

Hot Topics in Financial Management

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PROMOTING SOUND FINANCIAL
MANAGEMENT IN THE FEDERAL GOVERNMENT:
THE ROLE OF FINANCIAL MANAGERS AND WHAT
LIES AHEAD THROUGH THE 1990's



It is a great pleasure to be here with you today to discuss the state of Financial Management in the Federal Government and what lies ahead between now and the end of this century. While here at the Comptroller's school, you will be discussing and dealing with the issues facing us all today and hopefully will be leaving with a deeper understanding of the task that lies ahead if we are to be successful in improving the operations of a Federal Government that is becoming increasingly more complex.

Today, I would like to share my views with you on our role as managers and what we can do to improve financial management in the government. We in the General Accounting Office, as well as many of you, have been involved in a number of efforts involving every aspect of government financial management--budgetary processes, accounting systems, financial reporting, auditing, and keeping abreast of the computer explosion that is affecting each of these. I believe that even more attention to the problems in each of these areas is urgently needed in order to be responsive to the public's cry for greater accountability, a cry which was clearly evidenced by Proposition 13. As you are aware, more than ever before, citizens and public officials are asking questions about financial management and about the adequacy of control over governmental operations. They have a right to be concerned. Their questions relate directly to the capability of public officials to discharge their responsibility to the government's stockholders--

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the taxpayers. With the national debt over one trillion dollars and the annual interest on that debt now about 100 billion dollars, and the likelihood that it will grow even more, there will be no decrease in the demand for efficient management of government resources.

Given the size and complexity of the Department of Defense, this is a significant undertaking--one which will impact on all of us here today. Unfortunately, a number of events disclosed by the news media during the past several months make that undertaking even more difficult. The recent disclosures that last year the Air Force paid \$17.59 for a bolt that cost 67 cents in 1980 and that the Navy paid \$110 for a part that was available from government stock for 4 cents have caused the public to increase its demand for eliminating fraud, waste, and abuse in government operations. Moreover, the public is becoming more aware of the future costs of programs and Federal activities--such as loan guarantees and health, safety, and environmental regulations. This concern equates to a public challenge to disclose, in understandable terms, how well government operations are being carried out. Today, I would like to discuss how we can address this challenge during the rest of this decade and into the 1990's.

The first process occurring in the government financial management cycle, and one where improvements are critical, is the budgetary process. In 1966, we had a budget of about 125 billion dollars. Today, the budget is about 750 billion dollars with over

5,000 programs and activities. Considering the proliferation of programs--particularly within the last 15 years--no wonder the planning and budgeting process is in such severe difficulty.

At the federal level, the budget process has become extremely complicated and cumbersome. It is beset with severe timing problems, duplication, and an alarming increase in the use of continuing resolutions to finance government operations in the absence of appropriations. Also, and even more disheartening, are the delays in funding decisions such as those receiving media coverage which threatened to interrupt and halt government operations.

Currently, the budget process requires 13 appropriation bills to be passed each year to fund Federal Government operations. When any of these bills does not pass, various government agencies operate on continuing resolutions--essentially, permission to continue spending at the prior year's spending levels. However, even these resolutions may not be passed, and even if passed, they are not an efficient way to run a country. For example, if the new fiscal year appropriation was to be higher or lower, spending at the previous year's level distorts what the Congress intends. Also, Congress has been delaying voting on more and more funding decisions--either appropriation bills or continuing resolutions--until agencies are threatened with shutdowns or, as happened recently, until after some agencies actually do shut down. These delays not only affect the effective and efficient operation of government programs, but also the financial markets and the economic stability of the country.

I believe you would agree that it is clearly time for the federal budget process to be overhauled. Such an effort requires the creation of a high-level study group or commission to act as a catalyst for these badly needed changes. The budget process was last examined comprehensively in 1967.

Congress is well aware of the state of affairs and has considered a number of changes to the process. For example, one of the major provisions of the proposed Budget Reform Act of 1982, involved the establishment of a 2-year budget cycle. In addition, the bill proposed changes to streamline the budget process, provide additional time for oversight and other legislative activities, and provide stability and coherence for those receiving federal funds.

By themselves, proposed changes to the federal budgetary process can solve only some of the problems in federal financial management. The other financial management processes and systems that support federal policymaking--accounting and financial reporting in particular--also need to be strengthened and integrated with the budgetary process to meet the needs of Congress and the executive branch.

Currently, decisionmakers in both the executive branch and the Congress have to cope with separate and sometimes uncoordinated budgeting and accounting systems. These systems need to be integrated. One problem with nonintegrated systems is the inability to tie expenditures to specific areas of program or budgetary

concern. Budgets usually address significant areas of concern such as military readiness. Oftentimes, the federal accounting systems are designed to track expenditures by some other structure than that in the budget. The result is the inability to directly relate funds expended to the budget thereby preventing assurance that funds are expended as planned.

An excellent example of this inability is contained in a recent GAO report on how the \$72 billion increase between the fiscal 1980 and 1982 Department of Defense budgets was spent. One of the specific reasons the President requested and the Congress approved the large increase was to improve military readiness. We examined the use of the readiness funds at selected military bases and found some of the funds were used to buy a chain link fence and to build a new gate house, a visitors center, and a parking area. Obviously, the relationship between these expenditures and military readiness is not apparent.

In addition to the improvements needed in government budgetary processes and its integration with accounting, the accounting systems themselves--the second major area in the government financial management cycle--need to be improved. I believe we would all agree that the current concern with accounting is unprecedented. A tidal wave of criticism of financial accounting and reporting engulfed the financial management arena in the private sector as a result of a series of events beginning in the late 1960's. The 1975 New York City fiscal crisis did the same for the

government sector, and has prompted efforts to develop sound accounting and reporting systems.

The manager's job, basically, is to achieve goals at the least practicable cost, to make the best possible use of the resources entrusted to him or her, and to stay within spending and other limitations. To do this, managers need timely, complete, and accurate information on such things as:

- legal limits and resources,
- obligations and costs incurred and their relationship to budgeted amounts,
- work goals achieved and their costs,
- the degree to which work goals are met, and
- opportunities to achieve goals at a lower cost.

To be useful, the information must be tailored to the needs of the managers at different levels in the organizational hierarchy. This is where the accounting system comes into play. It should serve the information needs of each level by isolating particular information so that each manager is not burdened with extraneous information.

Reviews of accounting systems in operation have shown that many systems are not providing this information and are not operating as intended. The solution to these problems is one of the greatest opportunities for us to improve government financial management.

Internal controls are another area in which we all have a great deal of expertise and, therefore, can make a notable contribution to improved financial management. One reason accounting systems do not function as intended is their lack of good internal controls. Adequate internal controls form the cornerstone of a good accounting system, but only recently have they begun to receive the long overdue attention they rightfully deserve.

Even though effective internal controls have been mandated by law for federal agencies for over 30 years, the ever-increasing disclosures of fraudulent activities and ineffective management demonstrate that the focus on internal controls in the Federal Government has been inadequate at best. For example, a breakdown in the internal controls in the Federal Election Commission resulted in the embezzlement of \$500,000 by a Commission employee. The seemingly endless media disclosures of problems in the payment of social security benefits also demonstrate the inadequate focus on internal controls.

We strongly supported the enactment of the Federal Manager's Financial Integrity Act of 1982 as the necessary vehicle to bring about the improvement in internal controls and systems that will lead to sound financial management. This legislation requires each Federal agency to conduct ongoing evaluations of the adequacy of all its internal accounting and administrative control systems. These evaluations, conducted according to OMB guidelines, will determine whether the agencies' internal control systems comply

with the standards which the GAO has prescribed. The legislation requires the agency head to report annually to the President and the Congress on the effectiveness of the agency's internal controls or, if necessary, outline a plan and a timetable for correcting any control weaknesses.

The Inspectors General also will play a significant role in implementing the legislation because of their continuing responsibility for assessing agency accounting and administrative control systems. Before the first Office of Inspector General was created in 1976 at the Department of Health, Education, and Welfare, some agencies' audit functions, including the agencies' assessment of their own accounting and administrative control systems, were relatively weak. Since 1976, however, the creation of 18 statutory Offices of Inspector General has resulted in a significant change in the organizational placement and the activities and responsibilities of federal agency audit operations. We expect the assistance these offices give to implementation of this new Act will contribute greatly to improving internal controls in the Federal Government.

Another key element in financial management needing attention is sound financial reporting--the means by which financial information is communicated to government officials and the public as a basis for making informed decisions. Establishing and using accounting principles and standards that effectively communicate information concerning the economic resources of each agency and the

Federal Government as a whole is one of the most important issues facing today's financial manager.

Currently, GAO is in the process of analyzing the current principles and standards and revising them where necessary. Our objective is to determine what financial reporting disclosures should be made, to whom they apply, and where they should be made after we have seriously considered the relevance, reliability, and costliness of information.

We see federal accounting and reporting systems in the next decade moving in the direction of "standardization." The word is not new and should not surprise us.

As early as 1963, the desirability of standard systems was recognized. In a letter sent to the Secretary of Defense, the Comptroller General of the United States said in part that:

"The establishment of a uniform military pay system in our opinion, could be expected to simplify and improve materially the administration of military pay and allowances in many ways, including elimination of the multiplicity of individual service regulations."

Unfortunately, the advice was not heeded and each of the military services was permitted to develop its own system, creating problems which exist to this day.

Over the next several years, there were further efforts made to explore the feasibility of standardizing civilian payroll

systems. Unfortunately, the advice of these studies was also not heeded.

Now you may say, but we have heard all this before, what makes you think standardization efforts will have any more success today than they did in the past? I think the answer lies in the fact that for the first time the effort is receiving the top level support needed for success that was lacking in the previous efforts. For example, the Department of the Interior recently reviewed its separate personnel and payroll systems and has taken action to consolidate the systems into one system over the next 2 to 3 years. The Department of Commerce is also consolidating five of its separate and independent payroll systems into a single system.

If I sound optimistic, it is because I am. The standardization of our numerous, complex, error prone, and costly accounting and reporting systems is an idea whose time is right.

Auditing is another major area in which we can help bring about needed improvement in financial management. Improvements in budgeting, accounting, and financial reporting will not be effective without assurance that the management systems are working as intended and that full disclosure will be made of results at all levels of government. I believe the efforts of the auditing community will evolve to a systems approach and adopt reviews of a government organization as a whole, rather than concentrating solely on programmatic issues or individual administrative

management activities. The use of such an approach will have a tremendous impact on understanding and evaluating the overall effectiveness of an agency's financial management, especially as time passes and computer applications widen in scope and management becomes more and more dependent upon computers.

Any consideration of financial management would be incomplete without acknowledging the vast impact of computers both now and in the future on the manner in which government conducts its business. Widespread use of the computer is revolutionizing financial management particularly internal control systems.

Use of computers is increasing in virtually every financial management system in the Federal Government. The microcomputer explosion is already dramatically affecting the way we capture, process, store, and use data. Where are we heading? Some futurists think we are heading for the so-called "paperless society."

The feasibility of the paperless society has been demonstrated. The concept integrates various technologies such as mainframes, minicomputers, word processors, personal computers, electronic mail, and electronic fund transfers, and telecommunication where operations are geographically dispersed. Obviously, there is a great deal of difference between having demonstrated the feasibility and having wide-spread acceptance and usage. I suspect that there will be an evolutionary trend rather than a revolutionary move toward that goal. The important point, in my opinion, is that computers will impact dramatically upon future

financial management and bring about a change in the skills and attitudes required of us as managers.

The first large-scale general purpose electronic data processing computer system in the United States was delivered to the Bureau of the Census in 1951. Since then, there has been no slowdown in the rate of change and there is no reason to believe that we will not continue to have rapid change in equipment capabilities and in the strategies for using that equipment. There is also no reason to believe that the opportunities for increased capabilities and productivity will not be accompanied by potential problem areas if we are not alert. For example, the news media recently disclosed that a young man was able to obtain entry into one of the critical systems in the heart of the nation's premier cancer treatment and research center by using simple trial and error techniques. Using the same simple procedure, a half-dozen people gained access to perhaps as many as 60 computers this summer including ones at the nuclear laboratory in Los Alamos, a bank in Los Angeles, and a cement company in Canada.

These examples demonstrate that the need for more thorough internal controls will continue if not accelerate, in importance as computer technology advances. Just as the widespread use of computers in the past two decades reshaped our thinking of traditional internal controls, we must now adjust our thinking and to refine our techniques for controlling systems which will integrate various technologies and which, in many cases, be widely dispersed. If that was not difficult enough, many of the systems

in the 1990's will not have a "paper audit trail." Taking advantage of the rapidly expanding computer technology while keeping it under proper control is the challenge which we all face.

The attention being given to improving budgeting as well as financial accounting and reporting as well as the emphasis finally being placed on internal controls as evidenced by the recent passage of the Federal Manager's Financial Integrity Act of 1982, is an important step toward improving the management of the Federal Government. Other efforts have been put forth to study what other measures can and should be taken to bring about improvement. For example, the President's Private Sector Survey of Cost Control has studied many of the problems I have discussed here today. In addition, the Reagan Administration is undertaking a multiphased management effort under Reform 88 which will address, as one of its four principle concerns, federal budget and financial management systems.

These studies show that the level of interest in improving government financial management is high. When developing their proposal for needed improvements, it is my belief that these groups, as well as you and I, should consider several other issues. These issues include the need to:

- consolidate the Federal Government's accounting into several major accounting and finance centers;

- establish a much enhanced and stronger central financial management function in the executive branch that would be responsible for keeping the central books of account;
- continue efforts to develop consolidated financial statements for the Federal Government, which will require good accounting at the agency accounting centers and the proper flow of information to the central accounting function; and
- in the long run, perform an annual financial audit of the Federal Government.

If the needed improvements are made to the Federal Government's financial management, I believe an annual financial audit of the Federal Government might be both desirable and economical. If we could ever have 10 to 15 major accounting and finance centers operating on a standard system according to Comptroller General accounting standards and a proper flow of financial data to a central accounting function, then we might be ready to have an annual audit of the financial records and statements of the Federal Government. I support the concept of annual audit of consolidated statements for two basic reasons. First, I think the discipline of annual statements would be beneficial and bring pressure to managers at the agency level to ensure that systems are adequate to provide accurate and reliable data to the central unit. Secondly, if we had accurate and reliable data available,

managers could be required to use data in the decisionmaking process and performance could actually be measured in terms of accomplishment based on that data.

Although I recognize that it will be sometime before an annual audit can be done efficiently, we need to start moving now. The accomplishment of this goal will require a substantial personnel and system investment and support at the highest levels of government will be vital. With this support and our mutual efforts, we will ultimately achieve what we all want--improved financial management in the Federal Government.

The final topic I would like to address is the need for leadership. The achievement of long-term improvements in financial management will be largely dependent upon the availability of leadership and qualified staff.

For example, one of the major issues is the role of the Assistant Secretary for Management and Budget. Agencies have constantly changed the role and responsibility of this position which is comparable to a Chief Financial Office in a state, or city, or in one of our larger corporations. But history shows a variety of assigned responsibilities to the Assistant Secretary position, sometimes with the worst case being the separation of the accounting and budget functions. If progress is to be made, this key position must be clarified and made stable so that accountability can be clearly assigned.

Of course one person at the top cannot do it all. There must also be sufficient numbers of highly qualified professional career service persons at all levels within the financial management organization. Obtaining highly qualified staff will be particularly difficult in time of budgetary pressure to trim or eliminate important training programs. It will be compounded in the future by the more sophisticated ADP skills required to perform some of the simpler tasks. We must meet these challenges if the major problems in financial management are to be resolved.

We in GAO have accepted this challenge. For example, we are developing an improved training program to upgrade staff skills in using and auditing with computers. I cannot overstate how important it is that financial managers keep abreast of the tremendous development and growth of computer-assisted operations. We must also have adequately trained staff to cope with the potential for ineffective and inefficient use of advanced data processing systems.

In conclusion, let me again state that the need to restore public confidence in government is a pressing matter confronting all of us today and that the problems to be resolved to meet that need are far more complex than at any other time in history. In the past, good financial management was certainly desirable. Today I think it is essential and will remain so in the future.

It is clear that we can play a major role in this great challenge. Some of you will be called upon to perform audits, some to

design the accounting and reporting systems, some to implement the systems, and others to provide management direction. All of you--either directly or indirectly--can become involved in the challenge of responding to the country's need for efficient, effective, and economic use of government resources. You are in an advantageous position to move this goal forward because of the professional skills and credentials which you possess. Your active participation and leadership is needed. Together we can provide the financial management information and systems the public deserves. Together we can make great progress as we move through the 1980's and into the 1990's.