

**GAO**

**Testimony**

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**FISCAL YEAR 2008  
U.S. GOVERNMENT  
FINANCIAL STATEMENTS**

**Federal Government Faces  
New and Continuing  
Financial Management and  
Fiscal Challenges**

Statement of Gene L. Dodaro  
Acting Comptroller General of the United States



**GAO**

Accountability \* Integrity \* Reliability

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Highlights of [GAO-09-805T](#), a testimony before the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives

## Why GAO Did This Study

GAO annually audits the consolidated financial statements of the U.S. government (CFS). The Congress and the President need reliable, useful, and timely financial and performance information to make sound decisions and conduct effective oversight of federal government programs and policies.

Except for the 2008 and 2007 Statements of Social Insurance, GAO has been unable to provide assurance on the reliability of the CFS due primarily to inadequate systems and lack of sufficient, reliable evidence to support certain material information in the CFS. Unless these weaknesses are adequately addressed, they will, among other things, (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; and (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities.

This testimony presents the results of GAO's audit of the CFS for fiscal year 2008 and discusses federal financial management challenges and the long-term fiscal outlook.

## What GAO Recommends

Over the years, GAO has made numerous recommendations directed at improving federal financial management. The federal government has generally taken or plans to take actions to address our recommendations.

View [GAO-09-805T](#) or [key components](#). For more information, contact Jeanette M. Franzel or Gary T. Engel at (202) 512-2600 or Susan J. Irving at (202) 512-6806.

# FISCAL YEAR 2008 U.S. GOVERNMENT FINANCIAL STATEMENTS

## Federal Government Faces New and Continuing Financial Management and Fiscal Challenges

### What GAO Found

For the second consecutive year, GAO rendered an unqualified opinion on the Statement of Social Insurance; however, three major impediments continued to prevent GAO from rendering an opinion on the federal government's accrual basis consolidated financial statements: (1) serious financial management problems at the Department of Defense, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition, as of September 30, 2008, the federal government did not maintain effective internal controls over financial reporting and compliance with significant laws and regulations due to numerous material weaknesses. Moreover, financial management system problems continue to hinder federal agency accountability.

The federal government still has a long way to go, but over the years, progress has been made in improving federal financial management. For example, audit results for many federal agencies have improved; federal financial system requirements have been developed; and accounting and reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. In addition, the federal government issued a summary financial report which is intended to make the information in the *Financial Report of the U.S. Government* more understandable and accessible to a broader audience.

The federal government's response to the financial markets crisis and economic downturn has created new federal accountability, financial reporting, and debt management challenges. Such challenges will require utmost attention to ensure (1) that sufficient internal controls and transparency are established and maintained for all market stabilization and economic recovery initiatives; (2) that all related financial transactions are reported on time, accurately, and completely; and (3) these initiatives are effectively and efficiently financed. Moreover, while policymakers are currently understandably focused on efforts directed toward market stabilization and economic growth, once stability in financial markets and the economic downturn are addressed, attention will have to be turned with the same level of intensity to the serious longer-term challenges of addressing the federal government's large and growing structural deficits and debt.

Finally, the federal government should consider the need for further revisions to the current federal financial reporting model to recognize its unique needs. A broad reconsideration of issues, such as the kind of information that may be relevant and useful for a sovereign nation, could lead to reporting enhancements that might help provide the Congress and the President with more useful financial information to deliberate and monitor strategies to address the nation's long-term fiscal challenges.

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Madam Chairwoman, Ranking Member Bilbray and Other Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal years 2008 and 2007. The need for continued progress in improving federal financial management and accountability to the American people is more critical now than ever given the unprecedented actions that the federal government has taken and continues to take to address the economic downturn and restore stability to financial markets. I would like to commend you for continuing the annual tradition of oversight hearings on this important subject. The involvement of your subcommittee is critical to ultimately assuring such progress.

Importantly, the ultimate effect of recent unprecedented actions on the federal government's financial condition are not yet fully known and will not be fully reflected in the U.S. government's consolidated financial statements and *The Budget of the United States Government* until fiscal year 2009 and beyond. However, the breadth and magnitude of such actions will likely have a significant effect. Under the American Recovery and Reinvestment Act of 2009,<sup>1</sup> hundreds of billions of dollars are slated for, among other things, new or additional spending for investments in infrastructure and science, education and training, health programs, investments in energy infrastructure and programs, assistance to unemployed workers, health insurance assistance, health information technology, and state fiscal relief. In addition, under the Housing and Economic Recovery Act of 2008 and the Emergency Economic Stabilization Act of 2008,<sup>2</sup> additional hundreds of billions of dollars of federal funding will include capital and loans to support and sustain key financial institutions and other businesses, loans to assist certain borrowers in trouble on their mortgages, and insurance for certain securitized loans. The federal government's response to the current economic downturn and financial crisis has created additional accountability, financial reporting, and debt management challenges.

While there are new and many existing challenges to federal accountability and reporting, we also cite in our reports improvements made over the past decade. With this backdrop, our testimony today

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<sup>1</sup>Pub. L. No. 111-5 (Feb. 17, 2009).

<sup>2</sup>Pub. L. No. 110-289 (July 30, 2008) and Pub. L. No. 110-343 (Oct. 3, 2008), respectively.

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discusses (1) the major issues relating to the consolidated financial statements for fiscal years 2008 and 2007, including the significant remaining impediments to an opinion on the consolidated financial statements; (2) financial management systems problems that continue to hinder federal agency accountability; (3) new federal accountability, financial reporting, and debt management challenges created by the federal government's fiscal response to the financial crisis and economic downturn; (4) challenges posed by the federal government's current long-term fiscal outlook; and (5) the need for an improved federal financial reporting model.

Both the consolidated financial statements and our related audit report are included in the fiscal year *2008 Financial Report of the United States Government (Financial Report)*.<sup>3</sup> Our audit report would not be possible without the commitment and professionalism of Inspectors General throughout the federal government who are responsible for annually auditing the financial statements of individual federal agencies. The *Financial Report* was issued by the Department of the Treasury (Treasury) on December 15, 2008.<sup>4</sup> At that time, Treasury and the Office of Management and Budget (OMB) in coordination with GAO also issued, for the second year, a summary financial report, entitled *The Federal Government's Financial Health: A Citizen's Guide to the 2008 Financial Report of the United States Government*. This guide, which is included in the printed *Financial Report*, as well as printed separately, is intended to make the information in the *Financial Report* more understandable and more accessible to a broader audience. Both of these reports are available through GAO's Internet site, at <http://www.gao.gov/financial/fy2008financialreport.html> and Treasury's Internet site, at <http://www.fms.treas.gov/fr/index.html>.

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<sup>3</sup>Our audit work on the U.S. government's consolidated financial statements was conducted in accordance with U.S. generally accepted government auditing standards.

<sup>4</sup>Also, see GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, [GAO-05-958SP](#) (Washington, D.C.: September 2005), which was prepared to help those who seek to obtain a better understanding of the *Financial Report*.

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## Summary

Certain material weaknesses<sup>5</sup> in financial reporting and other limitations on the scope of our work resulted in conditions that for the 12th consecutive year prevented us from providing the Congress and the American people an opinion on the federal government's financial statements other than the 2008 and 2007 Statements of Social Insurance.<sup>6</sup> However, since the enactment of key financial management reforms in the 1990s, the federal government has made significant progress in improving financial management activities and practices. As shown in appendix I, 21 of 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions on their fiscal year 2008 financial statements.<sup>7</sup> In contrast, only 6 CFO Act agencies received unqualified audit opinions for fiscal year 1996. In addition, federal financial systems requirements have been developed. Also, accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. Further, fiscal year 2008 marked the third year in which the Statement of Social Insurance has been provided as a basic financial statement.<sup>8</sup> The Statement of Social Insurance displays the present value<sup>9</sup> of projected revenues and expenditures for scheduled

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<sup>5</sup>A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

<sup>6</sup>The consolidated financial statements other than the Statement of Social Insurance are referred to as the accrual basis consolidated financial statements. Most revenues reported in these financial statements are recorded on a modified cash basis.

<sup>7</sup>The 21 agencies include the Department of State. As of the date of our audit report, the auditors had disclaimed an opinion on the Department of State's fiscal year 2008 financial statements; however, because the department subsequently provided the auditors with sufficient evidential material to support the amounts reported on its financial statements, the auditors issued a second report, replacing the first, with an unqualified opinion of the Department of State's fiscal year 2008 financial statements.

<sup>8</sup>We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. Social insurance programs included in the Statement of Social Insurance are Social Security, Medicare, Railroad Retirement, and Black Lung.

<sup>9</sup>Present value is the discounted value of a payment or stream of payments to be received or paid in the future, taking into consideration a specific interest or discount rate.

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benefits of certain benefit programs that are referred to as social insurance (e.g., Social Security, Medicare). Importantly, we were able to render unqualified opinions on the 2008 and 2007 Statements of Social Insurance.

The federal government, however, still has a long way to go to address several principal challenges to fully achieving an exemplary level of federal financial management.<sup>10</sup> For example, three major impediments continue to prevent GAO from rendering an opinion on the federal government's accrual basis consolidated financial statements: (1) serious financial management problems at the Department of Defense (DOD), (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Further, in our opinion, the federal government did not maintain effective internal controls over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2008, due to numerous material weaknesses. Moreover, financial management system problems continue to hinder federal agency accountability.

The problems and challenges identified by our audit need to be viewed in conjunction with new challenges that have emerged from more recent developments. Of particular importance is the fact that as of June 26, 2009, federal debt held by the public as reported by Treasury was over \$1 trillion greater than what it had reported as of the end of fiscal year 2008. The increase in federal debt held by the public, which resulted largely from the federal government's fiscal response to the crisis in our financial markets and the economic downturn, create new federal accountability, financial reporting, and debt management challenges. While we acknowledge that the new President, the new Congress, and the American people have been understandably focused on addressing current problems with financial markets and responding to the economic downturn, and the increased borrowing such efforts entail, the nation's long-term fiscal challenge must be addressed. As we reported in our March 2009 fiscal outlook update,<sup>11</sup> our projections continue to show escalating and persistent debt that

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<sup>10</sup>GAO, *Critical Accountability and Fiscal Stewardship Challenges Facing Our Nation*, [GAO-07-542T](#) (Washington, D.C.: Mar. 1, 2007).

<sup>11</sup>GAO, *The Nation's Long-Term Fiscal Outlook: March 2009 Update*, [GAO-09-405SP](#) (Washington, D.C.: March 2009).

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illustrates the long-term fiscal path is unsustainable. We believe that the nation will need to apply the same level of intensity to this long-term fiscal challenge as is being directed to addressing the economic downturn and the current problems with financial markets.

Given the federal government's current financial condition and the nation's longer-term fiscal challenges, the need for the Congress and federal policymakers and management to have reliable, useful, and timely financial and performance information is greater than ever. Sound decisions on the current results and future direction of vital federal government programs and policies are more difficult without such information. Information included in the *Financial Report*, such as the Statement of Social Insurance along with long-term fiscal simulations and fiscal sustainability reporting, can help increase understanding of the federal government's long-term fiscal outlook.

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## Highlights of Major Issues Related to the U.S. Government's Consolidated Financial Statements for Fiscal Years 2008 and 2007

As has been the case for the previous 11 fiscal years, the federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the U.S. government's accrual basis consolidated financial statements. The underlying material weaknesses in internal control, as summarized on the following page, which generally have existed for years,<sup>12</sup> contributed to our disclaimer of opinion on the U.S. government's accrual basis consolidated financial statements for the fiscal years ended 2008 and 2007.<sup>13</sup>

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<sup>12</sup>We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2006 and on the accrual basis consolidated financial statements of the U.S. government for fiscal year 2007.

<sup>13</sup>A more detailed description of the material weaknesses that contributed to our disclaimer of opinion, including the primary effects of these material weaknesses on the accrual basis consolidated financial statements and on the management of federal government operations, can be found on pages 178 through 184 of the *Financial Report*.

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In summary, the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements were the federal government's inability to:

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the DOD, were properly reported in the accrual basis consolidated financial statements;
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;
- support significant portions of the total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain agencies;
- adequately account for and reconcile intragovernmental activity and balances between federal agencies;
- ensure that the federal government's accrual basis consolidated financial statements were (1) consistent with the underlying audited agency financial statements, (2) properly balanced, and (3) in conformity with generally accepted accounting principles (GAAP); and
- identify and either resolve or explain material differences that exist between certain components of the budget deficit reported in Treasury's records, which are used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of Changes in Cash Balance from Unified Budget and Other Activities, and related amounts reported in federal agencies' financial statements and underlying financial information and records.

Due to the material weaknesses and the additional limitations on the scope of our work, as discussed in our audit report, there may also be additional issues that could affect the accrual basis consolidated financial statements that have not been identified.

In addition to the material weaknesses that contributed to our disclaimer of opinion, which are discussed above, we found three other material weaknesses in internal control as of September 30, 2008.<sup>14</sup> These other material weaknesses were the federal government's inability to:

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to cost-effectively reduce improper payments,
- identify and resolve information security control weaknesses and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

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<sup>14</sup>A more detailed discussion of these weaknesses, including the primary effects of the material weaknesses on the accrual basis consolidated financial statements and on the management of federal government operations, can be found on pages 185 through 187 of the *Financial Report*.

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Further, our audit report discusses certain significant deficiencies in internal control at the governmentwide level.<sup>15</sup> These significant deficiencies involve the following areas:

- implementing effective credit reform estimation and related financial reporting processes for loans receivable and loan guarantee liabilities at certain federal credit agencies, and
- preparing the Statement of Social Insurance for certain programs.

Individual federal agency financial statement audit reports identify additional control deficiencies, which were reported by agency auditors as either material weaknesses or significant deficiencies at the individual agency level. We do not consider these additional control deficiencies to represent material weaknesses or significant deficiencies at the governmentwide level. Also, due to the issues noted throughout our audit report, additional material weaknesses and significant deficiencies may exist that were not identified and reported.

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## Addressing Major Impediments to an Opinion on the Accrual Basis Consolidated Financial Statements

Three major impediments to our ability to render an opinion on the U.S. government's accrual basis consolidated financial statements continued to be: (1) serious financial management problems at DOD, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Extensive efforts by DOD officials and cooperative efforts between agency chief financial officers, Treasury officials, and OMB officials will be needed to resolve these serious obstacles to achieving an opinion on the U.S. government's accrual basis consolidated financial statements.

## Financial Management at DOD

Essential to further improving financial management governmentwide and ultimately to achieving an opinion on the U.S. government's consolidated financial statements is the resolution of serious weaknesses in DOD's business operations. Reported weaknesses in DOD's business operations, including financial management, adversely affect the reliability of financial data, and the economy, efficiency, and effectiveness of its operations, and prevent DOD from producing auditable financial statements.

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<sup>15</sup>See page 188 of the *Financial Report* for more details on these significant deficiencies.

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DOD continues to dominate GAO's list of high-risk programs designated as vulnerable to waste, fraud, abuse, and mismanagement, bearing responsibility, in whole or in part, for 15 of 30 high-risk areas.<sup>16</sup> Eight of these areas are specific to DOD and include DOD's overall approach to business transformation, as well as business systems modernization and financial management.

The National Defense Authorization Act (NDAA) for Fiscal Year 2008,<sup>17</sup> codified Chief Management Officer (CMO) responsibilities at a high level in the department—assigning them to the Deputy Secretary of Defense—and establishing a full-time Deputy CMO (DCMO) and designating CMO responsibilities within the military services. While both of these positions are now in place at DOD, the CMO is not a separate, full-time position, and the DCMO, although full-time, does not have decision-making authority.

Importantly, DOD has taken steps toward developing and implementing a framework for addressing the department's long-standing financial management weaknesses with the goals of enabling the department to (a) provide timely, reliable, and accurate financial management information to decisionmakers; (b) sustain improvements; and (c) achieve financial statement auditability. Specifically, this framework, which is discussed in both the department's Enterprise Transition Plan (ETP)<sup>18</sup> and the Financial Improvement and Audit Readiness (FIAR) Plan,<sup>19</sup> includes the department's Standard Financial Information Structure (SFIS) and Business Enterprise Information System (BEIS). DOD intends this framework to define and put into practice a standard DOD-wide financial management data structure as well as enterprise-level capabilities to facilitate reporting and comparison of financial data across the department. DOD's most recent FIAR plan update indicates that it has

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<sup>16</sup>GAO, *High-Risk Series: An Update*, GAO-09-271 (Washington, D.C.: January 2009).

<sup>17</sup>Pub. L. No. 110-181, Div. A, title IX § 904 (Jan. 28, 2008).

<sup>18</sup>The ETP is intended to describe how DOD will transition from its current or "as is" operational environment to its intended or "to be" operational capabilities. The Business Transformation Agency is the DOD agency responsible for DOD's business transformation and the development and implementation of the ETP.

<sup>19</sup>DOD's FIAR Plan, initially issued in December 2005 and updated twice annually, is intended to provide DOD components with a framework for resolving problems affecting the accuracy, reliability, and timeliness of financial information and obtaining clean financial statement audit opinions.

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implemented SFIS in legacy accounting systems for several components, including the Air Force and Marine Corps.

We recently analyzed DOD's FIAR Plan, and found the plan does not yet provide the department or its components with clear, consistent, and specific guidance for implementing, measuring, and sustaining corrective actions, and for reporting incremental progress. Our report made several recommendations designed to increase the FIAR Plan's effectiveness as a strategic and management tool for guiding, monitoring, and reporting on financial management improvement efforts and increasing the likelihood of meeting the department's goal of financial statement auditability.<sup>20</sup> DOD management concurred with our recommendations and has begun initiatives to address our concerns.

While further improvement is needed, DOD's recent FIAR plans indicate many continuing efforts to achieve financial statement auditability, as well as new initiatives, including the following:

- Focusing on improvements in end-to-end business processes, or segments,<sup>21</sup> that underlie the amounts reported on the financial statements.
- Updating auditability assertion criteria to require that only personnel with sufficient objectivity assess the readiness of a segment for audit.
- Ensuring sustainability of corrective actions and auditability by fully implementing the requirements of OMB Circular No. A-123, Appendix A, which requires an annual assessment and statement of assurance regarding the continued effectiveness of internal control over financial reporting.
- Forming working groups to address issues in areas such as real property cost management and imputed cost, and Fund Balance with Treasury.
- Implementing the Defense Agencies Initiative, with the goal of achieving an auditable standardized system for smaller other defense organizations.

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<sup>20</sup>GAO, *Financial Management: Achieving Financial Statement Auditability in the Department of Defense*, GAO-09-373 (Washington, D.C.: May 6, 2009).

<sup>21</sup>DOD defines a segment as a component of an entity's business and financial environment. A segment can include (1) complete or partial business processes; (2) financial systems, business systems, or both; or (3) commands or installations. According to DOD, the environment's complexity, materiality, and timing of corrective actions are all factors that are taken into consideration when defining a segment.

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A recent notable success for the department was the U.S. Army Corps of Engineers (USACE), Civil Works' ability to achieve an unqualified audit opinion for fiscal year 2008. This accomplishment was the result of a sustained commitment on the part of management to improve USACE's business systems, processes, and controls. In contrast to this success, however, other DOD components' recent assertions of audit readiness have failed to withstand auditor scrutiny.

We are encouraged by DOD's efforts and will continue to monitor DOD's efforts to transform its business operations and address its financial management challenges. In the near future, we plan to review DOD's:

- process and controls over budgetary execution and accounting;
- component enterprise resource planning efforts for adherence to budget and schedule and the identification of common issues among these efforts that have impeded successful implementation;
- integration of strategic plans within the department that are intended to address, monitor, and report progress and status of financial management weaknesses;
- component design and implementation of financial improvement plans; and
- component corrective plans and actions designed to bring financial reporting segments to audit readiness.

## Intragovernmental Activity and Balances

Federal agencies are unable to adequately account for and reconcile intragovernmental activity and balances. OMB and Treasury require the CFOs of 35 executive departments and agencies to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these agencies are required to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts as of the end of the fiscal year. GAO has identified and reported on numerous intragovernmental activities and balances issues and has made several recommendations to Treasury and OMB to address those issues. Treasury and OMB have generally taken or plan to take actions to address these recommendations.

A substantial number of the agencies did not adequately perform the required reconciliations for fiscal years 2008 and 2007. For these fiscal years, based on trading partner information provided to Treasury through agencies' closing packages, Treasury produced a "Material Difference Report" for each agency showing amounts for certain intragovernmental activity and balances that significantly differed from those of its

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corresponding trading partners as of the end of the fiscal year. Based on our analysis of the “Material Difference Reports” for fiscal year 2008, we noted that a significant number of CFOs were unable to adequately explain the differences with their trading partners or did not provide adequate documentation to support responses on the CFO Representations. For both fiscal years 2008 and 2007, amounts reported by federal agency trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, there are hundreds of billions of dollars of unreconciled differences between the General Fund and federal agencies related to appropriation and other intragovernmental transactions. The ability to reconcile such transactions is hampered because only some of the General Fund is reported in the Department of the Treasury’s financial statements. As a result of the above, the federal government’s ability to determine the impact of these differences on the amounts reported in the accrual basis consolidated financial statements is significantly impaired.

In 2006, OMB issued Memorandum No. M-07-03, *Business Rules for Intragovernmental Transactions* (Nov. 13, 2006), and Treasury issued the Treasury Financial Manual Bulletin No. 2007-03, *Intragovernmental Business Rules* (Nov. 15, 2006). This guidance added criteria for resolving intragovernmental disputes and major differences between trading partners for certain intragovernmental transactions and called for the establishment of an Intragovernmental Dispute Resolution Committee. OMB is currently working with the Chief Financial Officers Council to create the Intragovernmental Dispute Resolution Committee.<sup>22</sup> OMB is also using a “Watch List” that lists federal agencies with large intragovernmental imbalances. The Watch List was developed to facilitate reductions in some of the largest intragovernmental imbalances, bring federal agency reporting into alignment with the Intragovernmental Business Rules, bring the appropriate representatives together from the respective agencies, and document the issues and resolutions.

Treasury is also taking steps to help resolve material differences in intragovernmental activity and balances. For example, Treasury is requiring federal agencies to provide documentation on how and when the agencies are resolving certain of their unresolved material differences.

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<sup>22</sup>The U.S. Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies and senior officials of OMB and Treasury who work collaboratively to improve financial management in the U.S. government.

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## Preparing the Consolidated Financial Statements

Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal agency leadership to fully implement the required business rules and continued strong leadership by OMB and Treasury.

While further progress was demonstrated in fiscal year 2008, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, properly balanced, and in conformity with U.S. GAAP.<sup>23</sup> Treasury's process for compiling the consolidated financial statements demonstrated that amounts in the Statement of Social Insurance were consistent with the underlying federal agencies' audited financial statements and that the Balance Sheet and the Statement of Net Cost were also consistent with federal agencies' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process did not ensure that the information in the remaining three principal financial statements was fully consistent with the underlying information in federal agencies' audited financial statements and other financial data. During fiscal year 2008, Treasury, in coordination with OMB, continued implementing corrective action plans and made progress in addressing certain internal control deficiencies we have previously reported regarding the process for preparing the consolidated financial statements. Resolving some of these internal control deficiencies will be a difficult challenge and will require a strong commitment from Treasury and OMB as they continue to implement their corrective action plans.

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## Federal Agencies' Financial Management Systems

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), as a part of the CFO Act agencies' financial statement audits, auditors are required to report whether agencies' financial management systems comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3)

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<sup>23</sup>Most of the issues regarding the preparation of the consolidated financial statements that we identified in fiscal year 2008 existed in fiscal year 2007, and many have existed for a number of years. In April 2009, we reported the issues we identified to Treasury and OMB and provided new recommendations for corrective action and discussed the status of certain previously issued recommendations in GAO, *Financial Audit: Material Weaknesses in Internal Control Continue to Impact Preparation of the Consolidated Financial Statements of the U.S. Government*, [GAO-09-387](#) (Washington, D.C.: Apr. 21, 2009). Treasury and OMB have generally taken or plan to take actions to address the recommendations we have made in this area.

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the *U.S. Government Standard General Ledger* (SGL) at the transaction level.<sup>24</sup> These factors, if implemented successfully, help provide a solid foundation for improving accountability over federal government operations and routinely producing sound cost and operating performance information. Over a decade has passed since FFMIA was enacted and the majority of agencies still do not have reliable, useful, and timely financial information with which to make informed decisions and ensure accountability on an ongoing basis. In fiscal year 2008, auditors reported 14 out of 24 CFO Act agencies' financial management systems were not in substantial compliance with one or more of the three FFMIA requirements and the lack of compliance with federal financial management systems requirements was the most frequently cited deficiency of the three FFMIA requirements.

In addition, on January 9, 2009, OMB issued a revised Circular No. A-127, *Financial Management Systems*, which redefines federal financial management systems requirements. We are concerned that the revised circular substantially reduces the scope and rigor of compliance testing for agency financial management systems, omits compliance with the SGL from the compliance indicators, and eliminates existing federal financial management systems requirements for the financial portion of mixed systems. Without independent auditor assessments of the financial portion of mixed systems' capabilities and compliance with these requirements, the Congress and agency management cannot be assured that data in these systems and not included in agency financial statements are reliable, resulting in increased risk of making operating, budget, and policy decisions based on faulty data reported in the financial portion of mixed systems—such as benefit payment, logistics, and acquisition systems—which are the source of data for the core financial system. Because of the importance of such data to routinely providing reliable, useful, and timely financial information for managing day-to-day operations, we believe it is important to retain financial management systems requirements for the financial portion of mixed systems and require auditors to assess compliance against such requirements. Further, the revised circular raised additional concerns because it does not definitively establish

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<sup>24</sup>FFMIA defines financial management systems as the financial systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions. The term mixed system means an information system that supports both financial and nonfinancial functions of the federal government or components thereof.

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responsibilities for the agency, service provider, and auditor for assessing compliance with FFMIA when utilizing a shared service provider under OMB's financial management line of business (line of business) initiative.

To reduce the cost and improve the outcome of federal financial management systems implementations, OMB continues to move forward on the line of business initiative, by leveraging common standards and shared solutions. OMB anticipates that the line of business initiative will help achieve the goals of improving the cost, quality, and performance of financial management operations. As we reported in May 2009,<sup>25</sup> although OMB has made progress in implementing the line of business initiative, the initiative focuses mainly on core financial systems and extensive work remains before the goals of the initiative are achieved.<sup>26</sup> For example, as we previously recommended in 2006, OMB has yet to finalize a financial management system concept of operations, which provides the foundation to guide line of business-related activities.<sup>27</sup> In addition, development of a migration timeline reflecting agencies' commitment for migrating to shared service providers has not yet been completed. Consistent and effective implementation of FFMIA will be needed to improve the capability of agencies' financial management systems to produce reliable, useful, and timely information for management to efficiently and effectively manage the day-to-day operations of the federal government and ultimately provide accountability to taxpayers and the Congress—a key goal of the CFO Act and FFMIA.

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<sup>25</sup>GAO, *Financial Management Systems: OMB's Financial Management Line of Business Initiative Continues, but Future Success Remains Uncertain*, [GAO-09-328](#) (Washington, D.C.: May 7, 2009).

<sup>26</sup>According to OMB, the goals of the line of business initiative are to (1) provide timely and accurate data for decision making; (2) facilitate stronger internal controls that ensure integrity in accounting and other stewardship activities; (3) reduce costs by providing a competitive alternative for agencies to acquire, develop, implement, and operate financial management systems through shared service solutions; (4) standardize systems, business processes, and data elements; and (5) provide for seamless data exchange between and among federal agencies by implementing a common language and structure for financial information and system interfaces.

<sup>27</sup>GAO, *Financial Management Systems: Additional Efforts Needed to Address Key Causes of Modernization Failures*, [GAO-06-184](#) (Washington, D.C.: Mar. 15, 2006).

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## Federal Actions Create New Challenges

The Emergency Economic Stabilization Act of 2009 (EESA), which authorized the Troubled Asset Relief Program (TARP); the Housing and Economic Recovery Act of 2008 (HERA); and the American Recovery and Reinvestment Act of 2009 (Recovery Act), enabled the federal government to take certain unprecedented actions involving hundreds of billions of dollars to stabilize the financial markets and promote economic recovery.<sup>28</sup> The nature and magnitude of these actions have created new challenges for federal accountability, financial reporting, and debt management. Such challenges will require utmost attention to ensure (1) that sufficient internal controls and transparency are established and maintained for all stabilization and recovery initiatives; (2) that all related financial transactions are reported on time, accurately, and completely; and (3) these initiatives are effectively and efficiently financed.

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## Federal Accountability and Financial Reporting Challenges

According to data provided by Treasury, as of June 26, 2009, the federal government had disbursed about \$339 billion of the approximate \$700 billion limit on TARP funds for a number of initiatives, which included among other things, preferred stock purchases of certain financial institutions, loans to automotive companies, and funding to certain financial institutions to facilitate home loan modifications.<sup>29</sup> Under HERA, the federal government placed the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) into conservatorship. As of July 2, 2009, the Federal Housing Finance Agency had reported that the federal government had provided about \$85 billion of capital to the entities through the first quarter of calendar year 2009 under senior preferred stock purchase agreements.<sup>30</sup> In addition,

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<sup>28</sup>Other legislation to address the financial markets crisis or the economic downturn include the Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22 (May 20, 2009), and the Economic Stimulus Act of 2008, Pub. L. No. 110-185 (Feb. 13, 2008).

<sup>29</sup>According to data provided by Treasury, as of June 26, 2009, numerous financial institutions participating in the TARP Capital Purchase Program (CPP) had repurchased their preferred stock from Treasury for a total of about \$70 billion. CPP preferred stock repurchases by financial institutions are deposited into the General Fund of the U.S. Treasury that is used to repay the debt that was issued to fund Treasury's original purchases. The proceeds received from the repurchases reduce the outstanding balance under the almost \$700 billion TARP limit. Treasury then may issue new debt to purchase new financial instruments if it so chooses.

<sup>30</sup>The \$85 billion excludes \$1 billion in liquidation preference on the senior preferred stock position obtained by Treasury from each entity upon initiation of the Senior Preferred Stock Purchase Agreement. The initial \$1 billion is not a draw on the Treasury's commitment under the agreement.

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according to Treasury, the federal government held about \$146 billion of the entities' mortgage-backed securities as of May 31, 2009.<sup>31</sup>

Regarding TARP, we have reported on actions needed and the status of efforts to address transparency and accountability issues, and have made related recommendations to help ensure these issues are adequately addressed. In our most recent report on TARP, we acknowledged Treasury's efforts to continue to improve the integrity, accountability, and transparency of TARP transactions; however, we concluded that some areas require ongoing attention.<sup>32</sup> Among the challenges is the need to properly measure and report each related purchase and loan transaction. The challenges of estimating and managing costs and measuring and reporting asset and liability values under TARP and other recent initiatives are likely to be even greater than those associated with more traditional federal lending activities given the fact that little, if any, historical information is available for certain transactions from which to base expected future cash flows. While contractual provisions may set forth required payments for certain transactions such as preferred stock purchases and debt obligations, for a substantial number of federal transactions under TARP and HERA there is a significant amount of uncertainty regarding the extent to which actual repayments to the federal government will be made. There is simply little or no history for certain of these large and unprecedented transactions. Moreover, the instability and dramatic changes in financial markets, such as occurred within the last year, make it very difficult to estimate the values of these assets and liabilities with any level of certainty. Therefore, it is critically important for adequate internal controls to be in place to help ensure that the cost of all TARP and other loans and loan guarantees are properly measured and reported and losses to the federal government minimized.

Regarding Recovery Act programs, major accountability and reporting challenges stem from the fact that nearly half of the approximate \$580 billion of additional federal spending associated with the Recovery Act will flow to nonfederal entities. In our April 2009 report on the Recovery Act, we reported that certain states and the District of Columbia are taking various approaches to ensure that internal controls exist to manage risk

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<sup>31</sup>HERA (Pub. L. No. 110-289) authorizes Treasury to purchase, for a limited amount of time, any amount of Fannie Mae or Freddie Mac securities, whether debt or equity.

<sup>32</sup>GAO, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-658](#) (Washington, D.C. June 17, 2009).

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including assessing known risks associated with spending under the Recovery Act and developing plans to address those risks.<sup>33</sup> However, officials in most of the states we reviewed and the District of Columbia expressed concerns about the lack of Recovery Act funding provided for accountability and oversight. Such concerns are important given that the Recovery Act includes many programs that are new or new to the recipient and, even for existing programs, the sudden increase in funds is outside of normal cycles and processes. Given that the majority of Recovery Act funding was initially projected to be made available to states and localities in 2009, 2010, and 2011, with lesser amounts available beyond that, actions taken now would significantly improve the ability of nonfederal entities to provide effective accountability over federal funding under the Recovery Act. We made several recommendations to OMB in April 2009 to help improve accountability and oversight of Recovery Act spending, including modifying the single audit process to be a more timely and effective audit and oversight tool for the Recovery Act. We are also issuing our July 2009 report on the Recovery Act today.<sup>34</sup> Going forward, it will be important for qualified personnel at all levels of government to implement proper controls and accountability measures to help ensure separate tracking and clear reporting of this spending from the federal level to the nonfederal recipients.

Over \$200 billion of the Recovery Act stimulus effort takes the form of tax expenditures—reductions in tax liabilities that result from preferential tax provisions such as tax exclusions, credits, and deductions. GAO has long been concerned that tax expenditures represent a substantial federal commitment yet lack the level of transparency and accountability associated with federal outlays.<sup>35</sup> As we move forward, the federal government needs to ensure that adequate information is obtained and analyzed about these provisions to inform judgments about the success of the entire stimulus package.

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<sup>33</sup>GAO, *Recovery Act: As Initial Implementation Unfolds in States and Localities, Continued Attention to Accountability Issues Is Essential*, [GAO-09-580](#) (Washington, D.C.: Apr. 23, 2009).

<sup>34</sup>GAO, *Recovery Act: States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stresses*, [GAO-09-829](#) (Washington, D.C.: July 8, 2009).

<sup>35</sup>GAO, *American Recovery And Reinvestment Act: GAO's Role in Helping to Ensure Accountability and Transparency*, [GAO-09-453T](#) (Washington, D.C.: Mar. 5, 2009).

## Federal Debt and Long-Term Fiscal Challenges

The nature and magnitude of the aforementioned actions to stabilize the financial markets and promote economic recovery have also created debt management challenges. As this Subcommittee knows, the Congress has assigned to Treasury the primary responsibility to borrow funds needed to finance any gap between cash in and cash out subject to a statutory limit. Since the onset of the current recession in December 2007, the gap between revenues and outlays has grown—even before any policy response. Because Treasury must borrow the funds disbursed, actions taken to stabilize financial markets—including aid to the auto industry— increase borrowing and so add to the federal debt. In addition, the revenue decreases and spending increases enacted in the Recovery Act also add to borrowing. Further, all of this takes place in the context of the longer-term fiscal outlook, which will present Treasury with continued management challenges even after the return of financial stability and economic growth.

The federal government faced large and growing structural deficits—and hence rising debt—even before the instability in financial markets and the economic downturn. The current debt limit, which has been raised 8 times since 2001, is at \$12.1 trillion. As you can see from table 1 below, it likely will have to be raised again this year.

**Table 1: Debt Held by the Public and Debt Subject to the Limit**

	Actual Fiscal Year 2001 (as of 9/30/01)	Actual Fiscal Year 2005 (as of 9/30/05)	Actual Fiscal Year 2008 (as of 9/30/08)	Projected Fiscal Year 2009 (President's FY 2010 Budget)
Debt held by the public (trillions of dollars)	\$3.3	\$4.6	\$5.8	\$8.5
Debt held by the public (percent of GDP)	33.0%	37.5%	40.8%	59.9%
Debt subject to the limit (trillions of dollars)	\$5.7	\$7.9	\$10.0	\$12.8

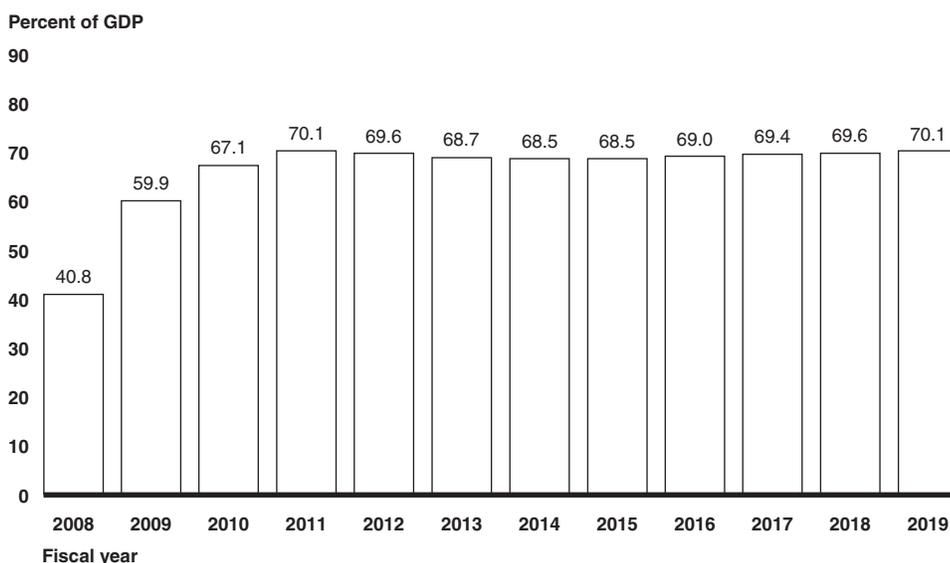
Source: Treasury and OMB.

Note: The current debt limit is \$12.1 trillion.

These immediate challenges, however, have eliminated the window for planning before the impending further ramp up in debt. As shown in figure 1, the President's budget projects debt held by the public growing

from 40.8 percent of gross domestic product (GDP) in fiscal year 2008 to 60 percent by the end of fiscal year 2009 and 67 percent by the end of fiscal year 2010.

**Figure 1: Debt Held by the Public Under the President’s Fiscal Year 2010 Budget**



Source: OMB.

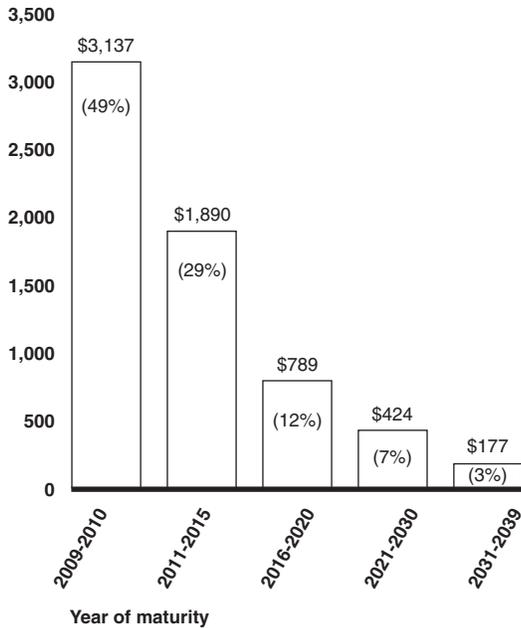
Note: The data are from *Budget of the United States Government, Fiscal Year 2010: Updated Summary Tables, May 2009*.

The near-term debt management challenge can be seen through several measures. At the end of May 2009, Treasury’s outstanding marketable securities stood at \$6,454 billion—an increase of \$657 billion since December 31, 2008, and an increase of \$1,918 billion since December 2007.<sup>36</sup> Interest rates have dropped dramatically since the start of the financial crisis, particularly for short-term debt. Although these relatively low interest rates have reduced Treasury’s borrowing costs to date, the amount of debt that must be rolled over in the short-term presents challenges. As shown in figure 2, as of May 31, 2009, approximately \$3,137 billion will mature in 2009 and 2010 and will have to be refinanced; this is 49 percent of the total outstanding marketable securities. Another 29 percent matures in 2011 through 2015. If the economy improves, Treasury may have to refinance significant amounts of debt at higher rates.

<sup>36</sup>Marketable securities, which comprise the vast majority of debt held by the public, consist of Treasury bills, notes, bonds, and Treasury inflation-protected securities.

**Figure 2: Marketable Securities by Year of Maturity, as of May 31, 2009 (Total Outstanding—\$6,454 billion)**

Dollars in billions (percentage of total outstanding)



Source: GAO analysis of Treasury data.

Note: Figure 2 does not include \$14 billion in marketable securities outstanding for the Federal Financing Bank, \$22.53 billion in matured notes, and \$47 million in matured bonds.

Treasury's primary debt management goal is to finance the federal government's borrowing needs at the lowest cost over time. Issuing debt through regular and predictable offerings lowers borrowing costs because investors and dealers value liquidity and certainty of supply. The mix of securities, which changes regularly as new debt is issued, is important because it can have a significant influence on the government's interest payments. Longer-term securities typically carry higher interest rates—or cost to the government—primarily due to concerns about future inflation. However, they can also offer the Treasury certainty about what its payments will be.

We believe the large share of the debt that must be rolled over in the next few years is cause for concern. Market experts generally believe that Treasury needs to increase the average maturity of its debt portfolio. Large and growing borrowing needs put a premium on understanding both current and future demand for U.S. Treasury securities. To support Congress' oversight of the use of TARP funds, we have work under way

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looking at how Treasury has financed borrowing associated with the financial market instability and analyzing additional ideas for debt management that might assist Treasury going forward. We encourage Treasury to explore a range of borrowing options that could support its lowest-cost-over-time borrowing objective and to take a strategic approach to the analysis of various options—recognizing that the federal government faces a long-term sustained increase in borrowing needs.

As I noted, the actions to restore financial market stability and economic growth take place within the context of the already serious longer-term fiscal condition of the federal government. While policymakers have been understandably focused on dealing with these financial market and economic growth challenges, attention also needs to be given to the long-term challenges of addressing the federal government's large and growing structural deficits and debt.

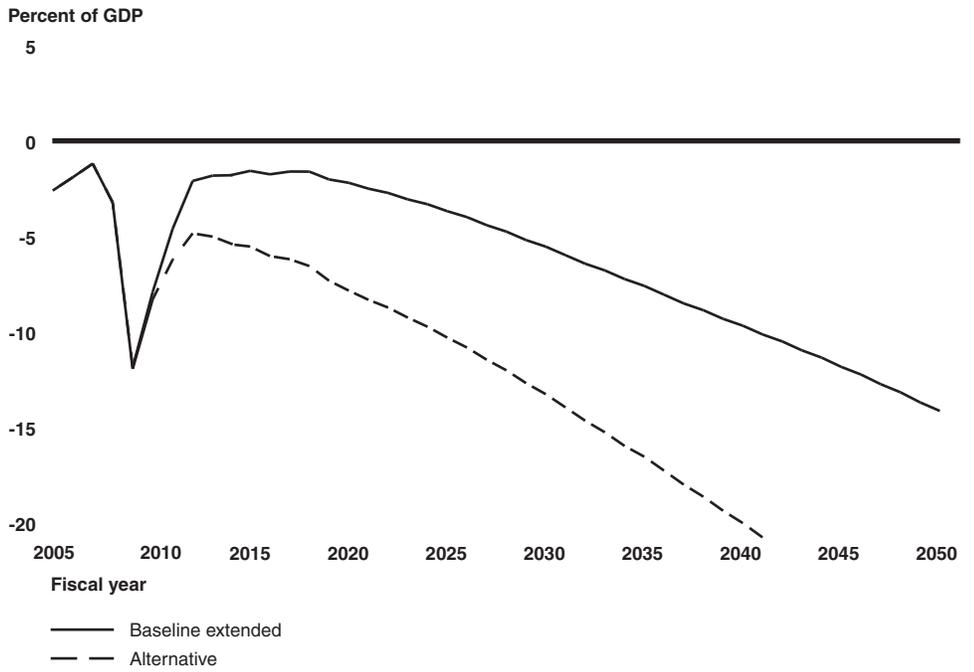
As discussed in the *Financial Report*, the federal government is on an unsustainable long-term fiscal path. The Statement of Social Insurance, for example, shows that projected scheduled benefits exceed earmarked revenues for social insurance programs (e.g., Social Security and Medicare) by approximately \$43 trillion<sup>37</sup> in present value terms over the 75-year projection period. GAO also prepares long-term fiscal simulations that are based on the Social Security and Medicare Trustees' projections, but provide a more comprehensive analysis of fiscal sustainability because they include revenue and expenditure projections for all other government programs. Our most recent long-term fiscal simulation was issued in March 2009.<sup>38</sup> Figures 3, 4, and 5 below show the results of GAO's March 2009 simulations.

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<sup>37</sup>On an open group basis (current and future participants).

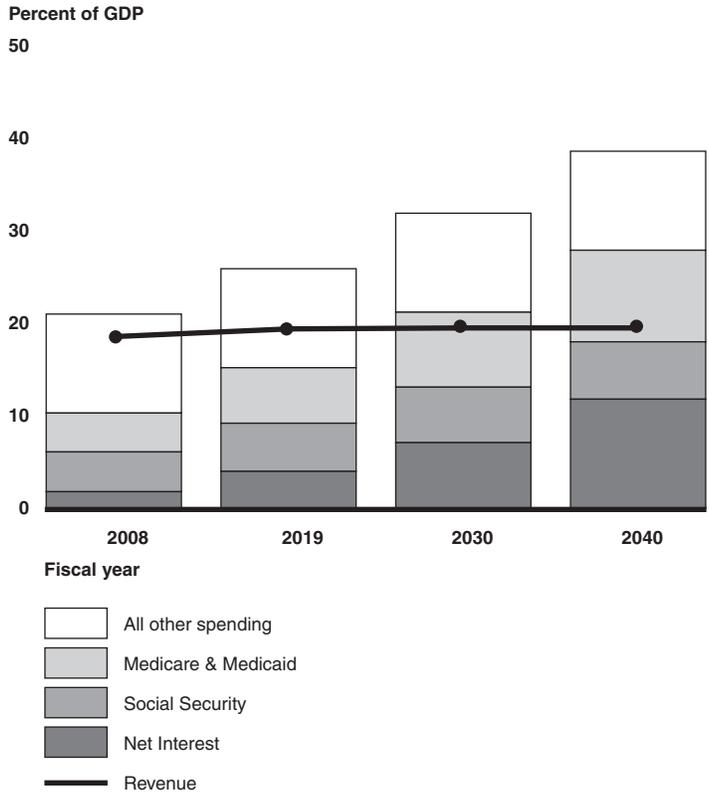
<sup>38</sup>GAO, *The Nation's Long-Term Fiscal Outlook: March 2009 Update*, [GAO-09-405SP](#) (Washington, D.C.: March 2009).

**Figure 3: Deficits as a Share of GDP under GAO's Two Different Fiscal Policy Simulations**



Source: GAO's March 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.  
Note: See [GAO-09-405SP](#).

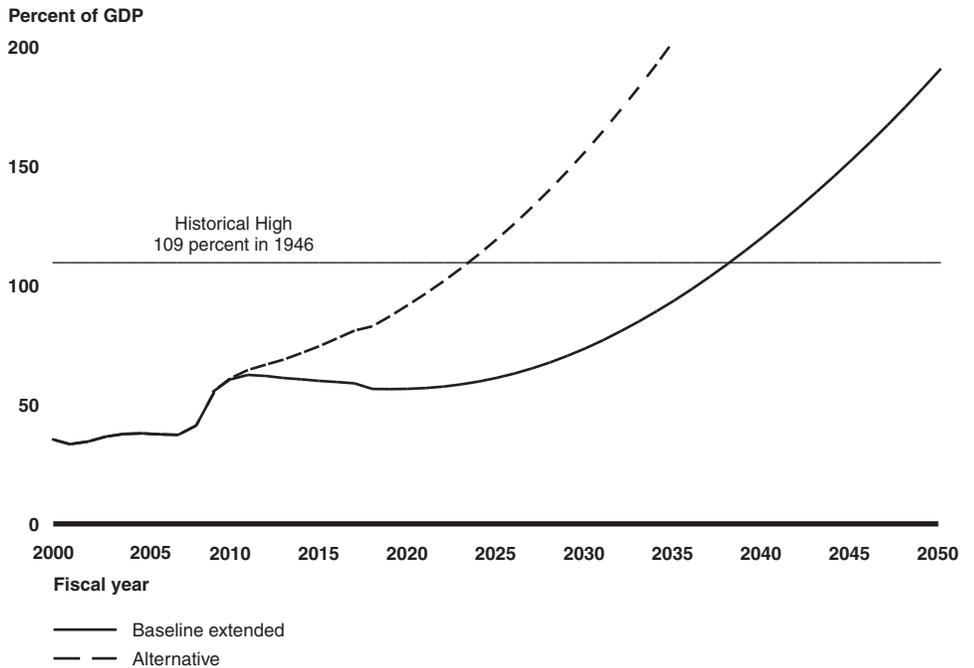
**Figure 4: Revenues and Composition of Spending as a Share of GDP Under GAO's Alternative Simulation**



Source: GAO's March 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.

Notes: Data are from GAO's March 2009 simulations based on the 2008 Trustees' assumptions for Social Security and Medicare. Discretionary spending other than Recovery Act provisions grows with GDP after 2009; Recovery Act provisions are included but assumed to be temporary. Expiring tax provisions are extended, except for expiring provisions enacted in the Recovery Act. After 2019, revenue as a share of GDP is brought to its 40-year historical average of 18.3 percent of GDP plus expected revenues from deferred taxes (i.e., taxes on withdrawals from retirement accounts). Medicare spending is adjusted based on the assumption that physician payments are not reduced as specified under current law.

**Figure 5: Debt Held by the Public as a Share of GDP Under GAO’s Two Different Fiscal Policy Simulations**



Source: GAO’s March 2009 analysis based on the Trustees’ assumptions for Social Security and Medicare.

Note: Information presented for fiscal years 2000 through 2008 is based on historical data and for fiscal years 2009 through 2050 is derived from fiscal policy simulations. See [GAO-09-405SP](#).

A quantitative measure of the long-term fiscal challenge measure is called the “fiscal gap.” The fiscal gap is the amount of spending reduction or tax increases that would be needed today to keep debt as a share of GDP at or below today’s ratio. The fiscal gap is an estimate of the action needed to achieve fiscal balance over a certain time period such as 75 years. Another way to say this is that the fiscal gap is the amount of change needed to prevent the kind of debt explosion implicit in figure 5. The fiscal gap can be expressed as a share of the economy or in present value dollars.

Under GAO’s alternative simulation, closing the fiscal gap would require spending cuts or tax increases, or some combination of the two, equal to 8.1 percent of the entire economy over the next 75 years, or about \$63 trillion in present value terms. To put this in perspective, closing the gap solely through revenue increases would require an increase in today’s federal tax revenues of about 44 percent, or to do it solely through spending reductions would require a reduction in today’s federal program spending (i.e., in all spending except for interest on the debt held by the

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public, which cannot be directly controlled) of about 31 percent to be maintained over the entire 75-year period.

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## The Federal Financial Reporting Model

The *Financial Report* provides useful information on the government's financial position at the end of the fiscal year and changes that have occurred over the course of the year. However, in evaluating the nation's fiscal condition, it is critical to look beyond the short-term results and consider the overall long-term financial condition and long-term fiscal challenge of the government—that is, the sustainability of the federal government's programs, commitments, and responsibilities in relation to the resources expected to be available.

Accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. However, it is appropriate to consider the need for further revisions to the current federal financial reporting model, which could affect both consolidated and agency reporting. While the current reporting model recognizes some of the unique needs of the federal government, a broad reconsideration of the federal financial reporting model could address the following types of questions:

- Do traditional financial statements convey information transparently?
- What is the role of the balance sheet in the federal government reporting model?
- What kind of information is most relevant and useful for a sovereign nation?
- How should items that are unique to the federal government, such as social insurance commitments and the power to tax, be reported?

In addition, further enhancements to accounting and financial reporting standards are needed to effectively convey the long-term financial condition of the U.S. government and annual changes therein. For example, the federal government's financial reporting should be expanded to disclose the reasons for significant changes during the year in scheduled social insurance benefits and funding. It should also include (1) a Statement of Fiscal Sustainability<sup>39</sup> that provides a long-term look at the

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<sup>39</sup>The Statement of Fiscal Sustainability would show the relationship between the present value of projected receipts and spending for social insurance and for all other federal programs.

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fiscal sustainability of all federal programs including social insurance programs, and (2) other sustainability information, including intergenerational equity and an analysis of changes in sustainability during the year.<sup>40</sup> Recently, the Federal Accounting Standards Advisory Board (FASAB) unanimously approved a proposed new standard on fiscal sustainability reporting.<sup>41</sup> Also, FASAB is currently considering possible changes to accounting for social insurance.<sup>42</sup>

In addition, there is a need for a combined report on the performance and financial accountability of the federal government as a whole. This report would include, among other things, key outcome-based national indicators (e.g., economic, security, social, and environmental), which could be used to help assess the nation's and other governmental jurisdictions' position and progress.

Engaging in a reevaluation of the federal financial reporting model could stimulate discussion that would bring about a new way of thinking about the federal government's financial and performance reporting needs. To understand various perceptions and needs of the stakeholders for federal financial reporting, a wide variety of stakeholders from the public and private sector should be consulted. Ultimately, the goal of such a reevaluation would be reporting enhancements that can help the Congress deliberate on strategies to address the federal government's challenges, including its long-term fiscal challenge.

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## Closing Comments

In closing, it is important that the progress that has been made in improving federal financial management activities and practices be sustained by the new administration. Across government, financial management improvement initiatives are under way, and if effectively implemented, they have the potential to greatly improve the quality of financial management information as well as the efficiency and

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<sup>40</sup>Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain federal responsibilities.

<sup>41</sup>Unless OMB or the Comptroller General of the United States object by September 28, 2009, the proposed standard, Statement of Federal Financial Accounting Standards No. 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, will take effect for fiscal year 2010.

<sup>42</sup>On November 17, 2008, an exposure draft was issued on accounting for social insurance, *Accounting for Social Insurance, Revised*.

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effectiveness of agency operations. However, the federal government still has a long way to go before realizing strong federal financial management. For DOD, the challenges are many. We are encouraged by DOD's efforts toward addressing its long-standing financial management weaknesses and its efforts to achieve auditability. Consistent and diligent top management oversight toward achieving financial management capabilities, including audit readiness, will be needed. The civilian CFO Act agencies must continue to strive toward routinely producing not only annual financial statements that can pass the scrutiny of a financial audit, but also quarterly financial statements and other meaningful financial and performance data to help guide decision makers on a day-to-day basis. Federal agencies need to improve the government's financial management systems to achieve this goal.

The nature and magnitude of actions the federal government has taken to stabilize the financial markets and promote economic recovery have created new challenges involving accountability, financial reporting, and debt management. A great amount of attention will need to be devoted to ensuring (1) that sufficient internal controls and transparency are established and maintained for all stabilization and recovery initiatives; (2) that all related financial transactions are reported on time, accurately, and completely; and (3) these initiatives are effectively and efficiently financed. Importantly, the recent increase in federal debt that has resulted largely from the federal government's response to the crisis in financial markets and the economic downturn must be viewed within the context of the nation's unsustainable long-term fiscal path. The longer action is delayed to address long-term fundamental fiscal problems, the greater the likelihood that actions to address such problems will be disruptive and destabilizing. The federal government faces increasing pressures to address the fiscal problems of Social Security and Medicare, yet a shrinking window of opportunity for phasing in adjustments. GAO is committed to sustained attention to this critically important matter.

Given the federal government's current financial condition and the nation's serious long-term fiscal challenge, the need for the Congress and federal policymakers and management to have reliable, useful, and timely financial and performance information is greater than ever. Sound decisions on the current and future direction of vital federal government programs and policies are more difficult without such information. We also will continue to stress the need for development of more meaningful financial and performance reporting on the federal government.

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Finally, I want to emphasize the value of sustained congressional interest in these issues, as demonstrated by this Subcommittee's leadership. It will be key that, going forward, the appropriations, budget, authorizing, and oversight committees hold agency top leadership accountable for resolving the remaining problems and that they support improvement efforts.

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Madam Chairwoman and Ranking Member Bilbray, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Subcommittee may have at this time.

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## **GAO Contacts and Acknowledgments**

For further information regarding this testimony, please contact Jeanette M. Franzel, Managing Director, and Gary T. Engel, Director, Financial Management and Assurance, at (202) 512-2600, as well as Susan J. Irving, Director, Federal Budget Analysis, Strategic Issues, at (202) 512-6806. Key contributions to this testimony were also made by staff on the Consolidated Financial Statement audit team.

# Appendix I: Fiscal Year 2008 Audit Results

**Table 1: Chief Financial Officers (CFO) Act Agencies: Fiscal Year 2008 Audit Results and Principal Auditors**

<b>CFO Act agencies</b>	<b>Opinion rendered by agency auditor</b>	<b>Agencies' auditors reported material weaknesses or noncompliance<sup>a</sup></b>	<b>Principal auditor</b>
Agency for International Development	Unqualified	√	OIG
Agriculture	Unqualified	√	OIG
Commerce	Unqualified	√	KPMG LLP
Defense	Disclaimer	√	OIG
Education	Unqualified	√	Ernst & Young, LLP
Energy	Unqualified		KPMG LLP
Environmental Protection Agency	Unqualified	√	OIG
General Services Administration	Unqualified	√	PricewaterhouseCoopers LLP
Health and Human Services	Unqualified	√	Ernst & Young, LLP
Homeland Security	<sup>b</sup>	√	KPMG LLP
Housing and Urban Development	Unqualified	√	OIG
Interior	Unqualified	√	KPMG LLP
Justice	Unqualified		KPMG LLP
Labor	Unqualified	√	KPMG LLP
National Aeronautics and Space Administration	Disclaimer	√	Ernst & Young, LLP
National Science Foundation	Unqualified	<sup>c</sup>	Clifton Gunderson LLP
Nuclear Regulatory Commission	Unqualified	√	Urbach Kahn & Werlin LLP
Office of Personnel Management	Unqualified		KPMG LLP
Small Business Administration	Unqualified		KPMG LLP
Social Security Administration	Unqualified		PricewaterhouseCoopers LLP
State	Unqualified <sup>d</sup>	√	Leonard G. Birbaum and Company, LLP
Transportation	Unqualified	√	KPMG LLP
Treasury	Unqualified	√	KPMG LLP
Veterans Affairs	Unqualified	√	Deloitte & Touche LLP

Source: GAO.

<sup>a</sup>Reported noncompliance with applicable laws and regulations and/or substantial noncompliance with one or more of the Federal Financial Management Improvement Act requirements.

<sup>b</sup>For fiscal year 2008, only the Consolidated Balance Sheet and the related Statement of Custodial Activity of the Department of Homeland Security were subject to audit; the auditor was unable to express an opinion on these two financial statements.

<sup>c</sup>The auditors reported no material weaknesses, no noncompliance with FFMIA, and no noncompliance with laws and regulations, except for a potential matter of noncompliance with respect to the Anti-Deficiency Act.

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<sup>d</sup>As of the date of our audit report, the auditors had disclaimed an opinion on the Department of State's fiscal year 2008 financial statements; however, because the department subsequently provided the auditors with sufficient evidential material to support the amounts reported on its financial statements, the auditors issued a second report, replacing the first, with an unqualified opinion of the Department of State's fiscal year 2008 financial statements.

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