

July 2007

MANAGERIAL COST ACCOUNTING PRACTICES

Implementation and Use Vary Widely across 10 Federal Agencies





Highlights of [GAO-07-679](#), a report to congressional requesters

Why GAO Did This Study

In the past 16 years, a number of laws, accounting standards, system requirements, and related guidance have emphasized the need for cost information in the federal government, establishing requirements and accounting standards for managerial cost accounting (MCA) information. In light of these requirements, GAO was asked to determine how federal agencies generate MCA information and how government managers use that information to support their decisions and provide accountability. Since 2005, GAO has reviewed and reported on MCA practices at 10 large civilian agencies resulting in five reports.

This report brings the overall observations of these studies together in one place.

What GAO Recommends

Our previous MCA reports included detailed recommendations to the agencies we reviewed. This report contains no new recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-679.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Robert E. Martin at (202) 512-6131 or martinr@gao.gov.

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Implementation and Use Vary Widely across 10 Federal Agencies

What GAO Found

Our work identified large disparities in the level of MCA implementation among federal agencies as well as the ways in which they use cost information. Of the 10 agencies we reviewed, only 3 had implemented MCA systems agencywide: the Department of the Interior (DOI), the Social Security Administration (SSA), and the Department of Labor (DOL). In addition, the Department of Transportation (DOT) had made significant progress in implementing MCA departmentwide. Three agencies—the Departments of Agriculture (USDA), Health and Human Services (HHS), and Housing and Urban Development (HUD)—planned to implement MCA systems when upgrading their overall financial management systems, but they had not yet adequately considered their MCA needs. The 3 remaining agencies—the Departments of Education, the Treasury, and Veterans Affairs (VA)—had no plans to implement MCA departmentwide, but some of their component agencies had implemented their own MCA systems. In addition, many agencies do not yet have the accurate, reliable, and timely data needed for MCA systems to ensure the outputs are useful and reliable.

Few of the federal agencies we reviewed were using MCA to make day-to-day decisions. Only DOI and SSA were using cost information routinely to manage operations entitywide. In addition, some component agencies of departments that did not have overall MCA systems were using cost information more routinely to evaluate programs, formulate budgets, and set fees and prices. DOL was developing plans for using its MCA system. Other agencies used cost information primarily for external financial reporting, and were only able to cite a limited number of examples showing how cost information was currently used to help make management decisions.

Strong leadership for MCA was in place at DOI, DOL, SSA, and DOT. Other agencies have not yet made concerted efforts to promote the benefits of MCA and oversee its implementation and use throughout their respective agencies. Although MCA can be implemented without an integrated financial management system, in those cases it tends to be used for single programs or projects rather than providing day-to-day information for managerial decision making agencywide. For MCA implementation to be successful, it must be tailored to the needs of the organization, be a tool managers can use to make everyday decisions, and be based on sound financial and nonfinancial data. Full MCA implementation across the federal government will require strong executive leadership, improved financial management systems, and a continuing transition in government culture to one of managing costs, in addition to managing the budget.

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United States Government Accountability Office
Washington, DC 20548

July 20, 2007

The Honorable Brian P. Billbray
Ranking Minority Member
Subcommittee on Government Management,
Organization, and Procurement
Committee on Oversight and Government Reform
House of Representatives

The Honorable Todd R. Platts
House of Representatives

A number of laws, accounting standards, information systems requirements, and related guidance have emphasized the need for cost information and cost management in the federal government. At the forefront, the Chief Financial Officers (CFO) Act of 1990¹ contains several provisions related to managerial cost accounting (MCA), one of which states that an agency's CFO should develop and maintain an integrated accounting and financial management system that provides for the systematic measurement of performance and the development and reporting of cost information. The Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and the Joint Financial Management Improvement Program's (JFMIP) *Framework for Federal Financial Management Systems*,² established accounting standards and system requirements, respectively, for MCA information at federal agencies. In addition, the Federal Financial Management Improvement Act of 1996 (FFMIA)³ required, among other things, that the systems of CFO Act agencies comply substantially with federal accounting standards and federal financial management systems requirements.

MCA offers a way for agencies to help maximize efficiency and effectiveness in using existing resources by identifying the true costs of

¹Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990).

²In December 2004, the JFMIP principals voted to modify the roles and responsibilities of the JFMIP Program Office, which is now known as the Financial Systems Integration Office (FSIO).

³Pub. L. No. 104-208, div. A., § 101 (f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

programs and providing better information for making decisions and enhancing accountability. Given this, as well as the requirements for CFO Act agencies to prepare MCA information, you asked us to determine the extent to which those agencies develop cost information and use it for managerial decision making. Accordingly, over the past 2 years, we completed reviews of MCA practices in 10 large CFO Act agencies, resulting in five reports.⁴ This report summarizes our findings from those reports on (1) the ways federal agencies generate managerial cost accounting information, (2) how government managers use cost information to support managerial decision making and provide accountability, and (3) the need for stronger leadership for implementing MCA in many of the agencies we reviewed. This capping report was prepared between September 2006 and June 2007 in accordance with generally accepted government auditing standards.

Results in Brief

More than 16 years after the passage of the CFO Act, we found that few federal agencies have systems that can routinely provide managers with reliable cost information to inform decision making. Of the 10 agencies we reviewed, only 3 had implemented MCA systems entitywide: the Department of the Interior (DOI), the Social Security Administration (SSA), and the Department of Labor (DOL). In addition, the Department of Transportation (DOT) had made significant progress in implementing MCA entitywide. Three agencies—the Departments of Agriculture (USDA), Health and Human Services (HHS), and Housing and Urban Development (HUD)—planned to implement MCA systems when upgrading their overall financial management systems, but they had not yet adequately considered their MCA needs. The three remaining agencies we reviewed—the Departments of Education, the Treasury, and Veterans Affairs (VA)—had no plans to implement MCA departmentwide, although VA was initiating a review to explore opportunities to do so. Further, some component agencies at Education, Treasury, and VA had implemented their own MCA

⁴ GAO, *Managerial Cost Accounting Practices: Leadership and Internal Controls Are Key to Successful Implementation*, [GAO-05-1013R](#) (Washington, D.C.: Sept. 2, 2005); *Managerial Cost Accounting Practices: Departments of Education, Transportation, and the Treasury*, [GAO-06-301R](#) (Washington, D.C.: Dec. 19, 2005); *Managerial Cost Accounting Practices: Department of Health and Human Services and Social Security Administration*, [GAO-06-599R](#) (Washington, D.C.: Apr. 18, 2006); *Managerial Cost Accounting Practices: Department of Agriculture and Department of Housing and Urban Development*, [GAO-06-1002R](#) (Washington, D.C.: Sept. 21, 2006); and *Managerial Cost Accounting Practices at the Department of the Interior*, [GAO-07-298R](#) (Washington, D.C.: May 24, 2007).

systems. In addition, some agencies do not yet have the accurate, reliable, and timely data needed for MCA systems to ensure the outputs are useful and reliable.

Few of the federal agencies we reviewed were using MCA to make day-to-day decisions. Only DOI and SSA used cost information routinely to manage operations entitywide. In addition, DOL was developing plans for using its recently implemented MCA system. Other agencies used cost information primarily for external financial reporting, and they cited a limited number of examples showing how cost information was used to help make management decisions. Finally, some components of agencies that did not have overall MCA systems used cost information more routinely to, among other things, evaluate programs, formulate budgets, and set fees and prices.

Strong leadership for MCA was in place at DOI, DOL, SSA and DOT. Other agencies have not yet made concerted efforts to promote the benefits of MCA and oversee its implementation and use throughout their respective components. Because implementing MCA takes time, requires monitoring, and inevitably mid-course adjustments, the managers who will use the information need to see its value and take ownership of the system. Strong leadership can set the tone and the expectations to make this happen, and encourage a continuing transition in federal government culture to one of identifying and managing costs, in addition to managing the budget.

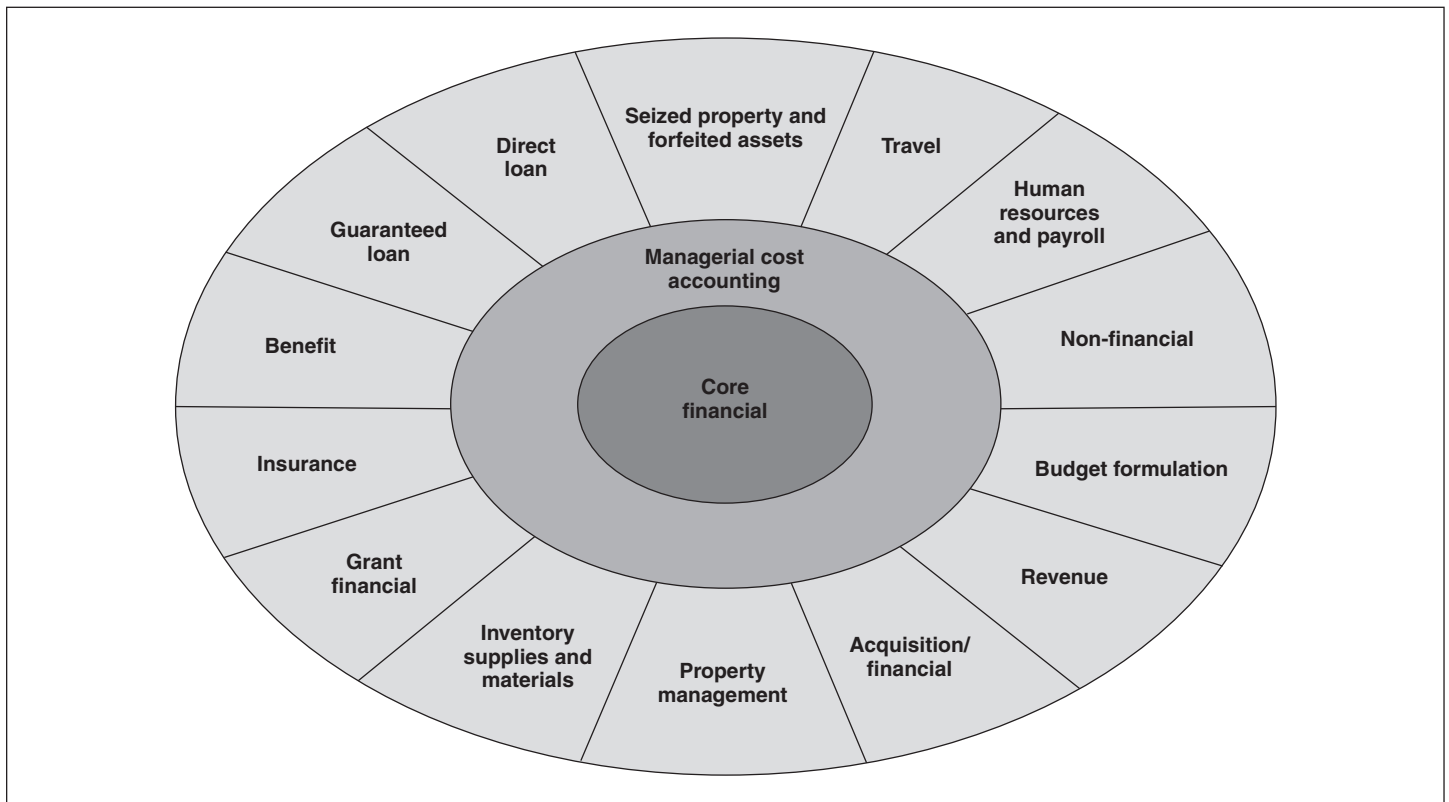
Background

The policies and standards prescribed for executive agencies to follow in developing, operating, evaluating, and reporting on financial management systems are included in Office of Management and Budget (OMB) Circular No. A-127, *Financial Management Systems*. The components of an integrated financial management system include the core financial system,⁵ a managerial cost accounting system, and certain administrative and programmatic systems. Administrative systems are those that are common to all federal agency operations,⁶ and programmatic systems are those needed to fulfill an agency's mission. Figure 1 illustrates how these systems should interrelate in an agency's overall systems architecture.

⁵Core financial systems, as defined by the Office of Federal Financial Management (OFFM), include managing general ledger, funding, payments, receivables, and certain basic cost functions.

⁶Examples of administrative systems include budget, acquisition, travel, property, and human resources and payroll.

Figure 1: Agency Systems Architecture



Source: OMB, *Core Financial Systems Requirements*, OFFM-NO-0106 (Washington, D.C.: January 2006).

The Statement of Federal Financial Accounting Standards No. 4 (SFFAS 4), *Managerial Cost Accounting Concepts and Standards for the Federal Government*, which became effective in fiscal year 1998, sets forth the fundamental elements for MCA in government agencies.⁷ The five standards in SFFAS 4 require government agencies to (1) accumulate and report the costs of activities on a regular basis for management information purposes; (2) establish responsibility segments, and measure and report the costs of each segment's outputs and calculate the unit cost of each output; (3) determine and report the full costs of government

⁷ In October 1997, the Federal Accounting Standards Advisory Board delayed SFFAS 4 implementation from fiscal year 1997 to fiscal year 1998.

goods and services, including direct⁸ and indirect⁹ costs; (4) recognize the costs of goods and services provided by other federal entities; and (5) use and consistently follow costing methodologies or cost finding techniques most appropriate to the segment's operating environment to accumulate and assign costs to outputs. SFFAS 4 states that MCA should be a fundamental part of the financial management system and, to the extent practical, should be integrated with other parts of the system.

There are many potential applications for cost information in the federal government. This information can be used by federal executives for budgeting and cost control, performance measurement, determining reimbursements and setting fees and prices, program evaluations, and decisions that involve economic choices, such as whether to do a project in-house or contract it out.¹⁰ The Congress can also use MCA information to determine how to fund programs and monitor agency performance, as well as to analyze the merits of proposals advocated by different parties. The public, in turn, can benefit from greater transparency about program performance and ready access to information on how its tax dollars are spent.

Managerial cost accounting entails answering a very simple question. How much does it cost to do something, be it an extensive overall program effort or the incremental and iterative efforts associated with a project activity? As such, it involves accumulating and analyzing both financial and nonfinancial data¹¹ to determine the costs of achieving performance goals, delivering programs, and pursuing other activities. The principal purpose is to assess how much it costs to do whatever is being measured, thus allowing management to analyze whether that cost seems reasonable, or to establish a baseline for comparison with others who do similar work. The factors analyzed and the level of detail depend on the operations and

⁸Direct costs are costs that can be specifically identified with an output, including salaries and benefits for employees working directly on the output, materials, supplies, and costs with facilities and equipment used exclusively to produce the output.

⁹Indirect costs are costs that are not specifically identifiable with any output and may include costs for general administration, research and technical support, and operations and maintenance for building and equipment.

¹⁰See Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, issued July 31, 1995.

¹¹Nonfinancial data measure the occurrences of activities and can include such things as hours worked, units produced, grants managed, inspections conducted, or people trained.

needs of the organization. Reliable financial and nonfinancial data are cornerstones of this assessment because if the data are wrong, the resulting analysis can give a distorted view of how well the organization is doing, thereby affecting decision making. MCA differs from financial accounting in that it is primarily intended to provide information for internal decision making rather than external reporting.

Evolution of Managerial Cost Accounting

With the growth of continuous improvement initiatives since the 1970s, the role of cost accounting has evolved in many organizations from measuring and reporting business initiatives to helping organizations implement management initiatives.¹² Activity-based Costing (ABC), which is a type of MCA, is a set of management information and accounting methods used to identify, describe, assign costs to, and report on an organization's operations.¹³ Activity-based Costing/Management (ABC/M) uses ABC to achieve the broad objective of improving management decision making and reducing costs by providing accurate cost information and encouraging continuous improvement efforts.¹⁴

The private sector began to use ABC/M in the 1980s to analyze work activities and provide information on core business processes to promote effectiveness in an era of increased competitiveness.¹⁵ At the same time, the federal government was experiencing growing problems in financial management, with frequent disclosures of fraud, waste, and abuse in federal programs. In 1985 the Comptroller General issued a two-volume report, entitled *Managing the Cost of Government: Building an Effective Financial Management Structure*, which provided the framework for the reforms needed to improve federal financial management and manage the cost of government.¹⁶

¹²Tom Albright and Marco Lam, "Managerial Accounting and Continuous Improvement Initiatives: A Retrospective and Framework," *Journal of Managerial Issues*, vol. XVIII, no. 2 (Summer 2006), 157-174.

¹³Clif Williams and Ward Melhuish, "Is ABC Destined for Success or Failure in the Federal Government?" *Public Budgeting & Finance* (Summer 1999), 22-36.

¹⁴Albright and Lam, 2006, p. 164.

¹⁵Williams and Melhuish, 1999, p. 22.

¹⁶GAO, *Managing the Cost of Government: Building an Effective Financial Management Structure*, [GAO/AFMD-85-35](#) and 35A (Washington, D.C.: February 1985).

The Chief Financial Officers Act (CFO Act) of 1990¹⁷ was the beginning of a series of management reform laws to improve federal financial management and set the stage for other key reforms that followed. Among other things, the CFO Act established a leadership structure for financial management, required audited financial statements, and strengthened accountability reporting. It contains several provisions related to managerial cost accounting, one of which states that an agency's CFO should develop and maintain an integrated accounting and financial management system that provides for the development of cost information and systematic performance measurement. The end goal of the CFO Act is to greatly enhance the ability of managers to do their jobs by providing the full range of financial information needed for day-to-day management.

The CFO Act was followed by the Government Performance and Results Act (GPRA) in 1993.¹⁸ GPRA requires agencies to develop strategic plans, set performance goals, and report on actual performance compared to goals each year. Accurate cost information can enhance the utility of selected performance measures. GPRA, in turn, was followed by the Government Management and Reform Act (GMRA) of 1994,¹⁹ which made the CFO Act's pilot program for annual audited agency financial statements permanent and expanded this requirement to all agencies covered by the CFO Act.

The Federal Financial Management Improvement Act of 1996²⁰ (FFMIA) built on this foundation in order to help generate reliable, useful, and timely information for management decision making and to help ensure ongoing accountability by requiring agencies covered by the CFO Act²¹ to have systems that comply substantially with federal accounting standards, such as SFFAS 4, federal financial management systems requirements and the *U.S. Government Standard General Ledger* (SGL)²² at the transaction level. In addition, FFMIA requires that we report to the Congress on its

¹⁷Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990).

¹⁸Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993).

¹⁹Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994).

²⁰Pub. L. No. 104-208, div. A., § 101(f), title VIII 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

²¹As of fiscal year 2005, 24 agencies were covered by the CFO Act.

²²The SGL provides a standard chart of accounts and transactions for agency financial systems.

implementation status each year. While the number of CFO Act agencies receiving unqualified opinions on their financial statements has increased from 11 in fiscal year 1997 to 19 in fiscal year 2005, the ability of federal financial management systems to fully address FFMIA requirements has not advanced at the same pace. For fiscal year 1997, 20 agencies were reported as having systems that were not in substantial compliance with at least one of the three FFMIA systems requirements; for fiscal year 2005, auditors for 18 of the CFO Act agencies reported that the agencies' financial management systems did not substantially comply with at least one of the three FFMIA requirements.

The federal government is one of the largest, most complex organizations in the world, and operating, maintaining, and updating its financial management systems is a monumental economic and technical challenge. The 10 agencies reviewed through our series of MCA engagements over the past 2 years represent a broad diversity of mission and purpose, and accounted for over 88 percent of the reported total net costs of civilian federal government agencies in fiscal year 2005 (see table 1).

Table 1: Reported Costs and Earned Revenues for 10 Civilian Agencies, for the Fiscal Year Ended September 30, 2005

(dollars in billions)

	Gross cost ^c	Earned revenue ^d	Percentage earned revenue	Net cost ^e	Percentage net cost
Department of Health and Human Services	\$623.4	\$39.6		\$583.8	
Social Security Administration	572.1	-2.0		574.1	
Department of Veterans Affairs	276.6	3.4		273.2	
Department of Agriculture	112.6	19.9		92.7	
Department of the Treasury ^a	82.3	3.1		79.2	
Department of Education	75.6	4.7		70.9	
Department of Transportation	62.4	0.6		61.8	
Department of Labor	50.0	0.0		50.0	
Department of Housing and Urban Development	43.6	1.3		42.3	
Department of the Interior	19.5	3.2		16.3	
Subtotal	\$1,918.1	\$73.8	37.3%	\$1,844.3	88.2%
Other civilian agencies	371.4	124.1	62.7%	247.3	11.8%
Total civilian agencies ^b	\$2,289.5	\$197.9	100.0%	\$2,091.6	100.0%

Source: Department of the Treasury, Financial Management Service, *Financial Report of the United States Government, 2005*, Washington, D.C.

^aInterest on Treasury securities held by the public is not included.

^bThis equals the total costs and revenues for the U.S. government, less costs and revenues for the Department of Defense and interest on Treasury securities held by the public.

^cGross cost is the full cost of providing agency goods and services.

^dEarned revenues arise when a government entity provides goods and services to the public or to another government entity for a price.

^eNet cost equals the gross cost less earned revenues.

Scope and Methodology

This report summarizes the results of our series of reviews concerning how 10 large federal agencies generate and use MCA information. In addition to summarizing our prior reports, we also researched literature on MCA implementation to learn whether the MCA practices and problems we found were similar to those in other federal agencies, state and local government, and private industry. The reports we summarized and the literature we reviewed are listed in appendix I.

We followed a consistent methodology when reviewing MCA at each of the 10 large civilian agencies. To obtain an understanding of how agencies generated managerial cost information, we reviewed documentation and interviewed officials on the status of MCA system implementation and the related obstacles to managerial costing. We also examined agency guidance and looked for evidence of leadership on and commitment to the implementation of entitywide cost management practices. Using the *Standards for Internal Control in the Federal Government*²³ as a guide, we identified internal controls over the reliability of financial and nonfinancial information used in MCA. To determine how managers used cost information to support decision making and provide accountability for government resources, we obtained an understanding of how agencies used cost accounting data for budgeting, costing services or products, preparing the Statement of Net Cost, managing contractors' reimbursable costs, and other managerial uses through a review of documentation provided by the agencies and interviews with agency officials.

During our reviews, we visited agency headquarters in Washington, D.C. We also visited certain component agencies at each department and held teleconferences with other agency officials as necessary. When possible, we corroborated information obtained in interviews with documents on policies, procedures, system descriptions, and flowcharts. We also reviewed prior Office of Inspector General (OIG), independent public

²³ GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

accountant, and our reports on MCA activities, systems, and data. In performing our work, we issued five reports, which are listed in footnote 4. The agencies provided comments on each of these five report drafts, which we considered and incorporated as appropriate. We performed this body of work in accordance with U.S. generally accepted government auditing standards between March 2005 and January 2007. We did not request comments from affected agencies on a draft of this capping report because, in accordance with our *Agency Protocols*, we do not seek comments from agencies when a product largely reflects our prior work.²⁴ This capping report was prepared between September 2006 and June 2007 in accordance with generally accepted government auditing standards.

Few Agencies Have MCA Systems That Can Provide Managers with Cost Information for Daily Use

Of the 10 CFO Act agencies we reviewed, only DOI and SSA had MCA systems in place that could provide managers entitywide with cost information on a routine basis for daily decision making. In addition, DOL had recently implemented a departmentwide MCA system and was developing plans for using it, and DOT had made significant progress in implementing MCA departmentwide. Three departments—USDA, HHS, and HUD—planned to implement MCA systems when upgrading their overall financial management systems, but they had not yet adequately considered their MCA needs. The remaining three departments—Education, Treasury, and VA—did not yet have procedures in place to ensure implementation of MCA departmentwide, although VA was initiating a review to explore opportunities for a departmentwide MCA system. Further, some component agencies at Education, Treasury, and VA had implemented their own MCA systems. The usefulness of each of the systems we reviewed, however, depends on the reliability of the financial and nonfinancial data used. Our review found many agencies still may not have accurate, reliable, and timely data throughout the year.

Entitywide MCA Implementation

DOI, SSA, DOL, and DOT had all chosen to implement MCA entitywide. The following paragraphs note the systems each implemented.

DOI has a departmentwide MCA system known as Activity-based Cost/Management (ABC/M), which provides information about the cost of work activities. Financial data are extracted daily from the DOI bureaus' stand-alone general ledger systems, and nonfinancial data are obtained

²⁴GAO, *GAO's Agency Protocols*, [GAO-05-35G](#) (Washington, D.C.: October 2004).

from other bureau source systems. ABC/M is intended to measure the cost of activities, such as issuing permits, maintaining trails, and performing site inspections. ABC/M provides information about the cost of approximately 300 work activities, which align to DOI's four strategic mission objectives. Nonfinancial data such as hours, miles, or acres are obtained from various source systems maintained by each of the bureaus and may be entered either manually or extracted from these systems. As noted later in this report, DOI's noncompliance with FFMIA requirements could affect the quality of financial data exported to its MCA systems. DOI is in the process of implementing a new integrated financial management system, Financial Business Management System (FBMS). The current FBMS implementation plan for the general ledger module calls for a phased implementation with seven deployments beginning in April 2006 and ending in fiscal year 2011.

SSA's agencywide MCA system, the Cost Analysis System (CAS), was first put in use in 1976. CAS collects data on full costs from SSA's nationwide network of offices, except for those expenses incurred by other agencies for SSA's benefit, such as certain postretirement costs paid by OPM. According to SSA officials, CAS integrates data from payroll, work measurement accounting, and other management information systems, and assigns costs to specific workloads. To better integrate data and systems for decision making, management is in the process of implementing the Managerial Cost Analysis System (MCAS), a new second-generation MCA system. SSA officials expect that MCAS will be implemented by September 2008. MCAS is intended to eliminate several legacy systems and integrate with a new data warehouse, provide more detailed management information, and help address outstanding audit findings, which noted a lack of policies, procedures, and documentation concerning the collection, review, and reporting of information for some individual performance indicators. In addition to annual financial statement audits, SSA's system of internal controls includes demonstrated tone at the top setting SSA's values, philosophy, and operating style; documented MCA policies and procedures; edit checks and variance analysis to help ensure data quality; routine monitoring and assessment of performance and financial information; and regular internal review of financial and feeder systems.

In its 2004 Financial Data Integration Improvement Plan, DOL identified MCA as one way to address its most pressing management challenges. DOL assigned responsibility for MCA development to the Office of the Chief Financial Officer. According to DOL officials, the resulting MCA tool, Cost Analysis Manager (CAM), will be able to identify, accumulate, and

assign costs to outputs and bring relevant cost information to the desktop computers of managers throughout the department. Component-specific CAM models were developed in all 10 DOL mission agencies and 5 of the 8 support offices. Planned systemwide refinements included automating the data extraction/import process and adding programs and outputs to baseline models.

In November 2003, DOT implemented a new integrated financial management system called Delphi, a component of which may be used by DOT's 12 operating administrations (OA) for cost accounting. Each of the 12 OAs was developing its own MCA system tailored to its respective needs. In addition, the Federal Aviation Reauthorization Act of 1996 requires the Federal Aviation Administration (FAA), one of the largest OAs, to develop a cost accounting system that accurately reflects the asset value, operating and overhead cost, and other financial measurement and reporting aspects of its operations.²⁵ According to DOT officials, FAA has completed implementing its MCA system, the Cost Accounting System (CAS), and CAS is already linked to Delphi. The other DOT OAs expected to have MCA models in place by the end of fiscal year 2007.

Some Agencies Are Planning to Implement MCA When Upgrading Their Financial Management Systems

USDA, HHS, and HUD planned to implement MCA systems as part of their ongoing efforts to upgrade their overall financial management systems, but they had not yet adequately considered their MCA needs at the time of our reviews.

USDA's current financial system was not designed to provide in-depth MCA information; however, a draft Financial Data Integration Improvement Plan (FDIIP) refers in general terms to incorporating MCA into the agency's financial management improvement efforts. The FDIIP includes the Financial Management Modernization Initiative (FMMI) system to replace USDA's current financial system. FMMI is scheduled to be fully implemented by the end of fiscal year 2012, and management expects it to include a cost accounting module. However, except for the date of overall implementation for FMMI and ongoing MCA initiatives at the Farm Services Agency, the Forest Service, and Rural Development, the FDIIP had not yet set time frames or requirements for the other component agencies to improve cost management.

²⁵Pub. L. No. 104-264, 110 Stat. 3213 (Oct. 9, 1996).

On its own initiative, one USDA component, the Food and Nutrition Service (FNS), implemented a National Data Bank (NDB) system to integrate detailed cost and program performance information with its state grantee program data reporting system. NDB includes both FNS and department-level direct and indirect costs. Officials said that internal controls over NDB data include audits by state auditors and CPA firms under the OMB Circular No. A-133 single audit process to determine whether state program and administrative costs charged to FNS are allowable.

HHS is currently implementing a new financial management system, Unified Financial Management System (UFMS), a commercial, off-the-shelf (COTS)-based Oracle software package, which is expected to replace outdated systems by fiscal year 2008. According to HHS officials, plans for UFMS include a module, Oracle Projects, which can be used for cost accounting. HHS officials told us that all components will incorporate Oracle Projects in their planned UFMS implementation and tailor it to meet their needs. However, there were differences between HHS expectations and plans for implementing Oracle Projects at the two components we reviewed. Specifically, a Center for Medicare and Medicaid Services (CMS) official told us CMS was uncertain whether it would use the Oracle Projects cost accounting module for MCA. Similarly, a Centers for Disease Control (CDC) official said that CDC had no current plans to use the module for MCA and had not yet completed a full assessment of its MCA needs. In the meantime, the Medicare Program Division at CMS developed its own ABC system for contractors to report their costs. The system took costs from the contractors' accounting systems, distributed the costs among activities, and provided CMS managers with fully loaded costs for products, services, and activities, which they use to monitor contractor performance.

In order to obtain MCA information, HUD currently must accumulate and integrate financial and nonfinancial data elements from a number of sources including a workload survey used to allocate costs to programs, and a financial Data Mart.²⁶ In response to our review, HUD acknowledged that a major core financial management systems modernization effort, the HUD Integrated Financial Management Improvement Project (HIFMIP),

²⁶Data Mart is HUD's repository for selected information extracted from its general ledger and other sources of financial and nonfinancial data. It has been used primarily as a cash management and financial reporting tool.

presented an opportunity to reassess the application of MCA practices at HUD. HIFMIP is an enterprisewide initiative to develop an integrated accounting system that HUD plans to have fully implemented in 2013. HUD expected, however, that any increased application of MCA would be done through its financial Data Mart which, according to HUD, provided the capability to combine accounting/cost data with other data sources to produce automated management reports. HUD also planned to pilot a full ABC effort in its Single Family Housing Mortgage Insurance Programs area and, upon assessment of that pilot effort, consider applying ABC in other areas.

Some Agency Components Developed MCA Systems Independently

Education, Treasury, and VA did not have plans in place to implement MCA departmentwide and had not taken steps at the department level to monitor component-level MCA implementation. However, each of the three departments had one or more component agencies that had developed its own MCA systems.

At Education, only 1 of 10 program offices, Federal Student Aid (FSA), had a MCA system in place at the time of our review. Education did not promote or monitor MCA implementation at the component offices, nor did it have policies and procedures for implementing MCA departmentwide. FSA's Activity-based Management system was initiated in response to the 1998 amendments to the Higher Education Act of 1965²⁷ that designated FSA a performance-based organization and required it to reduce administrative costs.²⁸ FSA used COTS software to assign full costs, both direct and indirect, and non-FSA overhead, to business processes.

By policy, Treasury delegated responsibility to implement MCA to its bureaus. Treasury retained oversight responsibility to ensure consistent implementation of MCA departmentwide, but had no specific procedures in place to ensure that consistent, periodic, department-level oversight was conducted. Treasury's Bureau of Engraving and Printing (BEP) used COTS software to accumulate and assign full costs to products,

²⁷Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1581, 1604-05 (Oct. 7, 1998).

²⁸A performance-based organization is a discrete management unit which commits to accountability for results by having clear objectives, specific measurable goals, customer service standards, and targets for improved performance. In exchange, it can be granted managerial flexibilities to achieve these aims and goals in areas such as personnel, procurement, financing, and real property.

organizational units, and specific operations. In addition to annual financial statement audits, various controls over financial and nonfinancial data were in place at BEP including periodic review of labor, material, and overhead costs, and risk-based inventory cycle counts of production units such as ink and paper to measure utilization and shrinkage. Similarly, Treasury's Financial Management Service (FMS) used COTS software to integrate financial and nonfinancial data from payroll, travel, requisition, and property systems. Internal controls included data validation rules to help ensure that transmitted data were accurate and fell within predetermined ranges, and FMS officials said that they reviewed data for reasonableness and researched variances.

By design and policy, VA did not have a departmentwide MCA model at the time of our review. Officials told us that VA's financial management priority had been the removal of a material weakness related to the lack of an integrated financial management system at the department. Subsequent to our review, however, VA officials said that they were investigating opportunities for a departmentwide MCA system.²⁹ They said that a centralized MCA system would improve the accessibility and availability of cost accounting data and enhance managerial decision-making throughout VA. Further, while one VA component agency had discontinued use of its MCA system in 2003, VA's Veterans Health Administration (VHA) used its Decision Support System (DSS) for MCA. DSS enabled cost analyses by VHA location, program, and activity, and tracked costs for individual patient care, although the extent and nature of DSS use varied from one medical facility to the next because of differences in staff training. DSS obtained data from 49 feeder sources, including VA's general ledger and VHA's Veteran's Health Information Systems and Technology Architecture (VistA), a nonfinancial workload information system.

²⁹Statement of the Honorable Tim S. McClain, General Counsel and Chief Management Officer, U.S. Department of Veterans Affairs, before the Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, U.S. House of Representatives, during an oversight hearing concerning *Implementing Cost Accounting at the Department of Veterans Affairs and the Department of Labor*, September 21, 2005.

Agencies Need Reliable Financial and Nonfinancial Data throughout the Year for MCA Systems to Be Useful

The completeness and accuracy of the data in MCA systems depends on the quality of the data from feeder systems, both financial and nonfinancial. Many agencies still may not have accurate, reliable, and timely financial and nonfinancial data available throughout the year.

Problems with Financial Data

Although agencies have made improvements and have other enhancements under way, the systems deficiencies that have prompted unfavorable FFMIA assessments indicate that the financial management systems of many agencies are still not able to produce reliable, useful, and timely financial information routinely. As shown in table 2, in fiscal year 2005, independent auditors concluded that 8 of the 10 agencies reviewed in our series of MCA engagements had systems that were not compliant with one or more of the three FFMIA requirements.³⁰ Only SSA and DOL met all three FFMIA requirements.

Table 2: Auditors' FFMIA Assessments for Fiscal Year 2005

CFO Act departments/agencies	Auditors' assessment of FFMIA compliance		Areas auditors identified as not in substantial compliance		
	Yes	No	Systems requirements	Accounting standards	SGL
Department of Agriculture		X	X	X	X
Department of Education		X	X		
Department of Health and Human Services		X	X		X
Department of Housing and Urban Development		X	X		
Department of the Interior		X		X	X
Department of Labor	X				
Department of Transportation		X	X	X	X
Department of the Treasury		X	X	X	X
Department of Veterans Affairs		X	X		
Social Security Administration	X				

Source: GAO, *Financial Management: Improvements Under Way but Serious Financial Systems Problems Persist*, GAO-06-970 (Washington, D.C.: September 2006), p. 68.

³⁰GAO, *Financial Management: Improvements Under Way but Serious Financial Systems Problems Persist*, GAO-06-970 (Washington, D.C.: Sept. 26, 2006).

Noncompliance with federal systems requirements

As seen in table 2, 7 of the 10 agencies we reviewed had systems that were not in compliance with federal financial management systems requirements, as required by FFMIA. These 7 agencies had problems such as nonintegrated financial management systems, inadequate reconciliation procedures, a lack of accurate and timely recording of financial information, and weak security controls over information systems. Agencies that lack integrated financial systems typically expend major effort and resources to develop information that their systems should be able to provide on a daily or recurring basis. In addition, opportunities for errors are increased when agency systems are not integrated. Improper reconciliation procedures contribute to errors in financial reporting. A reconciliation process, whether manual or automated, is a necessary and valuable part of a sound financial management system. The less integrated the financial management system, the greater the need for adequate reconciliations because data are being accumulated from a number of different sources. Accurate and timely recording of financial information is also essential for successful financial management. Agencies that have not accurately recorded transactions throughout the fiscal year must often make substantial manual efforts at year-end to prepare financial statements. These extensive last minute efforts are susceptible to error and increase the risk of misstatements. Finally, information security weaknesses place vast amounts of government assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, other sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Unresolved information security weaknesses can also compromise the reliability and availability of data recorded in or transmitted by an agency's financial management system.

Lack of adherence to federal accounting standards

According to their independent auditors, 4 of the 10 agencies we reviewed had systems that were not in compliance with federal accounting standards. Adherence to federal accounting standards requires that agencies account for transactions in a way that ensures federal financial reports provide users with understandable, relevant, and reliable information about the financial position, activities, and results of government operations. In their FFMIA reviews, auditors reported that three standards were most troublesome for agencies: SFFAS No. 1, *Accounting for Selected Assets and Liabilities*; SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*; and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. In particular, SFFAS 4 continued to be difficult for federal managers to implement.

Noncompliance with the
Standard General Ledger

Five of the 10 agencies we reviewed did not have systems that implemented the SGL at the transaction level, as required by FFMIA. Using the SGL promotes consistency in financial transaction processing and reporting by providing a uniform chart of accounts and pro forma transactions that give a basis for comparison at the agency and governmentwide levels. This standardizes the accumulation of agency financial information, enhances financial control, and supports financial statement preparation and other external reporting. Failure to use the SGL impedes the ability of the federal government to complete accurate, governmentwide financial statements.

During our series of MCA reviews, we noted numerous problems with financial data that illustrate the types of issues discussed in our FFMIA reviews. For instance, for fiscal year 2005, USDA's OIG reported that the agency needed stronger internal controls to improve the timeliness and accuracy of financial data available to managers and cited material weaknesses related to overall financial management across the agency. The agency's independent auditor identified "abnormal balances" in more than 90 accounts, totaling over \$1 billion, which had not been fully researched or corrected before the end of the fiscal year. Similarly, the Forest Service, a component of USDA, received an unqualified opinion on its fiscal year 2005 financial statements after making 177 accounting adjustments with an absolute value of \$1.9 billion. For fiscal year 2006, the USDA OIG again cited a material weakness related to improvements needed in overall financial management across the agency. Further, while indicating that the Forest Service made significant improvement in its reporting processes during fiscal year 2006, the OIG noted areas where further improvements are needed before the Forest Service can produce accurate and timely financial information.

Independent auditors also reported serious weaknesses in financial systems and processes at HHS, HUD, and DOT. At HHS, system limitations led many operating divisions to record numerous entries outside of the general ledger system, which required intensive manual procedures to prepare the year-end financial statements for fiscal year 2005. Similarly, according to the independent auditor's report covering the fiscal year 2006 financial statements, HHS continued to have serious internal control weaknesses in its financial management systems and processes, and still needed intensive manual procedures to prepare the year-end financial statements. In November 2005, HUD's OIG reported that the department relied on extensive manual procedures that were costly, labor intensive, and not always effective to prepare its annual financial statements. These problems continued in fiscal year 2006, with the HUD OIG reporting that

Problems with Nonfinancial
Data

HUD still relied on extensive compensating procedures. The DOT OIG reported that DOT had three material weaknesses affecting financial reporting for fiscal year 2005. In particular, the DOT OIG reported continuing serious weaknesses in timely processing of transactions and reconciliation of accounts at FAA, and problems with financial statement preparation and analysis and resolving reconciliation differences at the Federal Highway Administration (FHWA). For fiscal year 2006, the OIG reported that DOT still had two material weaknesses: (1) untimely processing of transactions and accounting for the FAA construction in progress account and (2) financial management, reporting, and oversight problems at the Highway Trust Fund agencies, including FHWA.

Agencies also need to ensure that nonfinancial data such as data on labor distribution, performance and workload, is accurate. Nonfinancial data are as important as financial data in determining reliable managerial cost information because they provide the basis for assigning costs to various programs, activities, or outputs and for determining program efficiency. For example, overcounting the number of people trained in a job training program in one city would result in an understatement of the unit cost of training each program participant in that city.³¹ Due to the inaccurate nonfinancial data, the program in this city could appear, falsely, to be more efficient in execution in comparison to similar programs in other cities.

As with financial data, adequately designed controls and properly implemented procedures for nonfinancial data are key when determining the cost of work outputs. In some of our MCA reviews, we noted that procedures to ensure reliability of nonfinancial data were not documented. Also, a lack of readily available system documentation could inhibit efforts to determine whether costs are properly assigned and preclude an opportunity to provide guidance for employees using the system. Some agencies rely on controls from the offices providing the nonfinancial data. Examples of problems with controls over nonfinancial data at Education, DOI, DOL, and VA follow.

Education's FSA officials relied mainly on controls within the offices that are the sources of nonfinancial data. In addition, they reviewed the

³¹If it cost \$100,000 to fund a training program, the unit cost of training each participant would be \$1,000 if 100 people were trained, but the unit cost would be \$2,000 if only 50 people were trained.

nonfinancial performance data periodically for anomalies by comparing data to standard system reports, and performing trend analyses and comparing data for consistency. FSA, however, had not documented the design of controls that are being used to help ensure the reliability of the nonfinancial data, nor had it documented that control procedures were properly completed.

DOI officials stated that DOI does not have written procedures for monitoring the quality and accuracy of its ABC/M data and that not all bureaus have written procedures for performance data validation and verification. In addition, controls over nonfinancial data are generally limited to a bureau-level review for reasonableness. DOI has acknowledged the need for independent department-level validation and verification of nonfinancial ABC/M data, and plans to follow up in 2007 to ensure that bureaus have implemented data validation and verification standards and procedures.

In its fiscal year 2004 performance plan, DOL identified the validation of labor distribution and performance data as one of its challenges. Labor cost is often the predominant factor when determining the cost of an activity. At DOL's largest component agency, the Employment and Training Administration (ETA),³² the OIG noted high error rates in performance data reported by grantees. In 2004 the OIG also raised concerns about DOL using those data for decision making. DOL officials responded that they were implementing additional data validation systems to address these issues. In fiscal year 2007, the OIG plans to audit the new data validation system developed by ETA to improve the reliability of program performance information reported by its grantees.

At VA's Veterans Health Administration (VHA), both independent auditors and the OIG have raised concerns about the quality of data for feeder systems for its Decision Support System (DSS). DSS has 49 feeder sources, including VistA. In August 2004, the OIG reported that most of the legacy systems, such as VistA, at Bay Pines Medical Center contained inaccurate data. The OIG further stated that this might be a systemic problem throughout VHA. In addition, the VA's VHA Decision Support Office was unable to readily produce documentation of the mechanism used to assign

³²DOL's Employment Training and Administration contributes to the more efficient functioning of the U.S. labor market by providing high-quality job training, employment, labor market information, and income maintenance services primarily through state and local workforce development systems.

indirect costs to cost objects in DSS. Subsequent to our audit, VHA officials said they took steps to address these issues, including the development and implementation of a standardized audit protocol to confirm the accuracy of the data fed into DSS and the uniformity of its processing.

Few Agencies Use Cost Information Routinely to Manage Their Operations

We found that progress implementing MCA practices, and thus the development of uses for cost information, while ongoing, is slow. Among the 10 agencies we reviewed, only DOI and SSA routinely used cost information entitywide to make decisions. In addition, DOL had recently implemented its MCA system, and was in the process of developing plans for using it. The other agencies used cost information primarily for external financial reporting in the Statement of Net Cost, and they cited isolated examples of how cost information was used to inform management decisions. These agencies did not provide evidence to us that cost information was routinely used to inform their decision making. Finally, some component agencies of departments that did not have overall MCA systems, including BEP and FMS at Treasury, FAA at DOT, and FNS at USDA, used cost information more routinely to, among other things, evaluate programs, formulate budgets, and set fees and prices.

Entitywide Uses of MCA Information

Management at 2 of the 10 agencies we reviewed routinely used MCA to make decisions, and a third agency was in the process of developing uses.

DOI used cost information to provide visibility on the costs of activities and initiatives of interest to departmental leadership. For example, a graphical report to senior Interior executives, called the Executive Dashboard, provided department leadership with access to some department-level program cost information. MCA was used to support recommendations to change work processes, reallocate resources, and prepare budgets and performance targets. DOI bureaus used MCA to project future resource needs based on estimated workloads, identify and examine workload trends, and set fees.

SSA's uses of MCA information included tracking productivity improvement, allocating administrative expenses to various funds, determining unit costs and production rates for various time periods, tracking workload output, measuring performance, assisting with budget formulation and execution, and facilitating recovery of the full cost for reimbursable activities such as earning records requests from pension funds and individuals. For example, during one of our subsequent reviews,

an SSA official said SSA used workload information from its Unified Measurement System, a component of the MCA system, and other financial information to reallocate workloads among two different field offices to better match available staff resources.³³ SSA also used the data to compare the estimated costs of moving staff versus moving work.

At the time of our review, DOL had only recently implemented its MCA system. DOL officials identified many potential uses for MCA data they expect will lead to better information for managerial decisions, and said they plan to use MCA to identify and analyze

- program costs across regions;
- comparative costs of grant management activities, by type of grant;
- full administrative costs related to the development of policies, regulations, and legislative proposals;
- unit costs of training and employment programs; and
- budget justifications and resource allocations.

For example, in one of our subsequent reviews,³⁴ Labor's ETA officials said they used financial information to help manage construction contracts for the \$1.4 billion Job Corps program. They said they used a report with project cost and schedule data to make program management decisions during monthly meetings with contractors. As another example, officials from Labor's Employee Benefits Security Administration (EBSA) told us they used obligation data from the core accounting system and unit cost data from the cost accounting system to allocate funding resources and manage their business. EBSA managers told us that they used the data to (1) determine the effect of funding constraints; (2) assess whether extraordinary measures, like a hiring freeze, are needed to remain within a given funding level; and (3) target resources to achieve the program's objectives.

Component Agency Uses of MCA Information

We also found several agency components that were using cost information to make decisions: BEP and FMS at Treasury, FAA at DOT, FNS at USDA, and FSA at Education.

³³GAO, *President's Management Agenda: Review of OMB's Improved Financial Performance Scorecard Process*, [GAO-07-95](#) (Washington, D.C.: Nov. 16, 2006).

³⁴[GAO-07-95](#).

BEP officials cited three ways they used MCA information. They were analyzing cost and spoilage information to help implement a new automated inspection process which, according to officials, resulted in a substantial reduction in cost without jeopardizing quality. They also told us they used MCA information to analyze the costs and benefits of a proposed robotics currency packaging system which, according to officials, could significantly reduce staffing at their manufacturing facilities. Finally, BEP officials cited using the information to identify decreasing efficiencies in older manufacturing presses as a way of targeting machines for overhaul.

According to FMS officials, examples of MCA information uses include formulating budgets, evaluating programs, and setting fees and prices for services provided to other government entities. Officials also told us FMS analyzes and reports unit costs for federal government payments and collections so it can provide services at a lower cost.

FAA used cost information to decide whether to contract out Air Traffic Organization Flight Service Stations. In addition to operating savings, FAA identified savings in the Facilities and Equipment appropriation as well as a reduction of 400 staff. FAA estimated total savings to be about \$2.2 billion over 10 years for contracting out service stations. FAA also used cost information to cancel a \$27 million weather program and to modify an airport radar surveillance program, avoiding a cost of \$7 million.

FNS used cost data to investigate changes in program participation rates and cost. For example, FNS officials told us they used cost data to analyze Women, Infants and Children (WIC) program cost increases related to the proliferation of WIC-only stores, which often charged higher prices than stores that also sell to the general public. Subsequent legislation required that average payments to WIC-only stores not be higher than average payments to other stores. Officials also stated that FNS used cost data to identify declining Food Stamp participation rates and costs in one state.

At FSA, officials said they used unit cost information to renegotiate and consolidate several contracts relating to the administration of FSA's direct loan program and reduce FSA's unit cost for loan consolidations from \$115 per unit to \$66 per unit, over a period of 18 months.³⁵

³⁵ [GAO-07-95](#).

Agency Leadership Is Fundamental to Successful MCA Implementation

Strong leadership and commitment from senior management may be the single most important elements in implementing and sustaining the institutional and cultural changes MCA requires. Leadership that understands the importance of timely, accurate cost information and can communicate its uses to managers is critical to the success of an MCA program. Because implementing MCA takes time, requires monitoring, and inevitably mid-course adjustments, the managers who will use the information need to see its value and take ownership of the system. Strong leadership can set the tone and the expectations to make this happen, and help change the culture in the federal government to one of managing costs, and not just managing the budget.

Strong Leadership Is Critical to Promoting the Benefits of MCA

We found strong leadership for MCA implementation at DOI, DOL, SSA, and DOT. Other agencies needed to step up efforts to promote the benefits of MCA and oversee its implementation and use throughout their respective agencies. At many agencies, stronger leadership was needed to ensure that both the larger agency and its components have policies requiring MCA implementation, procedures to monitor implementation entitywide, and internal controls to help ensure the reliability of financial and nonfinancial data used in MCA systems. Examples of how leadership at DOI, DOL, SSA, and DOT promoted the benefits of MCA and oversaw its implementation follow.

DOI leadership, including the Secretary, took an active role in promoting MCA implementation and use at its bureaus. DOI actions included directing the bureaus to take the lead developing MCA; establishing a department-level steering committee to provide overall guidance; facilitating issue coordination across the department; enlisting additional bureau-level input through several groups, including an FBMS steering committee; and issuing departmentwide policy and procedural guidance to ensure that bureau cost data are in line with Interior strategic goals.

In 2004, DOL identified MCA as one way to address its most pressing management challenges and assigned responsibility for its development to the Office of the Chief Financial Officer. DOL's Secretary discussed the MCA system in meetings with department heads, and component-specific MCA models were developed and put in place at all 10 mission agencies and 5 of the 8 support offices.

SSA's basic cost allocation policy was established about 1965, and SSA has used its existing Cost Analysis System (CAS) for MCA for over 30 years. In her opening message in the agency's 2004 Performance and Accountability

Report, SSA's Commissioner at that time committed to better integrating financial and budget data for decision making. In that regard, SSA was upgrading CAS at the time of our review. In addition, the implementation status of SSA's new Managerial Cost Analysis System, which will replace CAS, was being tracked as a monthly indicator.

DOT provided strong leadership and support for MCA from the Secretary's level by assigning two staff members from the Office of the Secretary to provide daily support to component agencies on MCA and to monitor their progress. In addition, the Office of Secretary emphasized the importance of MCA in several memoranda to the components, and outlined steps the components should follow to implement MCA. Also, MCA was discussed at monthly CFO meetings as well as at meetings of DOT's Cost Accounting Steering Group.

Focusing on Managing Costs Can Help Agencies Meet Government Reform Goals

Traditionally, government financial systems and government managers have focused on tracking how agencies spend their budgets, but have not focused on assessing the costs of activities to achieve efficiencies. MCA, on the other hand, begins with an output such as a service and traces the costs of activities needed to produce the service. It allows management to link services or other outputs directly with the budget and allocate resources based on the level of service they desire.

Under the President's Management Agenda (PMA), agencies must be able to measure performance and connect resources with results.³⁶ The PMA includes five governmentwide initiatives for improving government performance: strategic management of human capital, competitive sourcing, improved financial performance, expanded electronic government, and budget and performance integration. On a quarterly basis, the Office of Management and Budget (OMB) publishes a scorecard reporting system using green, yellow, or red to indicate agencies' current status and progress in implementing the five governmentwide initiatives.

To "get to yellow" on improved financial performance, agencies need to, among other things, receive unqualified opinions on their annual financial statements, meet financial statement reporting deadlines, and be in

³⁶Executive Office of the President, Office of Management and Budget, *The President's Management Agenda* (Washington, D.C.: 2002).

compliance with FFMIA requirements.³⁷ To “get to green,” agencies need to meet all requirements for getting to yellow and, in addition, provide evidence that financial information is available for managers on demand, that information is actively being used to help agencies achieve results in key areas of operations, and that the agency is implementing a plan to continuously expand the scope of its routine data use to inform management decisionmaking.³⁸ In other words, agencies need to demonstrate how financial data are used routinely by managers to make smarter decisions, and show how the data are used to address significant challenges faced by the agency. As of March 31, 2007, of the 10 agencies we reviewed, only HUD, Education, DOL and SSA had gotten to green on improved financial performance.³⁹

While there has been substantial progress in federal financial management and the way it is carried out since the passage of the CFO Act, challenges remain. To the extent programs are funded based on performance, agencies will need accurate cost information to justify budget requests. This will require a cultural change in traditional financial management

³⁷Executive Office of the President, Office of Management and Budget, *Achieving Green in Financial Performance, the President's Management Agenda, Improved Financial Performance Initiative*, Version 1, July 2005.

³⁸GAO recently reviewed OMB's methodology and supporting documentation for agency ratings reported on the PMA scorecard. See GAO, *President's Management Agenda: Review of OMB's Improved Financial Performance Scorecard Process*, [GAO-07-95](#), (Washington, D.C.: Nov. 16, 2006).

³⁹While HUD, Education, and DOL had received green ratings in improved financial performance, we noted room for improvement in MCA implementation at these agencies at the time of our MCA reviews. For example, HUD had not issued departmentwide policy guidance on MCA and the agency's plans for current and future systems lacked broad MCA functionalities. To improve HUD's implementation and use of reliable MCA methodologies, we made five recommendations to the Secretary of HUD. (See GAO, *Managerial Cost Accounting Practices: Department of Agriculture and the Department of Housing and Urban Development*, [GAO-06-1002R](#) (Washington, D.C.: Sept. 21, 2006). Education officials told us that they had not considered cost accounting a key issue because most of their appropriations were disbursed as grants and loans and administrative costs made up only 2 percent (\$1.3 billion) of Education's appropriations. Further, according to department officials, 61 percent of the \$1.3 billion was administrative costs attributable to FSA and were already subject to MCA methodologies. We recommended that Education develop and disseminate a department-wide MCA policy and develop procedures for monitoring implementation of its department-wide MCA policy. (See GAO, *Managerial Cost Accounting Practices: Departments of Education, Transportation, and the Treasury*, [GAO-06-301R](#) (Washington, D.C.: Dec. 19, 2005). DOL had recently implemented its departmentwide MCA system, and was still in the process of developing plans for using it. (See GAO, *Managerial Cost Accounting Practices: Leadership and Internal Controls Are Key to Successful Implementation*, [GAO-05-1013R](#) (Washington, D.C.: Sept. 2, 2005).

practices, from managing the budget to identifying desired outcomes and the costs of delivering them. Stronger leadership will be needed from senior management to effect this change where programs are being managed by budgets and appropriations. For example, managers at HUD told us it was a budget-driven organization primarily focused on oversight of its programs, and that it manages its operations principally with required budgetary data. They told us they believed they had sufficient information to effectively support budget formulation and management of enacted programs. In response to our recommendations about promoting the benefits and uses of MCA and developing an MCA policy for the agency, however, HUD's CFO stated that a new Executive Financial Management Advisory Committee would address both of these issues. USDA delegated responsibility for MCA to its components, but had not shown strong leadership to promote, guide, and monitor MCA implementation. As a result, some USDA managers were continuing to focus on budget management rather than improved cost management.

Although the views about how an organization can change its culture vary considerably, the organizations we and others have studied identified leadership as the most important factor in successfully making cultural changes. Departmental leadership throughout government must be totally committed in both words and deeds to changing the culture in the federal government to one of managing costs, in addition to managing the budget. In order to bring about this cultural change, top management will need to lead by example. Establishing policies, performance measures, and monitoring and reporting procedures are first steps, but in themselves are not enough to fundamentally restructure how the business of government is conducted.

Conclusions

Given the fundamental financial and accounting issues many federal agencies continue to address and the ongoing challenges inherent in implementing effective, integrated financial systems, it is not surprising that relatively few agencies are using MCA for day-to-day management. Our work identified large disparities in the level of MCA implementation among the agencies we reviewed as well as the ways in which they use cost information. Although MCA can be implemented without an integrated financial management system, in those cases it tends to be used for single programs or projects rather than providing day-to-day information for managerial decision making entitywide. While some agencies have made progress toward implementing MCA, full implementation will require strong executive leadership and participation, improved financial management systems, and a continuing transition in

agency culture to one of identifying and managing costs, in addition to managing the budget.

Full, effective MCA implementation will require resources and commitment up front if agencies are to achieve the long-term rewards of those efforts. As a result, it is key for leadership to understand the uses and advantages of MCA, communicate them to management, and work with the process as it continually evolves to foster better government. For MCA implementation to be successful across the federal government, it must be tailored to the needs of individual organizations, be a tool managers can use to make everyday decisions, and be based on sound financial and nonfinancial data.

We are sending copies of this report to the Director of the Office of Management and Budget and other interested parties. This report will be available at no charge on GAO's Web site at <http://www.gao.gov>. Should you or your staff have any questions on the matters discussed in this report, please contact me at (202) 512-6131 or martinr@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix II.



Robert E. Martin
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Appendix I: Research Resources

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Appendix II: Gao Contact and Staff Acknowledgments

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