planning
- Employee feedback survey & suggestion program
- Employee Advisory Council
- Enhanced employee communications & participation
- Skills & knowledge inventory
- Employee preference survey
- Frequent flyer miles
- Student loan repayment
- Recruitment & college relations
- Phased retirement initiative
- Training/development
- Recognition & rewards
- Business casual dress & business cards
- Enabling technologies
- Opportunity/inclusiveness
- Mentor/buddy programs
- Commuting subsidy
- Competency-based employee appraisal system
- Human Capital Officer
- Office of Opportunity & Inclusiveness
- Flexitime and telework
- Total compensation communications
- Classification and compensation review
- Human Capital Strategic Plan

Legislation Addressing GAO's Human Capital Challenges

Past

- Broad-banding system for mission staff
- Expedited hiring authority (e.g., internship program)
- Special pay rates
- Senior level for technical staff
- Targeted early out and buyout authority (3 years)
- Revised RIF rules

Recent

- Targeted early out and buyout authority (permanent)
- Annual pay adjustment rates
- Pay retention provisions
- Relocation benefits
- Increased annual leave for upper level employees
- Executive exchange program
- Re-designation of "General Accounting Office" to "Government Accountability Office"

GAO will continue to

LEAD

by example and pursue benchmark opportunities with entities in both the

Public and Private Sectors.

High Profile Accountability Failures Around the World

- Enron
- WorldCom
- Tyco
- Global Crossing
- Quest
- Adelphia
- CitiGroup
- Tenet
- Parmalat
- National Irish Bank
- Delorean
- Royal Ahold, NV
- Lernout and Hauspie
- Superior Federal Savings Bank
- Micro Strategy
- Arthur Andersen, LLP
- ImClone
- Waste Management
- Xerox
- Health South
- CreditSuisse First Boston
- Fiat
- Yukos
- Dexia
- Elan
- Adecco SA
- Seibel Systems
- Lucent Technologies

Accountability Breakdowns

- The major accountability failures over the last several years were not isolated instances. Many were the result of significant structural weaknesses in institutional corporate governance and accountability models combined with a lack of personal ethics and integrity.
- These failures have shaken investor confidence in U.S. and global capital markets and in financial reporting and auditing matters. They have resulted in
  - loss of investor confidence
  - loss of tens of billions of dollars in investor capital
  - loss of livelihood/retirement for tens of thousands of employees
  - significant impact on national economies
  - significant impact on public trust in a variety of institutions and parties

Accountability Breakdowns

- Forces that led to the corporate scandals and audit failures include
  - ineffective governance systems
  - ineffective regulation and oversight of the accounting profession
  - inadequate accounting and auditing standards
  - inadequate attest and assurance procedures
  - financial managers, along with their legal and financial advisors, working to achieve certain reporting results
  - inappropriate and unreasonable executive compensation arrangements
  - confusion over who the auditors work for
  - auditors' services to clients that impaired independence
  - auditors and financial professionals doing what was minimally required and fighting tighter standards
  - individual and institutional greed

Ongoing Reforms in the U.S.

- The Sarbanes-Oxley Act of 2002 included reforms in corporate governance and the accounting profession that were intended to
  - improve corporate financial reporting and internal control
  - provide management certifications of financial reports and internal control assessments
  - strengthen audit committees
  - change the relationship between the auditor and client
  - improve auditor independence
  - provide additional auditor assurance over internal control
  - provide oversight and regulation for auditors of publicly traded companies through creation of the Public Company Accounting Oversight Board (PCAOB)

Ongoing Reforms in the U.S.

July 2004 marked the two-year anniversary of the passage of the Sarbanes-Oxley Act.

Benefits are being seen in the following areas:

- enhanced public trust and confidence in the capital markets
- transformation of many aspects of corporate governance
- needed changes in auditor relationships with clients
- more active and effective audit committees
- increased CEO and CFO attention to financial reporting
- internal control requirements providing beneficial results and adding value for many companies
- PCAOB inspections of audit firms identifying areas where significant future improvements can be made in audit quality
- entities not covered by the Act considering implementing similar practices

Ongoing Reforms in the U.S.

Companies are encountering the following challenges:

- many companies are finding the internal control requirements to be more difficult and costly to implement than expected
- implementation timeframes have presented difficulties for some companies
- roles and workloads for members of boards and audit committees are greatly expanded

Moving forward:

- although progress is being made, it will take some time before we realize the full benefits of the Act
- a comprehensive review of the effectiveness of the Act will be needed after at least one full implementation cycle
- other issues of modernizing financial reporting and auditing will need to be addressed by standards setters

Corporate Governance Challenges

- Corporate and other governing boards must take steps designed to
  - maximize value to shareholders over time
  - manage risks for stakeholders
  - hold management accountable for results both currently and over time
- Investors outside the company should have the information they need to clearly judge corporate performance and to compare one company's performance and practices against others.

Corporate Governance Challenges

- Corporate leadership must establish a climate of integrity and transparency at the top that reaches to every level of the organization.
- CEOs must remember that they are stewards, not owners, of the organization and are ultimately responsible for
  - hiring the right type of people with the right skills and values
  - creating/demanding accountability throughout the organization
  - ensuring that ethics and values are an integral part of the workplace, i.e., “tone at the top”
- Everyone at every level should understand the role and function of the organization, how decisions are made, how decisions should be executed, and where to go if they believe that illegal or inappropriate acts have occurred.

GAO's Work to Modernize the Accountability Profession

GAO is actively working to modernize and transform the accountability profession in government and the private sector—and to lead by example in this area.

- independence standards issued in 2002
- assistance to the Congress in evaluating accountability profession issues and needed reforms prior to the Sarbanes-Oxley Act
- monitoring implementation of the Sarbanes-Oxley Act
- 2003 revision of *Government Auditing Standards*
- continually modernizing Yellow Book standards
- enhancing federal financial management, reporting, and accountability
- expanding the definition of success in financial management: clean opinion, no major weaknesses in controls or compliance, and financial systems that produce timely, accurate, and useful information for management
- coordination with accountability organizations around the world (e.g., INTOSAI, IFAC, IAASB)
- promoting modernization of accounting/reporting and attest/assurance practices both domestically and globally
- creation of the U.S. Auditing Standards Coordinating Forum

The Future Financial Reporting Model

In modernizing financial reporting, we need to

- review and revise the existing accounting and financial reporting model to reflect several dimensions:
  - meaningful financial reporting that is useful, timely, and relevant
  - generic provisions
  - industry information
  - entity-specific information (i.e., value and risk)
- recognize the difference between certain types of financial and other information:
  - historical cost
  - readily marketable assets
  - non-readily marketable assets
  - projection information
  - performance information

The Future Audit Model

In modernizing audit reporting we need to

- determine whether "generally accepted" is the appropriate framework versus "authoritative accounting principles" that could be used when the "generally accepted" framework may not provide a full and fair representation in the view of the auditor
- review and revise the existing audit reporting model to accomplish at least two objectives:
  - recognize that the opinion should address whether the financial statements are fairly presented in all material respects <u>and</u> prepared in accordance with authoritative accounting principles promulgated by FASB, FASAB, IFAC, and others, applied on a consistent basis
  - update the audit reporting model to link it with the new financial reporting model, and provide appropriate degrees of assurance for each type of information
- ultimately go global in connection with all major accounting and audit matters
- coordinate U.S. and domestic efforts in the interim

U.S. Auditing Standards Coordinating Forum

- Composed of PCAOB, GAO, ASB (AICPA)
- Seeks to
  - maximize complementary standards-setting agendas
  - minimize duplicative or competing efforts
  - identify any significant gaps not being addressed by the standards setters
  - assure consistency, where appropriate, in core auditing standards in the U.S.
  - develop strategies for overcoming challenges and avoid unintended barriers to movement between the sectors
  - modernize the accounting profession in the U.S.
  - explore opportunities for international harmonization

How Do We Move Forward?

- Good governance and accountability are critical
  - in the private sector to promote efficiency and effectiveness in the capital and credit markets, and overall economic growth, both domestically and internationally
  - in the public sector for the effective and credible functioning of a health democracy, and in fulfilling the government's responsibility to citizens and taxpayers
  - in both sectors to support a healthy economy that provides economic opportunities and benefits to citizens
- Sorting out the needs and effective and appropriate governance and accountability mechanisms for different sectors and types of organizations and on an international scale will be critical.

Rebuilding Public Trust

For any system to work, it must address three fundamental issues.

- First, provide incentives for people to do the right thing.
- Second, provide transparency to help assure that people do the right thing.
- Finally, have effective accountability mechanisms if people don't do the right thing.

Restoring public trust will require that every participant in the corporate reporting supply chain embrace and live by the following core concepts*

6. A spirit of transparency—stop playing games with financial and performance data. Use full disclosure.
7. A culture of accountability—management, staff, boards, auditors, and stakeholders. High quality, unbiased information to support decision-making.
8. People of integrity—commitment to individual integrity.

*Excerpts from *Building Public Trust: The Future of Corporate Reporting,*
Samuel DiPiazza, Jr. and Robert G. Eccles, 2002

Key Concepts in the Accountability Profession

- Public trust vs. personal interests
- Recognizing the difference between the floor (e.g., rules, regulations, laws, accounting standards) and the ceiling (e.g., principles, values)
- Doing what is right vs. what is acceptable
- Economic substance vs. legal form
- Being concerned with both fact and appearance (e.g., independence)
- Using judgment vs. completing checklists
- Recognizing that continuing improvement in today's rapidly changing world is essential
- Remember that trust is hard to earn, but easy to lose

In today’s world, individuals, organizations and professions that do not change may find themselves headed for extinction. At the same, each should have a set of core values that can stand the test of time

Three Key Ingredients Needed for These Challenging and Changing Times

- ***Leadership***
- ***Integrity***
- ***Innovation***

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